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October 22, 2013

Mr. Blake A. Hawthorne, Clerk
The Supreme Court of Texas
201 West 14th Street, Room 104
Austin, Texas 78701

Via Electronic Filing

Re: No. 13-0337; *PlainsCapital Bank v. William Martin*

Dear Mr. Hawthorne:

Please bring this amici curiae letter to the attention of the Court at your earliest convenience.

The Independent Bankers Association of Texas ("IBAT"), the Texas Bankers Association ("TBA"), and Texas Mortgage Bankers Association ("TMBA") are trade associations which, collectively, represent virtually all of the federally insured commercial banks in the state of Texas. All of the members of these associations make loans secured by real property. IBAT, TBA, and TMBA wish to submit this amicus curiae letter in support of PlainsCapital Bank's ("Plains") Petition for Review. The cost of this amicus curiae letter was paid by the three associations. Plains is a member of both TBA and of IBAT. PrimeLending, a wholly owned subsidiary of Plains Capital Bank, is a member of TMBA.

Background Summary.

Plains foreclosed on a residential property securing a construction loan in June 2008. It purchased the property at a non-judicial foreclosure sale for $539,000. It immediately sought to resell the property but was unable to do so until September 2009. At that time, it sold the property to a third party in an arm's-length sale for $599,000. Plains, which had incurred over $120,000 in resale costs, gave the borrower a credit for the higher resale price and sued the borrower for the remaining balance owed on the notes and its resale costs.

The trial court entered judgment for Plains. The borrower appealed to the Dallas Court of Appeals, which reversed the judgment of the district court and remanded for further trial court proceedings.

This case involves whether section 51.003 of the Texas Property Code applies when a lender sues for a deficiency based on the actual resale price of property acquired in a foreclosure sale rather than the foreclosure sales price. It also involves the definition of "fair market value" that applies to section 51.003 determinations—specifically, whether section 51.003 allows resale costs to be considered in determining fair market value.

Impact on Real Property Lending.

Texas lenders need certainty regarding their reliance on collateral as a secondary source of repayment of a loan. While institutions look first to the borrower (except in home equity transactions), they consider the value of collateral and the legal structure for realizing that value when they make mortgage loans. This Court currently has several cases pending before it that could affect when and how section 51.003 applies to a given transaction. For example,

International Bank of Commerce v. Dan Silvestri and the Estate of Tyler Todd, No. 13-0298, provides this Court with the opportunity to clarify the application of certain aspects of that statute to guarantors. *PlainsCapital Bank v. Martin*, by contrast, presents the question of whether that part of the Property Code applies if a lender does not choose to seek a deficiency based on the sales price of the collateral at a foreclosure sale, but waits instead until the actual arm's-length sale of the property to determine the real, out-of-pocket cost to the institution. The outcome of this case will help determine the collection methodology used by lenders in Texas. Furthermore, if lenders remedies are limited so that they cannot recover their actual loss, the cost of borrowing may well be indirectly impacted.

Bank regulatory scheme for "other real estate owned."

Banks having a national charter or a federal savings bank charter are regulated by the Office of Comptroller of the Currency ("OCC"). Banks having a state charter are regulated by the relevant state agency and either the FDIC or the Federal Reserve. In any event, the rules relating to management, accounting, and disposition of "other real estate owned" ("OREO") are comparable. OREO includes real property that is acquired through foreclosure. The OCC's Handbook on *Other Real Estate Owned* explicitly covers both national banks and federal savings banks.[1] *See* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/a-oreo.pdf. While the handbook was updated in September 2013, the requirements have not significantly changed.

All banks are limited in the length of time that they are permitted to hold OREO. This is basically a five year period, subject to extension. *See* 12 C.F.R. § 34.82 (2013) (national banks); 12 C.F.R. §§ 167.1, 167.5 (2013) (federal savings banks); TEX. FIN. CODE § 34.003 (state commercial banks). Therefore, all banks face the task of prudently disposing of OREO within that time frame. This means that the lender must have clear procedures in place to maintain and dispose of such OREO, taking into consideration not only the impact on the bank's balance sheet but also the myriad requirements imposed by a variety of state and federal laws.

