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UNIFORMITY OR DIVERSITY: RESIDENTIAL REAL ESTATE FINANCE LAW IN THE 1990s AND THE IMPLICATIONS OF CHANGING FINANCIAL MARKETS

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The financing of residential real estate transactions has changed dramatically over the past two decades.¹ Real estate credit markets, once locally segmented, have been integrated into national and international capital markets. The integration of capital markets has been achieved as a result of several factors, including the deregulation of financial institutions, the growth of the secondary mortgage market, the development of securitization, and the application of technological advances in information processing.

In light of this “revolution in real estate finance,”² today the central legal issue concerning real estate transactions is how the law should adapt to the new market realities. Many legislators and commentators have proposed that the current system of diverse state real estate finance laws be replaced with uniform law, either voluntarily adopted by states

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1. Some of the changes that have transformed residential real estate finance are also changing the way commercial real estate transactions are financed. See generally Richards, “Gradable and Tradeable”: *The Securitization of Commercial Real Estate Mortgages*, 16 REAL EST. L.J. 99 (1987) (discussing securitization of commercial real estate mortgages).

2. A. DOWNS, *THE REVOLUTION IN REAL ESTATE FINANCE* (1985).

or imposed by the federal government. Virtually all attempts to have states voluntarily adopt uniform real estate finance laws have failed, including, most recently, the Uniform Land Transactions Act.³ Greater success in achieving uniformity has been realized through federal preemption. During the 1980s, the federal government preempted state laws regulating usury, due-on-sale clauses, and the foreclosure of mortgage loans on multi-family dwellings insured by the Federal Housing Administration. Given the federal government's willingness to preempt state law, and the states' inability or unwillingness to adopt uniform law, uniformity of real estate finance law will most likely only be achieved as a result of similar federal intervention.

This Article examines the normative case for replacing diverse state real estate finance laws with a uniform national law. Part I describes the changes that have occurred over the past twenty years, culminating in the integration of real estate credit markets with general capital markets. Part II recounts efforts over the past twenty years to make the laws governing real estate finance more uniform across the nation.

Part III evaluates whether the arguments typically advanced by proponents of uniform law and federal preemption justify preemption of diverse state real estate finance laws. My focus in this part is on mortgage foreclosure laws. I conclude that the case for federal preemption of these state real estate finance laws is quite weak. Economic efficiency arguments for uniform national mortgage foreclosure law are unpersuasive. Spillovers generated by state mortgage foreclosure laws are likely to be modest and can be eliminated at low cost. Transaction costs and lost scale economies attributable to these laws are also likely to be small in magnitude. In fact, at the margin, state laws governing real estate finance may promote, rather than hinder, the objective of economic efficiency by generating market discipline over the lawmaking process. Uniform national law has also been frequently justified on the ground that meaningful differences among states have ceased to exist.⁴ However, despite their increasing interdependence, American states retain distinctive economic, political, demographic, and cultural characteristics. These differences among states are likely to require varying laws governing the relationship between mortgagors and mortgagees.

Finally, preferences for uniform national real estate law that are based on the belief that state legislative processes are unlikely to generate

3. ULTA, 13 U.L.A. 469 (1986). All references to the ULTA are to the 1977 version reprinted in 13 U.L.A. 469 (1986).

4. See *infra* notes 186-209 and accompanying text.

coherent laws seem especially out of place in the 1990s. Over the past two decades, state legislative capacity has substantially increased as a result of a series of institutional reforms. Empirical evidence suggests that contemporary state legislatures are capable of enacting coherent, innovative real estate finance laws that are responsive to the needs and desires of their citizens.⁵

My analysis also suggests that the question of which level of government should regulate commercial transactions is exceedingly complex and cannot be resolved merely by reference to the scope of the markets involved. The choice between uniform national law and diverse state laws must take into account the structure of the industry involved, the economic effects of regulation, and the political forces influencing federal and state legislative processes. For real estate finance, as well as other areas of commerce, the development of national markets does not automatically imply that national law is either necessary or desirable.

I. THE REVOLUTION IN RESIDENTIAL REAL ESTATE FINANCE: FROM LOCAL TO NATIONAL MARKETS

A. MORTGAGE MARKETS UNDER THE NEW DEAL REGIME

The contours of twentieth-century housing finance were largely established in the 1930s. Faced with a financial system in ruin, the federal government created the Federal Home Loan Bank (FHLB) system in 1932 to regulate and restore confidence in the nation's savings and loan (thrift) institutions.⁶ To improve the liquidity of these institutions, thrifts were permitted to borrow funds from Federal Home Loan Banks. At the same time, the Federal Savings and Loan Insurance Corporation (FSLIC) was instituted to insure the deposits of savings and loan customers. As part of their regulatory framework, thrift institutions were limited in their choice of both liabilities and assets. Thrifts were required to raise money through short-term time deposits and invest in long-term home mortgage loans.⁷ In addition to these restrictions on liabilities and assets, savings and loan institutions were limited to lending within their

5. See *infra* notes 210-281 and accompanying text.

6. Federal Home Loan Bank Act, Pub. L. No. 72-304, 47 Stat. 725 (1933).

7. See S. COOPER & D. FRASER, *THE FINANCIAL MARKETPLACE* 232, 292 (3d ed. 1990) (stating that dominant source of S&L funds is savings accounts and that thrifts have been subject to portfolio restrictions aimed at concentrating lending to mortgages); Weicher, *The Future of the Housing Finance System*, in *RESTRUCTURING BANKING & FINANCIAL SERVICES IN AMERICA* 296, 298 (W. Haraf & R. Kushmeider eds. 1988) (discussing S&L asset and liability restrictions).

local markets. Initially, thrifts could lend only within a fifty-mile radius of their home offices.⁸ Interstate branching was prohibited.⁹

To induce the thrifts to originate long-term, self-amortizing home mortgage loans with relatively low down payments, the federal government established the Federal Housing Administration (FHA) in 1934. The primary function of FHA is to insure mortgagees against the risk of borrower default. In addition to shielding thrifts from the risk of default, the federal government addressed the problem of liquidity by creating a government-owned agency called the Federal National Mortgage Association (FNMA) in 1938. FNMA's mission was to create a secondary market for the sale and purchase of FHA-insured mortgage loans.¹⁰

For the next half century, the institutions and regulatory framework that were created after the Great Depression continued largely intact. From the 1930s until the early 1980s the real estate capital market was separate from general capital markets. The typical home mortgage loan during this period was originated by a local savings and loan institution which raised funds from local residents by paying interest on their time deposits. The thrift usually held the loan in its portfolio until it matured, the borrower defaulted, or the borrower prepaid the debt.¹¹ Interest rates and the supply of credit were sensitive to local economic conditions,

8. See Weicher, *supra* note 7, at 299.

9. See M. LEA, HOUSING AND THE CAPITAL MARKETS 4 (1988).

10. See C. EDSON & B. JACOBS, SECONDARY MORTGAGE MARKET GUIDE § 5.01, at 5-3 (1990).

11. The description of the typical mortgage financing during this period is, of course, oversimplified. Savings and loan institutions were not totally reliant upon local depositors for their investment capital. Thrifts could borrow funds from Federal Home Loan Banks which, in turn, raised money in the general capital markets. In addition, thrifts could sell mortgage loans either through FNMA, if they were federally insured, or by using a mortgage broker. Nevertheless, the description in the text characterized the bulk of home loan mortgage activity until the growth of the secondary mortgage market in the 1970s and 1980s.

as well as national economic trends.¹² Several economists have characterized real estate finance markets during this period as “segmented.”¹³

B. INTEGRATION OF REAL ESTATE WITH GENERAL CAPITAL MARKETS

Over the past decade, the segmentation of real estate financial markets has dissolved. Real estate credit markets have been substantially linked to general capital markets as a result of numerous factors including deregulation, the growth of the secondary mortgage market, securitization, and technological advances.

1. *Deregulation of Real Estate Credit Markets*

During the late 1960s, savings and loan institutions, the predominant source of home mortgage credit in the United States, began to experience financial difficulties. As inflation increased, thrifts had to pay higher rates to attract time deposits. The industry's profits were squeezed due to the fact that it had to pay depositors high interest rates while its income was tied to long-term loans that earned relatively low rates.¹⁴ In response, the federal government, through a measure known as “Regulation Q,” sought to assist thrifts by placing a ceiling on the

12. Several empirical studies examining interest rate data for this period found that widespread regional differences existed in interest rates. Typically, interest rates were lowest in capital rich areas of the country such as the northeast and highest in growing areas such as the west. See L. GREBLER, D. BLANK & L. WINNICK, *CAPITAL FORMATION IN RESIDENTIAL REAL ESTATE* 221, 229 (1956) (showing that regional differentials in interest rates remained in 1940, but are less than in 1890); Fredrikson, *The Geographic Structure of Residential Mortgage Yields*, in 2 *ESSAYS ON INTEREST RATES* 187, 195-96 (J. Guttenberg ed. 1971) (Loans sampled in 1963 support the finding that yields on conventional mortgage loans are typically lower in the east and midwest than in the south and west.); Longbrake & Peterson, *Regional and Intra-regional Variations in Mortgage Loan Rates*, 31 *J. ECON. & BUS.* 75, 80 (1979) (using 1971 data to reach the same conclusion as Fredrikson, *supra*); Schaaf, *Regional Differences in Mortgage Financing Costs*, 21 *J. FIN.* 85, 93 (1966) (A substantial part of regional variation in interest rates is explained by the distance of the borrower from northeastern capital markets.). Recent studies have found that although differences in interest rates charged in states for home mortgage loans remain, they are smaller and no longer follow regional patterns. See *infra* note 57.

13. See B. BOSWORTH, A. CARRON & E. RHYNE, *THE ECONOMICS OF FEDERAL CREDIT PROGRAMS* 196 (1987) (“The residential mortgage market has historically been viewed as the principal example of a segmented market that has limited interaction with other financial markets.”); S. MAISEL, *REAL ESTATE FINANCE* 229 (1987) (showing that the mortgage market was once purely local and segmented into submarkets); Hendershott & Van Order, *Integration of Mortgage and Capital Markets and the Accumulation of Residential Capital*, 19 *REG. SCI. & URB. ECON.* 189, 197-98 (1989) (contrasting the segmented mortgage market model with neoclassical perfect markets).

14. See Weicher, *supra* note 7, at 301 (“Since S&Ls borrowed short and lent long, unanticipated inflation drove up the rates they paid on all their deposits, but they could earn more only on new mortgages.”).

rates that savings and loans and commercial banks could pay depositors.¹⁵ Nevertheless, the condition of thrifts deteriorated as entrepreneurs offered alternative investment vehicles such as money market funds that paid interest at rates above the ceiling permitted by Regulation Q. In a process called "disintermediation," savings and loan depositors withdrew their funds from thrifts and invested them in these alternative instruments.¹⁶

Faced with an ailing thrift industry, in the early 1980s the Federal Home Loan Bank Board promulgated regulations and Congress enacted laws to deregulate savings and loan institutions. Savings and loans were allowed to originate a wide variety of adjustable rate mortgage loans that would shield the institutions from a portion of the interest rate risk they bore with fixed rate loans.¹⁷ The Depository Institutions Deregulation and Monetary Control Act of 1980¹⁸ phased out Regulation Q deposit rate ceilings, permitted thrifts to invest in a wide variety of activities other than housing, and preempted state anti-usury laws for primary residence mortgage loans.¹⁹ The Garn-St. Germain Depository Institutions Act of 1982²⁰ further deregulated the thrift industry by increasing thrifts' lending powers, preempting state laws that prohibited the enforcement of due-on-sale clauses, and permitting the acquisition of failing institutions by thrifts in other states.²¹

Deregulation of thrift institutions has promoted the integration of real estate credit markets with national capital markets. The lifting of Regulation Q allows thrifts to offer depositors competitive interest rates, thereby tying the supply of home mortgage credit more closely to general capital markets. The preemption of state anti-usury laws similarly permits mortgage loan interest rates to rise to levels earned on similarly

15. Commercial banks were also subject to deposit rate ceilings that were lower than those applied to savings and loan institutions. See M. LEA, *supra* note 9, at 4.

16. See R. POZDENA, *THE MODERN ECONOMICS OF HOUSING* 161-62 (1988) (discussing disintermediation caused by deposit rate ceilings).

17. See Weichler, *supra* note 7, at 302.

18. Pub. L. No. 96-221, 94 Stat. 132 (1980) (codified in scattered sections of 12 U.S.C.).

19. See 12 U.S.C. § 1464, 1735f-7 (1988). For further discussion of the provisions of the Act that preempted state anti-usury laws see *infra* text accompanying notes 115-118.

20. Pub. L. 97-320, 96 Stat. 1469 (1982) (codified in scattered sections of 12 U.S.C.).

21. 12 U.S.C. § 1464, 1701j-3, 1823 (1988). For further discussion of the provisions of the Act that preempted state laws prohibiting the enforcement of due-on-sale clauses, see *infra* text accompanying notes 126-27. The Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183, imposes new restrictions upon thrift institution lending and investment activities.

risky investments. Although some geographic restrictions on thrift lending had been phased out over the previous decade, the provisions permitting out-of-state acquisition of failing thrifts chiseled away at yet another barrier to a national mortgage market.

2. *Growth of the Secondary Mortgage Market and Securitization*

The size and scope of the secondary mortgage market increased in the early 1970s and surged dramatically in the 1980s. In 1968 Congress split FNMA into two entities.²² The low income housing subsidy programs that had previously been administered by FNMA were taken over by a newly formed government agency called the Government National Mortgage Association (GNMA).²³ FNMA was restructured as a private corporation with ties to the federal government. Although stock in FNMA is privately owned, FNMA's fifteen-member board of directors includes five members selected by the President. FNMA also has certain advantages over financial institutions that are not related to the government, such as a line of credit with the United States Treasury and an exemption from federal securities registration and disclosure requirements. Under the Emergency Home Finance Act of 1970, FNMA was empowered to buy and sell conventional, as well as federally insured, mortgage loans.²⁴

In 1970 Congress established a new secondary mortgage market agency called the Federal Home Loan Mortgage Corporation (FHLMC).²⁵ Like FNMA, FHLMC has ties to the federal government. The legislation creating FHLMC provided that the three members of the Federal Home Loan Bank Board serve as FHLMC's directors.²⁶ FHLMC's mission is to purchase and sell conventional home mortgage loans.²⁷

22. Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 802(c), 82 Stat. 476, 536 (1968) (codified at 12 U.S.C. § 1716-1723(h) (1988)).

23. 12 U.S.C. § 1716b (1988).

24. Emergency Home Finance Act of 1970, Pub. L. No. 91-351, § 201, 84 Stat. 450, 450-51 (1971) (codified as amended at 12 U.S.C. § 1717 (1988)).

25. Federal Home Loan Mortgage Corporation Act, Pub. L. No. 91-351, § 301-10, 84 Stat. 451 (1970).

26. As a result of the abolition of the Federal Home Loan Bank Board, FHLMC now has 18 directors. The President appoints five directors with the remaining 13 chosen by the shareholders. See Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 731(h), 103 Stat. 183, 430.

27. At the time FHLMC was created, no secondary market entity had the power to buy and sell conventional mortgage loans. Nevertheless, the same legislation that established FHLMC also permitted FNMA to purchase non-federally insured mortgage loans. One of the reasons for the duplication of functions between the two entities is to further competition. In addition, the creation

FNMA and FHLMC were established to provide liquidity in the market for residential mortgage loans and to increase the flow of capital to housing.²⁸ Originating lenders had found that individual mortgage loans were difficult to sell in the absence of an organized secondary market. This illiquidity was primarily due to information limitations. The underwriting policies of lending institutions varied tremendously as did the mortgage contracts and loan documents that they used. In addition, each loan was secured by a unique property located in a particular geographic area subject to particularized demographic and market conditions. In the absence of uniform standards for originating and underwriting mortgage loans, as well as a standardized system for buying and selling these loans, the information costs of individual loan purchases were prohibitive.

Through their dominant role in the purchase and sale of home mortgage loans, FNMA and FHLMC standardized the practice of mortgage loan origination.²⁹ The agencies prescribe standards for loan documents and appraisals. They typically require that the loans they purchase carry a loan-to-value ratio of 80 percent or less. For loans with a higher loan-to-value ratio, the agencies usually require the purchase of FHA or private mortgage insurance.³⁰ In addition, the choice of terms available to borrowers is largely determined by criteria acceptable to the agencies.

Besides standardizing the practices of the home mortgage lending industry, FNMA, FHLMC and GNMA have increased the liquidity of mortgage loans by creating a market for the sale and purchase of the loans. The agencies issue commitments to purchase loans originated by thrift institutions, mortgage banks, and other financial intermediaries. This assurance that mortgage originators will be able to transform their home loans into cash reduces the interest rate risk of mortgage lending and stimulates the origination of home loans.³¹

of FHLMC was supported by thrift institutions which felt that FNMA was dominated by builders and mortgage bankers. See S. MAISEL, *supra* note 13, at 180.

28. See A. DOWNS, *supra* note 2, at 239-40; S. MAISEL, *supra* note 13, at 200-01.

29. Standardization was also prompted by FHA requirements that borrowers meet certain underwriting criteria prior to obtaining federal mortgage insurance.

30. See S. MAISEL, *supra* note 13, at 214-15 (FNMA and FHLMC may purchase loans with loan-to-value ratios over eighty percent provided that the loans are insured).

31. When originators sell mortgage loans in the secondary mortgage market, they typically retain the right to service the loans. Servicing rights are generally considered valuable financial assets that are themselves traded. See Biasucci & Martell, *Buying and Selling Mortgage Servicing*, 6 SECONDARY MORTGAGE MARKETS 29 (1990). Servicers, in return for a fee, collect loan payments from borrowers, pay the proceeds to the beneficial owners of the mortgages, pursue delinquent borrowers and bring mortgage foreclosure actions. In some instances, the servicer retains the risk of loss attributable to mortgage foreclosure in return for a higher servicing fee; in other cases, the risk is

The purchase and sale of home mortgage loans by FNMA and FHLMC promotes the geographic integration of real estate capital markets. Frequently, demand for residential real estate capital is not uniform throughout the nation.³² Some areas of the country grow faster than others and therefore require more credit. The agencies smooth out interregional differences in supply and demand by purchasing mortgage loans from rapidly growing regions with a high demand for capital and selling those loans to investors in regions with low levels of real estate activity.

The secondary mortgage market agencies also promote the integration of real estate credit markets with national and international capital markets.³³ The agencies raise funds from the capital markets by issuing short-term notes and long-term bonds. The agencies use these funds to purchase mortgage loans for their own portfolios, thereby providing a conduit linking the bond market with the mortgage market. FNMA's mortgage portfolio is enormous; it currently holds in excess of one hundred billion dollars worth of residential mortgages,³⁴ making it the single largest portfolio lender in the country.³⁵

The most important contribution of the secondary mortgage market agencies to the integration of real estate and general capital markets is

borne by the owner of the mortgage loans or the guarantor of the mortgage-backed security collateralized by the mortgage. See E. BALDWIN & B. STOTTS, *MORTGAGE-BACKED SECURITIES: A REFERENCE GUIDE FOR LENDERS AND ISSUERS* 47-153 (1990) (detailing mortgage-backed security programs and pricing of servicing fees). Even in those instances where a servicer does not bear default risk, it stands to lose money if the loans in its portfolio go into default. See *id.* at 251-52 (Servicer must continue paying principal and interest to holders of mortgage-backed securities after default; agencies will reimburse this expense, but will not pay interest on advances.); Kaplan, *The Legal and Regulatory Environment for Mortgage Bankers*, in *MORTGAGE BANKING: A HANDBOOK OF STRATEGIES, TRENDS AND OPPORTUNITIES* 71, 89 (J. Lederman ed. 1989) (FNMA and FHLMC can bring pressure on the originator or servicer of a loan to repurchase a loan in default.); Wolcott, *Servicing Risks: Managing Uncertainties*, *MORTGAGE BANKING*, June 1989, at 38 (Delinquent loans are expensive to service.).

32. See Villani, *The Secondary Mortgage Markets*, in *HOUSING AND THE NEW FINANCIAL MARKETS* 283, 285 (R. Florida, ed. 1986) (discussing the surplus of housing capital in the North and shortages in the West and Southwest).

33. See McMahan, *The Real Estate Capital Market: Historical Perspectives, Emerging Trends and Future Directions*, *REAL EST. ISSUES*, Fall/Winter 1987, at 11, 13 (Real estate capital markets have become international.).

34. See S. MAISEL, *supra* note 13, at 182 (FNMA has \$100 billion of mortgages in its portfolio.); *The U.S. Mortgage Market: A Statistical Overview*, 4 *HOUSING FIN. INT'L* 9 (1989) (FNMA holds \$103 billion of residential mortgage debt or 5% of all outstanding residential mortgage debt.).

35. See Weicher, *supra* note 7, at 311.

their promotion of securitization.³⁶ In 1970, GNMA introduced a program that guaranteed the timely payment of interest and principal on securities collateralized by pools of FHA-insured mortgage loans. In essence, each purchaser of a GNMA pass-through certificate owns an undivided interest in each of the FHA-insured mortgages pooled by the issuer of the security. Security holders are entitled to receive their proportionate shares of the principal and interest payments as they are paid by borrowers.

Since 1970, a bewildering array of mortgage-backed securities have been created to appeal to a wide variety of investors. Nevertheless, the basic design of a mortgage-backed security remains the same. An agency or private entrepreneur pools hundreds of home mortgage loans and issues a security that entitles the holder to receive interest and principal payments. Typically the payments of interest and principal are guaranteed by a secondary mortgage market agency or a private institution.³⁷ Several varieties of mortgage-backed securities, such as the collateralized mortgage obligation, differ from GNMA pass-through certificates in that the holder of the instrument is not deemed to own an undivided interest in each of the pooled mortgages. Instead, each security is divided into several classes or tranches that correspond to the demand of investors for instruments of varying maturities. Most holders of the security receive periodic payments of interest. However, principal payments and prepayments are not distributed pro rata to all security holders. Instead, holders of the first class (short-term interests) are entitled to all principal payments and prepayments until their investments are paid off. Additional principal payments and prepayments are then assigned to holders of longer term interests until all security owners have been repaid their capital.

Securitization of home mortgage loans has, in a rather short span of time, substantially advanced integration of real estate and general capital markets. Together with agency guarantees and private credit enhancement, pooling together mortgage loans of different borrowers and regions diversifies the mortgage-backed security holder's portfolio, thus lessening the risk of extending credit to the purchasers of homes. This decreased

36. For a detailed description of the securitization process, see W. BARTLETT, *MORTGAGE-BACKED SECURITIES* (1989). For analyses of legal issues concerning mortgage-backed securities, see Murray & Hadaway, *Mortgage-Backed Securities: An Investigation of Legal and Financial Issues*, 11 J. CORP. L. 203 (1986); Pittman, *Economic and Regulatory Developments Affecting Mortgage Related Securities*, 64 NOTRE DAME L. REV. 497 (1989).

37. In some instances the securities are overcollateralized, and thereby achieve a level of credit-worthiness similar to a guarantee.

risk enlarges the number of potential investors in housing credit.³⁸ Designing mortgage-backed securities to resemble bonds in terms of their maturities has also opened the housing credit market to investors who otherwise would not be interested in investing in long-term, home mortgage loans. By linking real estate credit markets with general capital markets, securitization of mortgages increases the flow of funds into residential real estate and reduces the interest rates paid by borrowers.³⁹

3. *Technological Advances*

Technological advances have also promoted the integration of capital markets. Computers and telecommunications have reduced the importance of geographic proximity between the lender and borrower.⁴⁰ Funds and information can be transferred instantaneously across great distances. Increasingly, electronic networks make interstate lending more feasible.⁴¹ Computer technology has reduced the transaction costs of evaluating the large number of mortgage loans purchased and sold each day through the secondary mortgage market.⁴² Technological innovation has also increased the capacity of specialized firms to expand into new areas and shift funds from one use to another.⁴³

C. EVIDENCE OF INTEGRATION

The integration of real estate credit markets with general capital markets has greatly accelerated over the past two decades. Although among financial institutions thrifts continue to originate the largest share of home mortgage loans, they no longer hold nearly as large a proportion of loans in their own portfolios as they once did. In 1970, thrift institutions held 40% of all mortgage loans outstanding; this proportion declined to 29% in 1988.⁴⁴ If holdings of mortgage-backed securities are included, the proportion of residential debt held by savings and loan institutions fell from 54% in 1980 to 44% in 1988. At the same time, the

38. For example, many institutions such as pension funds tend to shy away from extremely risky investments because of the fiduciary duty they owe to their beneficiaries. The lower risk of mortgage-backed securities attracts their capital to the housing market.