Banks must account for their OREO—both acquisition and disposition--in accordance with generally accepted accounting principles ("GAAP") as provided in the Federal Financial Institutions Examination Council ("FFIEC") call report instructions. ASC 820-10 provides guidance on measuring the fair value. Upon foreclosure, banks must record OREO at fair value less the estimated cost to sell. *See Other Real Estate Owned*, OCC Handbook at 6. Furthermore, banks are required to satisfy certain appraisal requirements for OREO. Thus, an appraisal or evaluation must be obtained soon after an OREO property is acquired through foreclosure. *See* 12 C.F.R. § 34.85 (2013) (national banks); 12 C.F.R. § 160.172 (2013) (federal savings banks); 12 C.F.R. part 323 (2013) (FDIC rules for state banks). These appraisals are designed to estimate a traditional standard of fair market value—i.e., the most probable price that a property will bring in an open and competitive market—for regulatory purposes. It should be noted that traditional fair market value is very different than section 51.003 fair market value, and an appraiser's determination of traditional fair market value is not always accurate, particularly when economic environments are changing, as they were in 2008 around the time of the Martin foreclosure.

[1] The OCC was given regulatory authority over federal savings banks as a result of the Dodd Frank Act. This resulted in the updating of various handbooks. For state chartered banks, the FDIC published guidance in 2008: http://www.fdic.gov/news/news/financial/2008/fil08062a.html.

Assuming that the value of the property is less than the amount of the indebtedness, there is an immediate deduction to the allowance for loan and lease losses ("ALLL"). The ALLL constitutes a part of a bank's capital. This reduction, then, has a negative impact on the bank's capital adequacy. Furthermore in a bank examination, the examiner will treat the OREO as a substandard asset, which will have a negative impact on the bank's safety and soundness evaluation, depending on the volume of OREO.

In short, banks have strong regulatory and economic incentives to assure that real property securing loans is sold to a third party and, if not sold to a third party during foreclosure, that it is actively marketed to achieve the best possible price to reduce the bank's and borrower's losses.

Offset for fair market value.

As discussed above, banks are subject to a strict regimen for determination of the fair value of OREO when it is acquired. This includes an offset for the costs. When section 51.003 was proposed in 1991, representatives of the various lending trade associations, including one of the authors of this amicus curiae letter, strongly advocated for offsets for the holding costs of the foreclosed property. These are found in subsections 51.003(b)(4) and (5). They are built into section 51.003's definition of fair market value (along with other factors, such as future sales price) and are comparable to the offsets required by banking laws and regulations. Thus, if this Court concludes that section 51.003 does in fact apply, it must apply all of the statute and not overlook the full explanation of the factors that constitute competent evidence of value. This would be consistent with the requirements imposed on lenders that are regulated banks and assures that the provisions of Texas law are correctly applied.

Purpose of section 51.003.

Amici strongly encourage this Court to consider carefully the history and applicability of section 51.003 to determine whether it is exclusive in its application or whether it merely applies to those cases where the lender seeks a deficiency based upon the foreclosure sale price. Here, Plains only sought damages for its actual out-of-pocket losses, which is distinguishable from the more traditional deficiency judgment tied to the foreclosure sale price.

At the time that this section was signed into law by Governor Richards on April 1, 1991, the state was in the throes of a significant period of real estate and bank volatility. This period is often referred to as the "Texas Savings and Loan Crisis" because of the large number of institutions that failed at that time. Real estate loans were crashing as well, with property values plummeting. Foreclosure sale processes were criticized, as lenders were accused of bidding artificially low prices for properties and, thereafter, suing borrowers for the large deficiencies that were created by the artificially low foreclosure sales prices

Today, as a result of regulatory changes and the enactment of section 51.003, lenders are less likely to sue borrowers for deficiencies based on artificially low foreclosure sales prices. In some areas and as to some types of properties, there are active bidders ready to acquire posted properties. All too frequently, however, the lender is the successful bidder on the property and the real estate (rather than the note) goes onto the bank's balance sheet, with the losses deducted from the ALLL. As discussed above, banks have economic incentives to assure that properties are well-marketed and that they are acquired at the correct valuation.

It appears in this case that Plains actively marketed the real property and found a willing buyer. Rather than seeking a deficiency based on the foreclosure sale price and the bank's costs in

this transaction, it applied the higher sales price obtained at the actual third-party sale. This differential is not a "deficiency" as it is commonly understood but, rather, is actual damages. This option—seeking only the actual damages rather than the artificial deficiency—should be encouraged by this Court rather than punished through an expansion of the law that inappropriately requires lenders to seek the artificial deficiency (and subject themselves to the application of section 51.003) rather than seeking only their actual out-of-pocket damages based on an actual resale price.

Review by this Court.

This case raises significant legal questions. IBAT, TBA, and TMBA believe that it would be beneficial to have clarity concerning the application of section 51.003 when actual damages based on actual resale value are sought. Therefore, we respectfully support the petitioner's request for review.

Sincerely,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing amici curiae letter brief of Independent Bankers Association of Texas, Texas Bankers Association, and Texas Mortgage Bankers Association has been forwarded to all counsel and parties of record listed below, on the 22nd day of October, 2013, via electronic service and/or U.S. Mail.

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