39. See *infra* text accompanying notes 49-57 (reviewing empirical evidence of the effect of the secondary mortgage market and securitization on interest rates).

40. See S. MAISEL, *supra* note 13, at 243.

41. See Weicher, *supra* note 7, at 323.

42. See Haraf & Kushmeider, *Redefining Financial Markets*, in RESTRUCTURING BANKING & FINANCIAL SERVICES IN AMERICA, *supra* note 7, at 1, 3.

43. See A. DOWNS, *supra* note 2, at 45.

44. *The U.S. Mortgage Market: A Statistical Overview*, *supra* note 34, at 9.

share of debt held by pension and retirement funds, typically in the form of mortgage-backed securities, more than doubled from 2.9% to 6.4%.⁴⁵

Secondary mortgage market activity exploded during this period. From 1970 to 1984, the proportion of all fixed rate residential mortgage loans sold through the secondary mortgage market increased from 32% to 61%.⁴⁶ In the early 1980s less than 5% of all newly originated, conforming⁴⁷ conventional fixed rate home mortgage loans were securitized. This proportion increased to over one-half by 1987.⁴⁸

Empirical studies confirm the integration of real estate credit markets with general capital markets. For example, Hendershott and Shilling examined the interest rate differentials between loans conforming to secondary mortgage market purchase requirements⁴⁹ and loans that did not conform and therefore could not be traded by FNMA, GNMA or FHLMC.⁵⁰ They found that when the size of the loan climbed above the conforming limit, the interest rate jumped from 15 to 30 basis points.⁵¹ This finding supports the proposition that the secondary mortgage market agencies reduced home mortgage loan interest rates by tying the real estate capital market to general credit markets.

Numerous studies have shown that the correlation between home loan interest rates and the rates offered by other financial instruments increased dramatically over the past decade. Roth, for example, compared rates for Treasury notes with rates offered by FHLMC mortgage-backed securities.⁵² He found that from 1972 through 1981, the correlation between the rates offered by the two instruments was relatively small

45. See Lasko, *Housing Finance in the USA in the 1990s*, 4 HOUSING FIN. INT'L 4, 6 (1989).

46. B. BOSWORTH, A. CARRON & E. RHYNE, *supra* note 13, at 70. According to one projection, by the year 2000, 80% of home loan originations will be sold through the secondary mortgage market. See Lasko, *supra* note 45, at 8.

47. FNMA and FHLMC do not purchase home mortgage loans that exceed certain annually adjusted ceilings. Loans that are below these ceilings are called conforming loans. In 1988, the ceiling was \$168,700. Hendershott & Van Order, *supra* note 13, at 191.

48. See *id.* at 192.

49. See *supra* note 47 for a description of the practice of secondary mortgage market agencies to purchase only those loans whose size is less than prescribed limits.

50. Hendershott & Shilling, *The Impact of the Agencies on Conventional Fixed-Rate Mortgage Yields*, 2 J. REAL EST. FIN. & ECON. 101 (1989).

51. *Id.* at 112. A basis point is equal to 1/100th of a percent interest rate.

52. Roth, *Volatile Mortgage Rates: A New Fact of Life?*, FED. RES. BANK OF KANSAS CITY ECON. REV., March 1988, at 16.

and statistically insignificant. From 1981 to 1987, however, the correlation increased to .91 and became statistically significant.⁵³ In 1989 Hendershott and Van Order examined the relationship between home loan interest rates and a "perfect-market" rate for GNMA pass-through securities.⁵⁴ They characterized the shift toward integrated markets in recent years as "striking."⁵⁵ According to their analysis, the fraction of change in GNMA security yields that is reflected in conventional home mortgage loans within two weeks rose from one-sixth in the early 1970s to one-half in the early 1980s to one in 1988.⁵⁶ They concluded that by 1988 the conventional fixed rate home mortgage loan market had become fully integrated with general capital markets.⁵⁷

II. DIVERSITY AND UNIFORMITY: EFFORTS TO ACHIEVE UNIFORM REAL ESTATE FINANCE LAWS

Compared to the rules governing commercial transactions involving personal property, laws regulating the sale and finance of real property have proved highly resistant to efforts to promote uniformity. Although all states have substantially adopted the Uniform Commercial Code as

53. *Id.* at 23. Roth also estimated a regression equation which showed a tripling of the coefficient that measured how closely the home loan rate and the Treasury rate tracked each other. *See id.* at 23-25. Another study by Gabriel showed that from the mid- to late-1970s, only 20% of the change in ten-year treasury yields was reflected within a week in home loan rate changes. By 1986-87, short term responsiveness had increased by a factor of three, with nearly 80% of a change in treasury yields being reflected in residential mortgage loan rates within one week. Gabriel, *Housing and Mortgage Markets: The Post-1982 Expansion*, 73 FED. RES. BULL. 893, 901 (1987); *see also* Devaney & Pickerill, *The Integration of Mortgage and Capital Markets*, 58 APPRAISAL J. 109, 113 (1990) (Data from 1983-87 show that a 10% change in treasury bill yields leads to a 6.5% change in the mortgage market within same month.).

54. Hendershott & Van Order, *supra* note 13. The authors used GNMA mortgage-backed securities as their benchmark because GNMA's are backed by the full faith and credit of the federal government and are traded like treasury securities. They estimated the perfect-market rate for these securities by econometric methods. *See id.* at 199-02.

55. *Id.* at 202.

56. *See id.* at 202. Hendershott and Van Order also found that the percentage change in GNMA security yields instantaneously reflected in home loan rates rose from zero in the early 1970s to 16 in the mid-1980s to 59 in 1986-88. *See id.*

57. *See id.* at 209. Additional evidence to support the conclusion that real estate credit markets have been largely integrated with general capital markets was reported in a 1987 study that examined interregional differences in home mortgage loan interest rates. *See* Zumpano, Karson & Rudolph, *Interregional Variation in Conventional Mortgage Terms and the Efficiency of the Residential Mortgage Market* (1987) (unpublished paper presented at the 1987 Financial Management Meeting in Las Vegas, Nevada). The authors found that although regional differences in the contract rate for home mortgage loans were significant in 1968 and 1978, they had ceased to be statistically significant in 1988. Nevertheless, fees and other charges included in computing the effective interest rate did reflect statistically significant regional differences. *See id.* at 23.

their substantive law for personal property transactions,⁵⁸ no state has yet adopted the Uniform Land Transactions Act proposed by the National Conference of Commissioners on Uniform State Laws in 1975.⁵⁹ Real estate transactions remain subject to a range of diverse laws promulgated by each of the fifty states.

Before evaluating the normative arguments advanced for supplanting the existing system of state real estate finance law with uniform national rules, in this part I briefly outline the most important areas in which state laws governing real estate finance differ from each other. I then recount the failure of efforts to encourage states to agree voluntarily to adopt uniform laws governing real estate transactions. Lastly, I examine the increasing tendency of federal courts and Congress to supplant state law with federal rules in light of the states' reluctance to adopt uniform law.

A. THE DIVERSITY OF STATE REAL ESTATE FINANCE LAWS

State laws and customs concerning real estate finance differ from each other in numerous respects. The following summary of differences merely scratches the surface of these divergent practices. The typical real estate finance transaction involves a borrower who signs a promissory note that evidences the borrower's obligation to repay the lender the sum of money advanced.⁶⁰ In most cases the lender requires that the borrower convey to it a security interest in the real property. If the borrower defaults on the obligation to repay, the lender is entitled to foreclose upon the security interest by having the real property sold, thereby recouping some or all of the debt.⁶¹ If the proceeds of the sale exceed the amount of the outstanding debt, the borrower is entitled to the surplus; if

58. Louisiana has adopted article 9 of the Uniform Commercial Code, but not article 2. Some commentators have nevertheless noted the continued lack of uniformity in the law governing secured financing caused by amendment and judicial interpretation. See, e.g., Knippenberg & Woodward, *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2520-21 (1990); Mooney, *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and Future of the U.C.C.*, 41 BUS. LAW. 1343, 1346, 1350-53 (1986); Taylor, *Uniformity of Commercial Law and State-by-State Enactment: A Confluence of Contradictions*, 30 HASTINGS L.J. 337, 341-42 (1978).

59. See *infra* text accompanying notes 90-91. States have been more responsive to uniform law in the regulation of condominiums. More than one-third of the states have adopted a version of the Uniform Common Interest Ownership Act or the Uniform Condominium Act. See Buck, *Beware the Inadvertent Condominium: The Commercial Common Interest Community — Choices Under the Uniform Common Interest Ownership Act and the Uniform Condominium Act*, 22 REAL PROP., PROB. & TR. J. 65, 65-66 (1987).

60. See G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 1.1, at 1 (2d ed. 1985).

61. See *id.* § 1.1, at 4.

the foreclosure proceeds fail to extinguish the entire debt, the lender may usually sue the borrower for the deficiency.

Although the typical transaction sketched above is common to each of the fifty states, the states have different laws governing the form of the transaction and the relationship between mortgagees and mortgagors. For example, lenders in some states use mortgages as their form of security interest while lenders in other states use deeds of trust. A mortgage conveys an interest in the property directly to the lender whereas a trust deed conveys the property to a trustee to hold for the benefit of the lender.⁶² The legal significance of the conveyance of a mortgage or deed of trust also differs among states. A mortgage or deed of trust in a title theory state gives the mortgagee or trustee legal title to the property, subject to defeasance upon the repayment of the debt. In lien theory states, however, the mortgage or deed of trust merely grants the mortgagee or trustee a lien against the property with no present rights to possession or title.⁶³

State laws differ most greatly with respect to the methods a mortgagee may use to foreclose its mortgage or deed of trust and the protections accorded to borrowers.⁶⁴ All states permit mortgagees to utilize judicial foreclosure.⁶⁵ Upon default by a mortgagor, the mortgagee may file an action in court to foreclose its lien on the real property. All parties — including junior lienors — whose interests in the property will be extinguished by the foreclosure action must be served notice of the proceeding. At the foreclosure proceeding any defendant may assert a defense against the foreclosure action. Most foreclosure actions are uncontested: the court usually grants a judgment to the mortgagee and directs the sale

62. Deeds of trust are typically utilized in states that permit foreclosure by power of sale. See *infra* text accompanying notes 68-69. Since power of sale foreclosure takes place without court supervision and frequently results in the lender purchasing the property, a trustee is utilized to insulate the lender from charges of conflict of interest.

63. Some states characterize mortgages or deeds of trust according to a hybrid model that has characteristics of both title and lien theory. These states are usually characterized as "intermediate theory" states. Lien theory states are typically those in the western portion of the United States; title states are typically located in the East. The practical significance of whether a state characterizes a mortgage or deed of trust as conveying title or a lien may be more apparent than real. In most title states, courts do not permit a mortgagee to take possession of the real property as long as the mortgagor remains in good standing under the loan. Indeed, even after default, some title theory states do not permit lenders to gain possession of the property until after they foreclose the mortgage or deed of trust. See G. NELSON & D. WHITMAN, *supra* note 60, § 1.5, at 10-11.

64. In addition to differences in the methods of foreclosure, states prescribe varying notice periods and have different rules governing the remedies of mortgagees prior to foreclosure. See R. LIFTON, *PRACTICAL REAL ESTATE IN THE '80S: LEGAL, TAX AND BUSINESS STRATEGIES* 286-93 (2d ed. 1983).

65. See G. NELSON & D. WHITMAN, *supra* note 60, § 7.11, at 505-06.

of the property by a court officer.⁶⁶ Judicial foreclosure has been criticized by many commentators as expensive and time-consuming.⁶⁷ Half of the states permit mortgagees to utilize private power of sale foreclosure. If the mortgage or deed of trust includes a power of sale clause, the mortgagee may bypass the courts and have the property sold without judicial supervision. After publication of notice, the trustee or sheriff⁶⁸ conducts a sale of the property. Power of sale foreclosure usually is more expeditious and less expensive than judicial foreclosure and is therefore frequently preferred by lenders.⁶⁹ In addition to judicial and power of sale foreclosure, at least two states permit strict foreclosure.⁷⁰ Under strict foreclosure, upon default the mortgagee is entitled to retain the property pledged as security for the loan regardless of whether its value exceeds the amount of the outstanding debt.⁷¹

Besides widely divergent mortgage foreclosure practices, states provide a wide variety of postforeclosure remedies. Close to half of the states have enacted statutory rights of redemption.⁷² A typical statutory right of redemption permits the mortgagor to buy back the property sold at the foreclosure sale by paying the successful bidder the price paid at

66. For a description of the mechanics of foreclosure sales, see R. KRATOVIL & R. WERNER, *MODERN MORTGAGE LAW AND PRACTICE* § 41.09 (1981).

67. See G. NELSON & D. WHITMAN, *supra* note 60, § 7.11, at 506 (stating that judicial foreclosure is "complicated, costly, and time-consuming"); Claurette, *State Foreclosure Laws, Risk Shifting, and the Private Mortgage Insurance Industry*, 56 J. RISK & INS. 544, 546 (1989) (stating that judicial foreclosure proceedings are costly).

68. If a power of sale clause is included in a mortgage, the mortgagee will typically delegate the responsibility for conducting the sale to a third party such as the county sheriff. The use of a third party insulates the mortgagee from charges of conflict of interest should it happen to purchase the property at the foreclosure sale. The conflict of interest problem may also be avoided by using a deed of trust rather than a mortgage. See *supra* note 62.

69. Nevertheless, some lenders prefer judicial foreclosure, despite its expense, because of the greater certainty of title produced by judicial confirmation of the foreclosure sale. In addition, two commentators have suggested that mortgagees might prefer judicial foreclosure because power of sale foreclosure may be subject to due process objections if a court finds state action and the property is sold without appropriate notice. See R. KRATOVIL & R. WERNER, *supra* note 66, at § 41.08(c), (h).

70. See CONN. GEN. STAT. ANN. § 49-15 (West 1978 & Supp. 1990); VT. STAT. ANN. tit. 12, § 4528 (1973 & Supp. 1990). Strict foreclosure usually takes place only after a judicial proceeding. See G. NELSON & D. WHITMAN, *supra* note 60, § 7.9, at 501.

71. See G. NELSON & D. WHITMAN, *supra* note 60, § 7.9, at 501.

72. A statutory right of redemption is different from the equity of redemption. Under the law of all states, mortgagors possess an equity of redemption that permits them to avoid foreclosure by repaying all sums owed to the mortgagee prior to the foreclosure sale. If a mortgagor exercises its equity of redemption, it is either reinstated in good standing under the loan or is entitled to a reconveyance of the mortgage lien. Technically, the foreclosure action cuts off the equity of redemption. Statutory rights of redemption come into play only after the equity of redemption has been foreclosed. A. AXELROD, C. BERGER & Q. JOHNSTONE, *LAND TRANSFER AND FINANCE* 189 n.21 (3d ed. 1986).

the foreclosure sale plus costs and interest.⁷³ The period during which the mortgagor can exercise the statutory right of redemption varies from three months to two years.⁷⁴ Usually, the mortgagor is entitled to retain possession of the mortgaged property during the redemption period.⁷⁵

States have also enacted a wide variety of laws designed to protect mortgagors from personal liability in the event that the proceeds of the foreclosure sale are less than the outstanding debt. Several states flatly prohibit mortgagees from seeking deficiency judgments against purchase money mortgagors.⁷⁶ Some statutes prohibit deficiency judgments only when a particular type of foreclosure process is utilized, most commonly the power of sale foreclosure.⁷⁷ Many states limit the amount of deficiency judgments to the difference between the outstanding loan principal and the fair market value of the property on the date of the foreclosure sale rather than the difference between the outstanding debt and the price obtained at the sale.⁷⁸ Several states permit suits for deficiency judgments, but protect mortgagors from a multiplicity of lawsuits by "one action" rules.⁷⁹ The typical one action rule requires a mortgagee to bring its claim for a deficiency judgment as part of the foreclosure action; otherwise the mortgagee forfeits its right to a deficiency judgment.

73. See, e.g., IOWA CODE ANN. § 628.11 (West 1950 & Supp. 1990); KAN. STAT. ANN. § 60-2414(a) (1983).

74. Compare WYO. STAT. § 1-18-103(a) (1989) (ninety day redemption period) with S.D. CODIFIED LAWS ANN. § 21-52-13 (1987) (The redemption period may be extended to two years.).

75. See, e.g., *Ropfogel v. Enegren*, 7 Kan. App. 2d 644, 647, 646 P.2d 1138, 1141 (1982) ("The debtor is given the right of possession during the redemption period and the rents and profits derived from the mortgaged property during that period are exempt from seizure by any creditor not authorized to levy by the redemption statute."); G. NELSON & D. WHITMAN, *supra* note 60, § 8.4, at 616 (presenting a general discussion of statutory redemptions). For a more detailed description of the structure and purposes served by statutory rights of redemption and anti-deficiency judgment legislation, see Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489 (1991).

76. See, e.g., ARIZ. REV. STAT. ANN. § 33-814(G) (1990) (No deficiency judgment is permitted when the trust property is two and one-half acres or smaller and used as a one or two family residence.); CAL. CIV. PROC. CODE § 580(b) (West 1976 & Supp. 1991) (No deficiency judgment is permitted when a purchase money mortgage or deed of trust is foreclosed if the property is used as a dwelling by the borrower.).

77. See, e.g., CAL. CIV. PROC. CODE § 580(d) (West 1976 & Supp. 1991) (No deficiency judgment is permitted when the property is foreclosed under a power of sale.).

78. See, e.g., N.Y. REAL PROP. ACTS. § 1371 (McKinney 1979) (The court determines the market value.); S.C. CODE ANN. §§ 29-3-660 to -740 (Law. Co-op. 1976 & Supp. 1989) (The defendant may request an appraisal.). As of 1980, seventeen states had adopted statutes limiting deficiency judgments to the difference between fair market value and the outstanding loan balance. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 908 (1980).

79. See, e.g., MONT. CODE ANN. § 71-1-222 (1989) (Only one action is allowed for recovery on a debt secured by a mortgage.); NEV. REV. STAT. ANN. § 40.430 (Michie 1986) (same).

B. EFFORTS TO PROMOTE VOLUNTARY ADOPTION OF UNIFORM REAL ESTATE FINANCE LAW

In the face of widely divergent state laws, efforts have been made to encourage states to adopt uniform laws to regulate real estate transactions. The first efforts to promote uniform real estate law date from the early part of this century. The National Conference of Commissioners on Uniform State Laws proposed the Uniform Real Estate Mortgage Act of 1927, and in 1940 proposed the Model Power of Sale Foreclosure Act. Neither of these suggested laws was adopted by a single state.⁸⁰

In 1975 the National Conference of Commissioners on Uniform State Laws tried once again to promote uniform state real estate laws. After six years of drafting, the Conference adopted the Uniform Land Transactions Act (ULTA). The ULTA had initially covered a wide variety of real estate issues including contracts, conveyancing, finance, condominiums, recording, priorities and mechanics liens. In response to concerns that the uniform law would be too unwieldy, the version adopted by the Commissioners was limited to contracts, conveyancing, and finance.⁸¹ Following review and recommendations by the American Bar Association, the Commissioners amended the ULTA in 1977, and it was endorsed by the ABA in 1978.⁸²

Prefatory comments to the ULTA indicate that the Commissioners felt that uniform law was necessary to facilitate the operation of the secondary mortgage market and to make real estate sales and financing transactions more economical and efficient.⁸³ The ULTA was designed to resemble the Uniform Commercial Code and adopted many of the Code's definitions and principles.⁸⁴ Article 3 applies to all real estate-

80. See Reeve, *The New Proposal for a Uniform Real Estate Mortgage Act*, 5 LAW & CONTEMP. PROBS. 564, 570 (1938); Note, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971, 1001 n.139 (1987) (authored by Jo Anne Bradner). In addition, the federally sponsored Central Housing Committee proposed a revised Uniform Real Estate Mortgage Act in 1937. No state has yet adopted this proposal. See R. SKILTON, GOVERNMENT AND THE MORTGAGE DEBTOR (1929 TO 1939) 203-04 (1944).

81. See Bruce, *An Overview of the Uniform Land Transactions Act and the Uniform Simplification of Land Transfers Act*, 10 STETSON L. REV. 1, 2 (1980). The portions of the original proposal dealing with recording, priorities, and mechanics liens were included in the Uniform Simplification of Land Transfers Act approved by the Commissioners in 1976. The portions discussing condominiums were redrafted as the Uniform Condominium Act and approved by the Commissioners in 1977. *Id.*

82. ULTA, 13 U.L.A. 469 (1986).

83. See ULTA, Prefatory Note, 13 U.L.A. at 470. The Commissioners also expressed a desire to simplify and modernize the laws governing real estate transactions. *Id.* at 470-71.

84. See Bruce, *supra* note 81, at 4-5 (The ULTA borrows definitions and principles from the UCC.). The concepts imported into real estate law from the Uniform Commercial Code include

secured transactions, regardless of whether the security interest used is a mortgage or deed of trust, or whether the state adheres to lien or title theory. Among the more important provisions of the ULTA are its rules permitting mortgagees to take possession of the real property after default and allowing them to enforce due-on-sale clauses.

The ULTA's most important provisions concern foreclosure. Under the Act, the preferred method of foreclosure is by power of sale.⁸⁵ The Act permits mortgagees to bypass judicial foreclosure, provided that relatively stringent notice requirements are met. The ULTA also requires that every aspect of the sale be reasonable. A major innovation of the ULTA is the concept of the "protected party." The primary protected party is the individual homeowner.⁸⁶ Under the Act, protected parties are entitled to grace periods⁸⁷ and are immune to deficiency judgments on purchase money security interests.⁸⁸ The ULTA, however, abolishes statutory rights of redemption for all mortgagors, including protected parties.⁸⁹

The real estate bar greeted the ULTA with a mixture of criticism and praise.⁹⁰ However, if the Act's success or failure is measured by how many states have adopted it, the ULTA has been a dismal failure. To date, no state has adopted the ULTA. In 1985, the Conference tried once again to promote uniform real estate finance law by revising Article 3 of the ULTA and renaming it the Uniform Land Security Interest Act (ULSIA). To date, no state has adopted the ULSIA, although proponents expect that it will soon be introduced in several state legislatures.⁹¹

good faith and unconscionability. *Id.* See ULTA § 1-301, 13 U.L.A. at 493 (discussing good faith obligation); ULTA § 1-311, 13 U.L.A. at 502 (discussing unconscionability).

85. See ULTA § 3-508, 13 U.L.A. at 613; Bruce, *supra* note 81, at 12 (The preferred method of foreclosure is power of sale.); Pedowitz, *Mortgage Foreclosure Under the Uniform Land Transactions Act (As Amended)*, 6 REAL EST. L.J. 179, 187 (1978) (same). Judicial sale is also available as an option to mortgagees. ULTA § 3-509, 13 U.L.A. at 616.

86. ULTA § 1-203(a), 13 U.L.A. at 490.

87. A notice of intention to foreclose on a property occupied by a protected party may not be sent until a period of five weeks after nonpayment or nonperformance has elapsed. ULTA § 3-505(b), 13 U.L.A. at 609.

88. ULTA § 3-510(b), 13 U.L.A. at 618.

89. See Pedowitz, *supra* note 85, at 195.

90. Compare Kuklin, *The Uniform Land Transactions Act: Article 3*, 11 REAL PROP., PROB. & TR. J. 12 (1976) (criticizing ULTA) with Pedowitz, *supra* note 85, at 197-98 (approving ULTA).

91. Telephone interview with Norman Geis, Esq., Chairman of the American College of Real Estate Lawyers Committee on Law Reform (Apr. 16, 1990).

C. IMPOSITION OF FEDERAL LAW

In light of the consistent failure of efforts to persuade states voluntarily to adopt uniform law, federal courts and the Congress have increasingly intervened to reject state real estate finance laws. One area in which federal imposition of uniform rules occurs is the foreclosure of loans by the federal government. As I discussed in Part I, the federal government has actively participated in the mortgage market for the past fifty years through its mortgage insurance programs administered by FHA and through the purchase and sale of mortgage loans by GNMA or by federally related agencies such as FHLMC or FNMA.⁹² Frequently, the government, as mortgagee, must foreclose mortgage liens.⁹³ In several cases, federal courts have ruled that state mortgage foreclosure laws do not apply when the federal government is the mortgagee.

One of the earliest federal cases rejecting an element of state mortgage foreclosure law is a 1970 decision of the Ninth Circuit Court of Appeals, *United States v. Stadium Apartments*.⁹⁴ In *Stadium Apartments*, the mortgagor of an FHA-insured apartment complex waived its statutory right of redemption when it executed an FHA-approved mortgage. Upon default by the mortgagor, the mortgagee assigned the mortgage to the United States Department of Housing and Urban Development (HUD) which obtained a foreclosure judgment. The district court held that the mortgagor's waiver of its redemption rights was unenforceable and decreed a one year statutory right of redemption pursuant to Idaho law. On appeal, the Court of Appeals for the Ninth Circuit held that federal law applied to the foreclosure action, that Congress had not expressly adopted state law, and that federal courts should not borrow the state redemption law as federal common law. Among the reasons given by the court for its refusal to borrow state law was its concern that the federal government should not be subject to the "vagaries of the laws of the several states."⁹⁵ The court also indicated that statutory rights of redemption would harm the federal interest by increasing the cost of foreclosure and chilling the bidding at the foreclosure sale.⁹⁶

92. See *supra* text accompanying notes 10-39.

93. The federal government may become a mortgagee when it is assigned the mortgage as a result of a default under mortgage insurance programs or because it holds the mortgage in its own portfolio.

94. 425 F.2d 358 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970).

95. *Id.* at 364 (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943)).

96. See *id.* at 365-66. The continued vitality of *Stadium Apartments* remains in some doubt. Subsequent to the ruling in *Stadium Apartments*, the Supreme Court set forth a new standard to govern when federal courts should borrow state law as the federal rule of decision in cases involving federal creditors. In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), the Court held that

Numerous other federal court decisions have refused to borrow state real estate finance laws when the federal government or a federally-related agency is the mortgagee. For example, in *United States v. Victory Highway Village*,⁹⁷ the Eighth Circuit held that state statutory rights of redemption did not apply to a foreclosure in which FNMA was the mortgagee.⁹⁸ The paramount reason underlying the court's refusal to borrow state law as the federal rule of decision was its concern that foreclosure laws and practices would differ from state to state.⁹⁹ In *United States v. Haddon Haciendas Co.*,¹⁰⁰ the Ninth Circuit ruled that California antideficiency law would not stand in the way of federal damage actions against mortgagors for waste. The court observed that state rules insulating mortgagors from damages for waste would lead to poor maintenance of federally subsidized housing.¹⁰¹

in the absence of a congressional directive to the contrary, state law governs the relative priority of private and consensual liens arising from federal programs. The Court adopted a three part test to determine whether state law should be adopted as the federal rule of decision in similar cases: (1) whether the federal program by its nature must be uniform throughout the nation; (2) whether application of state law would frustrate specific objectives of the federal program; and (3) the extent to which application of a federal rule would disrupt commercial relationships predicated upon state laws. *See id.* at 728-30. Commentators have suggested that the *Kimbell Foods* test is much more deferential to state law than the test adopted by the Ninth Circuit in *Stadium Apartments*. *See, e.g., Note, Toward Adoption of State Law as the Federal Rule of Decision in Cases Involving Voluntary Federal Creditors*, 73 MINN. L. REV. 171, 189 (1988); *cf. Burbank, Interjurisdictional Preclusion, Full Faith and Credit and Federal Common Law: A General Approach*, 71 CORNELL L. REV. 733, 758 (1986) ("Increasingly, the Court, while asserting that a matter is governed by federal law, has determined that there is no need for a uniform federal rule."). Indeed, subsequent decisions by the Ninth Circuit have borrowed state statutory redemption laws in foreclosures brought by the Small Business Administration ("SBA") and the Farmers Housing Administration ("FmHA"). *See United States v. Pastos*, 781 F.2d 747 (9th Cir. 1986) (SBA); *United States v. Ellis*, 714 F.2d 953 (9th Cir. 1983) (FmHA). Nevertheless, the Ninth Circuit has been careful to avoid overturning *Stadium Apartments*. *See Pastos*, 781 F.2d at 752 (distinguishing FmHA from SBA). In addition, courts in other circuits continue to rely upon *Stadium Apartments* as precedent. *See, e.g., United States v. Victory Highway Village*, 662 F.2d 488, 497-98 (8th Cir. 1981) (refusing to borrow Minnesota statutory right of redemption in HUD foreclosure); *United States v. Elverud*, 640 F. Supp. 692, 696 (D.N.D. 1986) (refusing to borrow North Dakota right of redemption in FmHA foreclosure).

97. 662 F.2d 488 (8th Cir. 1981).

98. *See also United States v. Elverud*, 640 F. Supp. 692 (D.N.D. 1986) (The FmHA is not subject to a state statutory right of redemption.). *But see United States v. Ellis*, 714 F.2d 953 (9th Cir. 1983) (The FmHA is subject to a state statutory right of redemption.); *United States v. Pastos*, 781 F.2d 747 (9th Cir. 1986) (The SBA is subject to a state statutory right of redemption.).

99. *See Victory Highway Village*, 662 F.2d at 498.

100. 541 F.2d 777 (9th Cir. 1976). *See also United States v. Gish*, 559 F.2d 572 (9th Cir. 1977) (The court refused to borrow an Alaska anti-deficiency judgment law in an SBA foreclosure.), *cert. denied*, 435 U.S. 996 (1978); *United States v. Larson*, 632 F. Supp. 1565 (D.N.D. 1986) (The court refused to apply a North Dakota anti-deficiency judgment law in an SBA foreclosure.). *But see United States v. Dismuke*, 616 F.2d 755 (5th Cir. 1980) (The court borrowed a Georgia anti-deficiency judgment statute in an SBA foreclosure.); *United States v. Vallejo*, 660 F. Supp. 535 (W.D. Wa. 1987) (The court borrowed a Washington anti-deficiency judgment law in a VA foreclosure.).

101. *See Haddon Haciendas*, 541 F.2d at 784.

The courts have not been alone in creating a federal real estate finance law to replace that of the states. Prior to the 1970s, the regulation of real estate transactions was almost entirely the domain of state and local governments.¹⁰² However, beginning in the mid-1970s and accelerating in the 1980s, Congress has repeatedly overridden state real estate finance law in favor of uniform national law. The first effort to achieve national real estate law was the Federal Mortgage Foreclosure Act proposed by the Nixon administration in 1973.¹⁰³ The bill included a series of congressional findings blaming disparate state laws for inhibiting the free flow of mortgage money to homeowners, burdening federal programs, increasing the costs of borrowing, and impeding the secondary mortgage market.¹⁰⁴ Under the legislation, all mortgages made, owned, insured, or guaranteed by an instrumentality of the federal government would have been subject to a uniform system of mortgage foreclosure.¹⁰⁵ A mortgage foreclosure commissioner, appointed by the Secretary of HUD, would have been empowered to conduct non-judicial foreclosure proceedings.¹⁰⁶ In addition, the bill would have expressly abolished all state statutory rights of redemption.¹⁰⁷ The Federal Mortgage Foreclosure Act, a part of the Housing Act of 1973, failed to pass Congress.

However, in 1968 and 1974, Congress passed and the President signed two laws designed to protect home loan consumers. The Truth-in-Lending Act of 1968¹⁰⁸ requires lenders to supply borrowers with a wide range of information including the amount of the loan, the finance charge as expressed by the "annual percentage rate," the payment schedule, the default and delinquency charges, the prepayment penalties, and

102. See C. EDSON & B. JACOBS, *supra* note 10, at § 10.1 ("Until the end of the 1960's there was no practice of law more locally oriented than residential real estate.").

103. S. 2507, 93d Cong., 1st Sess. §§ 401-419 (1973) reprinted in *Administration's 1973 Housing Proposals: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs*, 93d Cong., 1st Sess. 394 (1973). In 1969, a federal commission had urged the administration to study real estate laws "with a view toward making them more uniform across the country." COMMISSION ON MORTGAGE INTEREST RATES, REPORT OF THE COMMISSION ON MORTGAGE INTEREST RATES TO THE PRESIDENT OF THE UNITED STATES AND TO THE CONGRESS 117 (1969).

104. See S. 2507, *supra* note 103, at § 402. FNMA was among the entities that testified in favor of the Federal Mortgage Foreclosure Act. In his statement, the chairman of FNMA condemned the lack of uniformity of state foreclosure laws, blaming these laws in part for the under-maintenance and vandalism of inner city properties. See *Housing and Community Development Legislation 1973: Hearings Before the Subcommittee on Housing of the Committee on Banking and Currency, House of Representatives*, 93d Cong., 1st Sess. 1182-88 (1973) (prepared statement of Oakley Hunter, President and Chairman of the Board, Federal National Mortgage Association).

105. S. 2507, *supra* note 103, at § 404.

106. *Id.* §§ 405-412.

107. *Id.* § 415(d).

108. Pub. L. No. 90-321, tit. I, 83 Stat. 146 (codified as amended at 15 U.S.C. §§1601-1665 (1988) as part of the Consumer Credit Protection Act).

the nature of the property securing the loan.¹⁰⁹ Although the Truth-in-Lending Act did not formally preempt state regulation, it has greatly influenced the requirements of state disclosure laws.¹¹⁰ The Real Estate Settlement and Procedures Act of 1974 (RESPA) requires all lenders of federally related¹¹¹ residential mortgage loans to make available to mortgagors settlement forms listing, in detail, all charges that the mortgagor will be responsible for at the settlement or closing of the transaction.¹¹² In addition, the legislation requires the distribution of booklets to all borrowers explaining the real estate transaction and the rights of mortgagors under RESPA.¹¹³ The Act also restricts the payments of fees or kickbacks for referrals incident to settlement services.¹¹⁴

Congress enacted more intrusive federal regulation in the 1980s. In 1980, it passed the Depository Institutions Deregulation and Monetary Control Act¹¹⁵ which included a limited preemption of state usury laws. The Act preempted state laws that limited the amount of interest, discount points, finance charges, or other charges for mortgage loans secured by first liens on most types of residential property. States were permitted to reinstate their usury laws, provided that they acted before

109. See 15 U.S.C. § 1638 (1988). The required disclosures under the Truth-in-Lending Act were limited by the Truth-in-Lending Simplification and Reform Act of 1980, Pub. L. No. 96-221, tit. VI, 94 Stat. 168 (1980). They now focus on the amount financed, the annual percentage rate, the total finance charge, payments, and sales price.

110. See Eskridge, *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1100 (1984) (In practice, the federal law dictates state disclosure requirements.).

111. A federally-related loan is a loan related to HUD or intended to be sold to FNMA, GNMA, or FHLMC. In addition, all loans made by lenders with federally insured deposits or regulated by federal agencies are deemed to be federally related. See 12 U.S.C. § 2602(1) (1988). Therefore, RESPA applies to virtually all home mortgage loan transactions. See C. EDSON & B. JACOBS, *supra* note 10, at § 10.02(1)(a).

112. RESPA, Pub. L. No. 95-533, § 4, 88 Stat. 1724, 1725 (1974) (codified as amended at 12 U.S.C. § 2603 (1988)).

113. See *id.* § 5 (codified as amended at 12 U.S.C. § 2604 (1988)).

114. See *id.* § 8(a) (codified as amended at 12 U.S.C. § 2607(a) (1988)). Additional federal regulation of home loan mortgage transactions prohibits discrimination. See Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-2000, tit. III, § 302, 89 Stat. 1124, 1125 (codified as amended at 12 U.S.C. § 2801 (1988)); Community Reinvestment Act of 1977, Pub. L. No. 95-128, tit. VIII, §§ 802-806, 91 Stat. 1111, 1147-48 (codified as amended at 12 U.S.C. §§ 2901-2905 (1988)); Equal Credit Opportunity Act, Pub. L. No. 93-495, § 701, 88 Stat. 1500, 1521 (1974) (codified as amended at 15 U.S.C. § 1691 (1988)); Fair Housing Act, Pub. L. No. 90-284, §§ 804-901, 82 Stat. 73, 81-80 (1968) (codified as amended at 42 U.S.C. §§ 3601-3631 (1988)).

115. Pub. L. No. 96-221, tit. V, § 501(a)(1), 94 Stat. 132, 161 (1980) (codified at 12 U.S.C. § 1735f-7 (1988)).

April 1, 1983.¹¹⁶ Among the reasons given for the preemption of usury laws was the concern that mortgage funds would not be available in states with usury restrictions, thereby frustrating national housing objectives.¹¹⁷ Preemption was also justified as necessary to the proper functioning of the secondary mortgage market.¹¹⁸

The Multifamily Mortgage Foreclosure Act of 1981¹¹⁹ enacted several of the principles that had been proposed in the 1973 Federal Mortgage Foreclosure Act for mortgage loans held by the federal government.¹²⁰ The Act provides for the appointment of a foreclosure commissioner, nonjudicial foreclosure, and the abolition of postforeclosure rights of redemption.¹²¹ Among the justifications for preemption included in the Senate Budget Committee's report is the need to reduce costly delays in foreclosing mortgage loans that result in property deterioration, as well as management and holding expenses. The law was also designed to provide "an efficient, equitable and, most important, relatively expeditious nonjudicial foreclosure remedy."¹²²

In 1982, federal preemption resolved one of the largest legal controversies involving real estate in recent memory—the enforceability of the "due-on-sale" clause. A due-on-sale clause is a provision in a promissory note or mortgage that permits the mortgagee to accelerate payment of the debt in the event that the property securing the loan is sold without the mortgagee's express permission.¹²³ As interest rates soared in the early 1980s, lenders increasingly exercised their acceleration option when properties were sold. A number of state legislatures and courts enacted laws or handed down decisions declaring due-on-sale clauses unenforceable as unreasonable restraints on alienation.¹²⁴ In 1976, the Federal

116. Fifteen states and the Commonwealth of Puerto Rico have reinstated their usury laws. For a list of states that have reinstated their usury laws, see C. EDSON & B. JACOBS, *supra* note 10, § 10.03 & n.70.

117. S. REP. NO. 368, 96th Cong., 1st Sess. 20 (1980), *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 236, 254-55.

118. *See id.*

119. The Multifamily Mortgage Foreclosure Act of 1981, Pub. L. No. 97-35, §§ 361-369I, 95 Stat. 422, 422-31, is contained in the Omnibus Budget Reconciliation Act of 1981, 12 U.S.C. §§ 3701-3717 (1988).

120. Since the overwhelming majority of mortgage loans are held by private investors, the Multifamily Mortgage Foreclosure Act governs only a small percentage of all mortgage foreclosures.

121. *See* 12 U.S.C. § 3713(d) (1988).

122. S. REP. NO. 139, 97th Cong., 1st Sess. 264 (1981), *reprinted in* 1981 U.S. CODE CONG. & ADMIN. NEWS 396, 560.

123. *See, e.g.,* Dawn Inv. Co. v. Superior Court, 30 Cal. 3d 695, 697, 639 P.2d 974, 975, 180 Cal. Rptr. 332, 333 (1982).

124. *See, e.g.,* Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 374 (1978).

Home Loan Bank Board issued a regulation preempting state restrictions on the enforceability of due-on-sale clauses with respect to loans held by federally chartered thrift institutions, an action that was later upheld by the Supreme Court in *Fidelity Federal Savings & Loan Association v. de la Cuesta*.¹²⁵ Congress thereupon enacted, as part of the Garn-St. Germain Depository Institutions Act of 1982,¹²⁶ a law that preempted all state interference with the enforceability of due-on-sale clauses, regardless of the identity of the lender or the nature of the property. Congress acted to protect the solvency of lending institutions as well as the efficiency of the secondary mortgage market. According to the Senate report accompanying the legislation, "[d]ue on sale restrictions . . . adversely affect secondary mortgage markets, which rely on uniform, homogenous mortgage documents to efficiently operate and provide mortgage money for lenders and home buyers."¹²⁷

The revolution of real estate finance that has occurred over the past two decades has already resulted in dramatic changes in real estate law. The responsibility for enacting laws governing real estate transactions, once the exclusive province of states and localities, has begun to shift to the federal government.¹²⁸ Having failed to adopt uniform law voluntarily, states are now in the position of having uniformity imposed by Congress. In the remainder of this Article, I explore the normative case for

125. 458 U.S. 141 (1982).

126. Pub. L. No. 97-320, 96 Stat. 1469 (1982) (codified as amended in scattered sections of 12 U.S.C.).

127. S. REP. NO. 536, 96th Cong., 1st Sess. 21 (1982) reprinted in 1982 U.S. CODE CONG. & ADMIN. NEWS 3054, 3075. The President of FHLMC testified before Congress in support of preemption. According to his submission to a House subcommittee, "[w]ithout this type of preemption, it is difficult for the Corporation and other nationwide secondary market participants to administer different due-on-sale policies to comply with the different state laws especially when the laws are in such a state of flux." See *Federal Home Loan Mortgage Corporation's Decision to Enforce Due-on-Sale Clause: Hearing Before a Subcommittee of the Committee on Gov't Operations, House of Representatives*, 97th Cong., 2d Sess. 185 (1982) (letter from Philip Brinkerhoff, President of FHLMC, to Kent Colton, Staff Director, President's Commission on Housing, July 31, 1981).

128. In addition, to the Truth-in-Lending Act, RESPA, the Depository Institutions Deregulation and Monetary Control Act, the Multifamily Mortgage Foreclosure Act and the Garn-St. Germain Depository Institutions Act, Congress has passed two other major pieces of legislation that have preempted state laws affecting real estate finance. In 1982, Congress enacted the Alternative Mortgage Transaction Parity Act of 1982 as part of the Garn-St. Germain Depository Institutions Act. See 12 U.S.C. § 3801 (1988). The Act preempts state restrictions on lenders that originate alternative mortgage loans. The Act permitted states to override the federal preemption if they acted before October 15, 1985. Three states chose to retain restrictions. See C. EDSON & B. JACOBS, *supra* note 10, § 10.05 & n.101. Congress also passed and the President signed the Secondary Mortgage Market Enhancement Act of 1984, Pub. L. No. 98-440, 98 Stat. 1689 (codified in scattered sections of 12 U.S.C. and 15 U.S.C.). The Act preempts state blue sky regulations for private issuers of mortgage-backed securities. States may act within seven years to reinstate their blue sky regulations.

supplanting diverse state real estate finance laws with uniform national law.

III. AN EVALUATION OF THE CASE FOR UNIFORM NATIONAL REAL ESTATE FINANCE LAW

Initiatives to promote uniformity of mortgage law, either through voluntary state enactment of uniform laws or through federal preemption, have more often been justified by vague generalities than by reasoned analysis. Typically, a uniform national rule of law is proposed to reduce the substantial costs supposedly generated by diverse state rules¹²⁹ or to promote the growth of the secondary mortgage market.¹³⁰ Not infrequently, federal preemption is proposed to reform existing real estate finance law, although no reason is advanced as to why the federal government, rather than the states, is the appropriate body to legislate the reform.¹³¹

In this Part, I critically examine several arguments for preempting state real estate finance laws and establishing uniform law. My focus is on laws relating to mortgage foreclosure.¹³² The justifications most frequently given for federal preemption of state commercial law can be clustered under three categories: (1) State lawmaking promotes economic inefficiency;¹³³ (2) population characteristics and economic circumstances in the United States do not substantially differ among states so as

129. See, e.g., Clauretie & Herzog, *How State Laws Affect Foreclosure Costs*, 6 SECONDARY MORTGAGE MARKETS 25, 28 (1989) (The awareness that foreclosure laws affect lender and insurer losses may spur efforts to implement uniform law.); Pedowitz, *supra* note 85, at 198 (Uniformity can engender confidence in lenders that collateral may be reached without high expense and delay.).

130. See, e.g., Malloy, *The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions*, 39 SW. L.J. 991, 1018 (1986) (“[F]or the law to facilitate a competitive market in mortgage-related securities authority must exist at the national level to coordinate, administer, and develop appropriate regulations and legal doctrines.”); Note, *Balancing Private and Public Initiatives in the Mortgage-Backed Security Market*, 18 REAL PROP., PROB. & TR. J. 426, 443 (1983) (authored by Andrew Lance) (Proposals for uniform law raised hopes that impediments to the secondary mortgage markets would be removed.); ULTA, Prefatory Note, 13 U.L.A. 469, 470 (1986) (Variance in the law is an impediment to the secondary mortgage market.).

131. See, e.g., G. NELSON & D. WHITMAN, *supra* note 60, § 8.8, at 631 (“Because the mortgage market is pervasively national in scope and its impact on the national economy is increasingly significant, the traditional state by state approach to real estate foreclosure is a luxury of federalism we can ill continue to afford.”).

132. The main reason for this emphasis is that state laws concerning mortgage foreclosure are particularly idiosyncratic. See *supra* text accompanying notes 64-79. In addition, most proponents of uniform mortgage law and federal preemption have singled out laws relating to mortgage foreclosure for special criticism.

133. See *infra* notes 139-185 and accompanying text.

to justify divergent legal rules;¹³⁴ and (3) state legislative processes are inferior to those of the federal government.¹³⁵ I conclude that none of these rationales is sufficiently supported to justify preemption of state mortgage foreclosure laws.

Implicit in my analysis is the proposition that proponents of preempting state real estate finance law bear the burden of persuasion. State regulation of real property has been ingrained in our legal tradition since the nation was founded. In particular, throughout our history, Congress and the federal courts have deferred to state legislative choices with respect to the manner in which debts may be enforced against property owners.¹³⁶ Of course, the mere fact that a legal norm is part of a venerable tradition should not stand in the way of reevaluating its desirability in light of societal change. Nevertheless, several factors counsel against changing the structure of real estate finance law in the absence of a strong theoretical or empirical justification. First, the time horizon of residential real estate investments is typically lengthy, often ranging up to and beyond thirty years. Therefore, reliance upon settled legal rules and predictable patterns of legal evolution is especially important in this area. In addition, any change in law entails significant costs. Finally, one advantage of state lawmaking as compared to federal legislation is the expanded possibility for the adoption of new and innovative legal rules and policies. As Justice Brandeis observed in his famous dissent in

134. See *infra* notes 186-209 and accompanying text.

135. See *infra* notes 210-282 and accompanying text.

136. Historically, Congress has been particularly solicitous of state procedures for executing money judgments. In response to court decisions holding that federal courts did not have an obligation to borrow state laws with respect to judgment executions, Congress enacted a law in 1828 that provided in part that "writs of execution and other final process issued on judgments" in federal courts should "be the same, except their style, in each state, respectively, as are now used in the courts of such state." Process Act of 1828, ch. 68, 4 Stat. 278, 281 (1846). For an exhaustive history of the debates surrounding the Process Act of 1828 and other statutes prescribing adherence to state judgment execution procedures, see Warren, *Federal Process and State Legislation*, 16 VA. L. REV. 421, 435-50 (1930). The requirement that federal courts adhere to state judgment execution procedures exists today in Federal Rule of Civil Procedure 69(a) which requires that "[t]he procedure on execution, in proceedings supplementary to and in aid of a judgment, and in proceedings on and in aid of execution shall be in accordance with the practice and procedure of the state in which the district court is held, existing at the time the remedy is sought, except that any statute of the United States governs to the extent that it is applicable." FED. R. CIV. P. 69(a). Several courts have observed that Rule 69(a) applies to mortgage foreclosure actions. See *Federal Land Bank v. Hassler*, 595 F.2d 356, 358 (6th Cir. 1979) (The court applied Rule 69(a) to a mortgage foreclosure sale and held that a judicial sale in accordance with Michigan practice does not constitute a seizure or levy entitling a U.S. Marshal to a commission.); *Travelers Ins. Co. v. Lawrence*, 509 F.2d 83, 90 (9th Cir. 1974) (same). But see *United States v. Petty Motor Co.*, 767 F.2d 712, 715 (10th Cir. 1985), cert. denied, 475 U.S. 1056 (1986) (A judicial sale in a mortgage foreclosure is not the same as an execution on a judgment and therefore does not fall within the scope of Rule 69(a).).

New State Ice Co. v. Liebmann,¹³⁷ states can experiment with a variety of policy approaches. Successful innovations can be adopted by other states or the federal government.¹³⁸ The negative effects of "failed" experiments, however, can usually be limited to the citizens of one state, rather than spread throughout the nation.

A. ECONOMIC EFFICIENCY

Uniform national real estate finance law might be desirable if the existence of diverse state laws led to economic inefficiency. In this section, I examine several possible sources of economic inefficiency caused by state legislation. Specifically, I analyze whether state real estate finance laws might be inefficient as a result of spillovers and interstate competition, transaction costs, and lost economies of scale. I conclude that, unlike some areas of commercial law, diversity resulting from state regulation of real estate finance is unlikely to be inefficient. In fact, efficiency considerations may even provide modest support for the existence of state mortgage laws.

1. *Spillovers and Interstate Competition*

Economic efficiency requires that the benefits of government regulation exceed the costs.¹³⁹ Economists and lawyers have long recognized that laws are more likely to be efficient if all of the costs and benefits of a regulation fall within the political jurisdiction responsible for enacting the legislation.¹⁴⁰ To the extent that the costs of a law or policy exceed the benefits generated, residents of the political jurisdiction would have an incentive to convince their elected representatives to amend or repeal

137. 285 U.S. 262, 311 (1932) (Brandeis, J. dissenting) ("[A] single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."). For a discussion of the role of states in policy experimentation, see Schill, *Intergovernmental Takings and Just Compensation: A Question of Federalism*, 137 U. PA. L. REV. 829, 870-71 (1989).

138. Among the state initiatives later adopted by the federal government are unemployment compensation, health and safety regulations, and public financing of political campaigns. See Benson, *Values of Decentralized Government* in *ESSAYS IN FEDERALISM* 1, 13-14 (1961); Derthick, *Preserving Federalism: Congress, the States, and the Supreme Court*, 4 BROOKINGS REV. 32 (1986). State experimentation has also served as a model for other states. See Schleiber, *American Federalism and the Diffusion of Power: Historical and Contemporary Perspectives*, 9 U. TOL. L. REV. 619, 636 (1978).

139. See F. STEPHEN, *THE ECONOMICS OF THE LAW* 58-59 (1988) (discussing the Kaldor-Hicks measure of efficiency and its relationship to cost-benefit analysis).

140. See W. OATES, *FISCAL FEDERALISM* 3-20 (1972); Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23, 45 (1983); Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457, 466 (1988).

the inefficient legislation or, alternatively, to apply pressure indirectly by exiting the community. These incentives to use voice or exit¹⁴¹ to repeal or avoid inefficient government regulation would diminish considerably if some or all of the costs of the regulation were externalized to citizens of other jurisdictions.

Numerous opportunities exist for a state to enact legislation with benefits that are largely internalized, but with costs that are substantially externalized.¹⁴² For example, some states might enact product liability laws to protect their citizens. Manufacturers encounter serious difficulties in charging citizens of any one state the marginal cost generated by their product liability laws. Among the most important reasons that differential pricing is so difficult is that personal property, the subject of the regulation, can easily be transported from state to state.¹⁴³ Even if manufacturers were able to charge retailers in a protective state the marginal costs of that state's product liability law,¹⁴⁴ a resident of a protective state could shop in a state that had no product liability law where the price would presumably be lower, bring the product back to his or her home state, and still take advantage of that state's protective laws. Since developing and administering an effective system of differential pricing would be costly or impossible,¹⁴⁵ residents of states with especially protective product liability laws do not bear the full costs of their regulation and may enact an inefficient level of protection when viewed from the economy as a whole.

Lax state regulation may also generate economic inefficiency because of externalized costs.¹⁴⁶ The most obvious example is air pollution. Frequently air pollution generated by automobiles or industries in a

141. See A. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970).

142. In some cases the externalized costs are merely incidental to the achievement of state objectives. In other cases the externalization of costs is an integral part of the legislative program. See Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 570-75 (1983) (discussing state efforts to disadvantage out-of-state commercial interests by enacting import restraints, natural resource severance taxes, and income taxes on interstate businesses already subject to taxation elsewhere).

143. See Rice, *Product Quality Laws and the Economics of Federalism*, 65 B.U.L. REV. 1, 56 (1985).

144. Rice argues that differential prices may also be impeded by price discrimination laws. See *id.* at 5 n.8.

145. But see Kitch, *Regulation, the American Common Market and Public Choice*, 6 HARV. J.L. & PUB. POL'Y 119, 125 (1982) (suggesting a market-oriented approach to provide differential product liability protection).

146. Policies of a state that generate externalities will not inevitably result in allocative inefficiency. If legal entitlements are clear and transaction costs are minimal, the state that bears the

particular state affects residents of other states. Residents of the state that is the source of the pollutants might not wish to enact strict anti-pollution standards because they have a high tolerance for pollutants, the topographical structure of their state shields them from adverse effects, their political culture eschews an activist public sector,¹⁴⁷ or they fear the loss of business attributable to increased regulation. Regardless of the reasons behind their inaction, a substantial risk exists that entrusting environmental decisionmaking authority to state legislatures will lead to too little regulation since the residents of the state do not bear the full costs of their actions.

Suboptimal regulation may also be attributable to the well-known problem of the prisoner's dilemma.¹⁴⁸ A prisoner's dilemma describes situations in which all parties could be made better off if they cooperated with each other, but cooperation is unlikely to occur because of high transaction costs, insufficient information, or strong incentives to defect.¹⁴⁹ The problems involved in the prisoner's dilemma affect many types of state regulation. For example, a state may hesitate to regulate air pollution because its citizens would bear the full costs of the regulation, but would not receive the full benefit. In essence, anti-pollution regulation may be a public good that states underproduce because citizens in other states can free-ride on the benefits. Transaction costs and strategic bargaining may limit the ability of states to agree on ways to share the cost of regulation. Assuming that the aggregate benefits of pollution control are less than the costs, achieving an efficient level of pollution control may be impossible without the intervention of the federal government.¹⁵⁰

Even in the absence of public goods problems, competition among states for business capital may lead to inefficient levels of state

externalized cost can bargain with the state generating the externality to stop the externality-promoting policy or activity. See Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15-16 (1960). However, unclear legal entitlements, high transaction costs, and strategic bargaining may make such agreements difficult or impossible to reach and enforce. See Inman & Rubinfeld, *A Federalist Fiscal Constitution for an Imperfect World: Lessons from the United States*, in FEDERALISM: STUDIES IN HISTORY, LAW, AND POLICY: PAPERS FROM THE SECOND BERKELEY SEMINAR ON FEDERALISM 79, 86-87 (H. Scheiber ed. 1988).

147. See *infra* text accompanying notes 194-201.

148. Mashaw & Rose-Ackerman, *Federalism and Regulation*, in THE REAGAN REGULATORY STRATEGY 111, 117 (G. Eads & M. Fix eds. 1984).

149. See Inman, *Markets, Governments, and the "New" Political Economy*, in 2 HANDBOOK OF PUBLIC ECONOMICS 647, 663-72 (A. Auerbach & M. Feldstein eds. 1987).

150. See Inman & Rubinfeld, *supra* note 146, at 87-88 (Federal intervention may be necessary to remedy failed Coasian bargains among jurisdictions.).

regulation.¹⁵¹ For example, if a state were to enact a worker safety law that added to the cost of products manufactured in the state, manufacturers might have an incentive to locate in or relocate to states with less stringent health and safety laws.¹⁵² To avoid being placed at a competitive disadvantage, each state might forego efficient regulation.¹⁵³ Again, if the benefits of regulations such as worker safety laws exceed their costs, the problem of the prisoner's dilemma may make state decision-making authority undesirable on efficiency grounds.¹⁵⁴

However, interstate spillovers and competition do not justify federal preemption of state mortgage foreclosure laws.¹⁵⁵ First, the total costs

151. See Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 666 (1974) (State corporate law leads to a "race for the bottom."). But see Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 279-81 (1985) (Empirical evidence shows that reincorporations in Delaware are not related to negative shareholder returns.); Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 256 (1977) (State regulation will lead to laws favorable to stockholders.).

152. Whether firms would have an incentive to relocate depends upon who bears the costs of the regulation. If competition from producers not subject to worker safety regulations requires the manufacturer to bear the cost, it would have an incentive to leave the state provided that the cost imposed by the regulation exceeded the cost of relocation. However, it is possible that a manufacturer might be able to pass the cost of the regulation back to its sources of inputs, thereby diminishing any incentive to relocate. For example, the employees of a manufacturer might be willing to accept lower wages in return for a safer working environment. Cf. E. REHBINDER & R. STEWART, ENVIRONMENTAL PROTECTION POLICY 4 n.1 (1985) (In theory, workers in states with stringent environmental protection laws might accept lower wages in return for environmental benefits.).

153. Cf. Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 YALE L.J. 1196, 1211-12 (1977) (Collective action problems may lead states to adopt lower environmental standards than they would otherwise prefer.).

154. States are also likely to be inappropriate jurisdictions to enact redistributive programs. See W. OATES, *supra* note 140, at 6-8 (Redistribution at the local level will cause an influx of low income households and an exodus of high income households.); Briffault, *Our Localism: Part II—Localism and Legal Theory*, 90 COLUM. L. REV. 346, 451 (1990) (State redistribution is limited by the ability of industries and affluent residents to migrate.); Peterson & Rom, *American Federalism, Welfare Policy, and Residential Choices*, 83 AM. POL. SCI. REV. 711, 725 (1989) (Data support the hypothesis that if redistribution policies are set by state and local government, the aggregate level of redistribution will be less than if the policies had been set at the national level.); Rose-Ackerman, *Cooperative Federalism and Co-optation*, 92 YALE L.J. 1344, 1345 (1983) ("[S]tate and local governments are poor instruments of redistributive policy.").

155. Federal preemption of state usury laws and restrictions on due-on-sale clauses might, however, be justified by spillover concerns. During the late 1970s and early 1980s, as interest rates for home mortgage loans exceeded 16 percent, many state usury laws set interest rate ceilings below the market rate causing lenders to refrain from making loans in those states. See Crafton, *An Empirical Test of the Effect of Usury Laws*, 23 J.L. & ECON. 135, 140 (1980) (Usury laws lead to a decrease in mortgage loan origination.); Nathan, *Economic Analysis of Usury Laws*, 10 J. BANK RES. 200, 204 (1980) ("[R]esearch indicates that usury restrictions have limited the flow of credit to mortgage markets."); Ostas, *Effects of Usury Ceilings in the Mortgage Market*, 21 J. FIN. 821, 831 (1976) (Usury laws reduced mortgage loan volume.). The issuance of mortgage-backed securities is premised on the geographic diversification of loans in the mortgage pools on which the securities are

generated by state mortgage foreclosure laws are likely to be modest in size thereby limiting the potential size of any externality.¹⁵⁶ In a recent article, I used net present value simulation and multiple regression analyses to estimate the magnitude of costs generated by state mortgagor protection laws.¹⁵⁷ I found that the costs attributable to these laws are quite modest, at least when compared to the estimates offered by other researchers.¹⁵⁸ Nevertheless, given the present structure of the mortgage market, possible inefficiencies associated with externalities may be present. Federally related secondary mortgage market agencies such as FNMA, GNMA and FHLMC do not price mortgage loans differentially to reflect the expected costs attributable to state mortgage laws.¹⁵⁹ Since a large proportion of loans are sold in the secondary mortgage market,

based. See *supra* text accompanying note 38. The reduction or cessation of home lending attributable to usury laws threatened the securitization process and therefore created an externality for borrowers and investors in other states. Similarly, federal preemption of state restrictions on the enforceability of due-on-sale clauses is also partially justified by the fact that these laws generated large costs for people outside the states that enacted them. State legislation and judicial decisions that retrospectively refused to enforce due-on-sale clauses effected an enormous wealth transfer from investors in mortgages to borrowers with existing home loans. In many cases, the investor was located in a state other than the one that enacted the due-on-sale restrictions. Furthermore, studies demonstrated that restrictions on the enforceability of due-on-sale clauses eroded the net worth of an already unstable thrift industry. See FEDERAL HOME LOAN BANK BD. TASK FORCE ON DUE-ON-SALE, FINAL REPORT AND TECHNICAL PAPERS OF THE TASK FORCE ON DUE-ON-SALE 2 (1982) (In 1981, 40% of the losses incurred by state chartered savings and loan institutions in California were attributable to due-on-sale clause restrictions.); Dale-Johnson, Dietrich, & Langetieg, *A Legal and Economic Analysis of the Due-on-Sale Clause: A Retrospective Examination*, 10 RES. L. & ECON. 105, 116 (1987) (estimating that due-on-sale restrictions led to the loss of about 45% of California savings and loan institutions' net worth). If the institutions were to become insolvent, as many have in the 1980s, taxpayers throughout the nation would be called upon to pay their liabilities. See Rosenbaum, *Southwest to Get Economic Benefits in Savings Bailout*, N.Y. Times, June 25, 1990, at A-1, col. 6 (describing the transfer of wealth from the Northeast and the Midwest to the Southwest to deal with insolvent savings and loan institutions). Even more directly than usury laws, state laws retrospectively limiting the enforceability of due-on-sale clauses generated externalities that might have justified federal preemption.

156. Of course, even if the aggregate costs of mortgagor protection laws were substantial, efficiency concerns would not provide a strong justification for federal preemption as long as the costs of the laws were fully internalized. If the costs of mortgagor protection laws are externalized, however, their relatively small magnitude indicates that the potential size of the externality is quite limited.

157. In particular, I examined statutory rights of redemption and state prohibitions on deficiency judgments. See Schill, *supra* note 75, at 500-15.

158. I estimated that an eleven-month statutory right of redemption would increase the interest rate charged by lenders for new home mortgage loans by 7.3 basis points. My research also indicates that prohibitions on deficiency judgments are not significantly related at the 90% confidence level to increased home mortgage loan rates. See *id.* at 512-14.

159. Interview with Robert Van Order, Chief Economist, FHLMC (January 1990); cf. Steinbach, *The Local Nature of Housing*, MORTGAGE BANKING, June 1990, at 61, 63 (criticizing FNMA and FHLMC for employing national underwriting guidelines). For a description of the way FHLMC prices mortgages, see FHLMC, 1 SELLER & SERVICERS GUIDE 31-33 (1984). The failure to price loans to reflect state mortgage laws is likely to be attributable to one of two explanations.

mortgage originators typically do not include the full expected cost of differential mortgage laws in the interest rates charged to customers. Therefore, in a manner similar to the product liability example discussed above, some of the costs of state mortgage foreclosure laws are likely to be borne by out-of-state investors in mortgage loans and mortgage-backed securities.

Unlike the case of product liability, however, it should be relatively simple and economical to internalize fully any significant externalities created by state mortgage law. Instead of preempting state law, Congress need only require FNMA, GNMA and FHLMC to adjust the price they pay for loans to reflect the expected cost of state real estate finance laws.¹⁶⁰ Given the elaborate pricing models already used to evaluate real estate investments,¹⁶¹ such an adjustment factor for state laws is unlikely to add significantly to transaction costs.¹⁶²

Differential pricing of mortgages to reflect varying state laws would not encounter the problems that impede pricing personal property to reflect diverse product liability laws.¹⁶³ The legal protections are tied to property that, by definition, cannot be moved from one state to another. Therefore, mortgagors purchasing property in one state would be unable to obtain the benefits of another state's laws.¹⁶⁴

When analyzing the effects of interstate spillovers and competition on economic efficiency, one should not conclude that the interstate effects

First, as my empirical analyses suggest, these laws are likely to generate only modest costs. Therefore, the benefits of pricing the expected costs of the laws may be less than the costs. Second, as federal agencies or agencies with a relationship to the federal government, FNMA, GNMA, and FHLMC may fear that "discriminating" against the laws of particular states will create political problems in Congress.

160. Differential pricing of mortgage loans to reflect the cost of state laws might indirectly promote uniform real estate finance law. Once the externality created by the secondary mortgage market is internalized, states with exceptionally protective laws might decide that the costs of the laws outweigh their benefits. Uniform real estate finance law, voluntarily adopted by states, would be unobjectionable from the standpoint of economic efficiency.

161. For a summary of mortgage pricing models, see Hendershott, *Mortgage Pricing: What Have We Learned So Far?*, 14 AM. REAL EST. & URB. ECON. A.J. 497 (1986).

162. See *infra* text accompanying note 183 (discussing the widespread dissemination of information about state mortgage laws).

163. See *supra* text accompanying notes 143-45.

164. Some commentators have speculated that in the future mortgages might be transferrable from property to property as a household moves. See *The Portable Mortgage*, BANKERS RES., Oct. 5, 1987 at 2 (A new loan product offered by Chase Home Mortgage permits a mortgagor to transfer the balance of the mortgagor's loan to new homes in Chase's market area.). If interstate transfers of mortgage liens become prevalent, a prospect that is unlikely considering the different legal formalities among states, then mortgagors could pay less than the full costs generated by the laws of the state in which their property was located.

of state regulation always impede economic efficiency. On the contrary, some commentators have hypothesized that competition among jurisdictions can promote, rather than detract from, the objective of economic efficiency. As Tiebout observed, the ability of people to move to different jurisdictions creates a market for public goods.¹⁶⁵ The existence of decentralized decisionmaking at the state or local level permits individuals to "vote with their feet," selecting a package of taxes, services, and regulation that is more likely to reflect their preferences than any probable combination offered by the national government.¹⁶⁶

Tiebout's model was initially designed to explore the efficiency-enhancing aspects of a system of local governments. Several commentators, however, have incorporated Tiebout's insights to develop a normative theory favoring state over federal regulation.¹⁶⁷ According to Easterbrook, "Competition among the states to create attractive systems of economic regulation is greatest if states may adopt *any* regulations they choose . . . so long as the residents of the state that adopts the regulation also bear the whole monopoly overcharge."¹⁶⁸ In effect, these commentators argue that state competition leads to more efficient results than a federal monopoly over regulation.¹⁶⁹

Just as proponents of uniform national law must be careful not to overstate the negative effects of interstate spillovers and competition, proponents of state decisionmaking authority should recognize the limited role that interstate competition for households and firms is likely to play in promoting economic efficiency.¹⁷⁰ The ability of households and firms to move to jurisdictions offering desirable packages of taxes, services, and regulations drives Tiebout's model. The model assumes perfect information, costless mobility, a large number of different communities

165. See Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956).

166. See *id.* at 418, 420. For a critique of the normative underpinnings of the Tiebout model, see Briffault, *supra* note 154, at 417-25.

167. See, e.g., T. DYE, *AMERICAN FEDERALISM: COMPETITION AMONG GOVERNMENTS* 1-33 (1990) (discussing the advantages generated by interstate competition); Kitch, *Regulation and the American Common Market* in *REGULATION, FEDERALISM AND INTERSTATE COMMERCE* 9, 13 (A. Tarlock ed. 1981) (Decentralized authority places strong incentives on jurisdictions to promulgate efficient rules.).

168. Easterbrook, *supra* note 140, at 45 (emphasis in original).

169. See T. DYE, *supra* note 167, at 1-33; Kitch, *supra* note 167, at 9, 13.

170. Indeed, Easterbrook seems sensitive to this qualification. See Easterbrook, *supra* note 140, at 44 ("A few pieces of (solid) evidence suggest that people sort themselves out by moving to particular jurisdictions—much more so within states, where there are thousands of competing jurisdictions, than among states.")

to choose from, and the absence of external effects.¹⁷¹ Although the evidence is by no means uncontradicted, several empirical studies of intra-metropolitan mobility have shown that people do behave in a manner consistent with Tiebout's model.¹⁷² Nevertheless, the failure of economists to demonstrate consistently the empirical validity of Tiebout's model at the local level should make one particularly careful about claiming its efficacy at the state level, especially for individual households. Except for people living near state borders, the cost of relocating from one state to another due to dissatisfaction with a particular set of public policies may be prohibitive. Not only must one gather information about the range of taxes, services, and regulation offered by competing jurisdictions, but one would frequently have to sell one's house and obtain new employment.¹⁷³

171. See Tiebout, *supra* note 165, at 419.

172. See Cebula, *An Analysis of Migration Patterns and Local Government Policy Toward Public Education in the United States*, 32 PUB. CHOICE 113, 119-20 (1977) (Expenditures on education and levels of property taxation affect migration to localities.); Gramlich & Rubinfeld, *Micro Estimates of Public Spending Demand Functions and Tests of the Tiebout and Median-Voter Hypotheses*, 90 J. POL. ECON. 536, 558 (1982) (Michigan data indicate that variations in expenditure residuals are smaller for urban communities than for the entire sample; actual spending conforms to desired levels in Tiebout-like communities.); Hamilton, Mills & Puryear, *The Tiebout Hypothesis and Residential Income Segregation*, in FISCAL ZONING AND LAND USE CONTROLS: THE ECONOMIC ISSUES 101, 112 (E. Mills & W. Oates eds. 1975) (The number of school districts in a metropolitan area significantly influences the degree of suburban income segregation.); Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. POL. ECON. 957, 968 (1969) (New Jersey data show that local property values are negatively related to the effective tax rate and positively related to per pupil school expenditures.). *But see* Lowery & Lyons, *The Impact of Jurisdictional Boundaries: An Individual-Level Test of the Tiebout Model*, 51 J. POL. 73, 91-93 (1989) (A comparison of a jurisdictionally fragmented metropolitan area to a consolidated metropolitan area indicates that patterns of dissatisfaction with local services are unrelated to institutional relationships, and in fragmented jurisdictions few citizens intended to opt for exit option.); Pack & Pack, *Metropolitan Fragmentation and Local Public Expenditures*, 31 NAT'L TAX J. 349, 358-59 (1978) (A considerable disagreement exists within Philadelphia suburbs with respect to demand for public goods and services.); Pack & Pack, *Metropolitan Fragmentation and Suburban Homogeneity*, 14 URB. STUD. 191, 199 (1977) (Income homogeneity in Pennsylvania localities is quite limited, which suggests that substantial variation in demand for public goods existed.); Rose-Ackerman, *Tiebout Models and the Competitive Ideal: An Essay on the Political Economy of Local Government*, in 1 PERSPECTIVES ON LOCAL GOVERNMENT FINANCE AND PUBLIC POLICY 23 (1983) (criticizing and evaluating empirical research on the Tiebout model).

173. Very few studies test whether the Tiebout model accurately predicts interstate mobility. Researchers have examined whether people move to individual states in response to different tax policies and different levels of social welfare benefits. One empirical study shows that a relatively progressive tax system and high levels of transfer spending tends to reduce the net migration of whites into a state. See Althaus & Schachtler, *Interstate Migration and the New Federalism*, 64 SOC. SCI. Q. 35, 40 (1983). Empirical studies also show that poor people tend to move to states that offer comparatively high welfare benefits. See Cebula & Koch, *Welfare Policies and Migration of the Poor in the United States: An Empirical Note*, 61 PUB. CHOICE 171, 175 (1985); Peterson & Roin, *supra* note 154, at 725. Another empirical study demonstrates that whites who move between states do not

Nevertheless, at the margin, state lawmaking authority is likely to provide some discipline that would be absent if the federal government were the only decisionmaker.¹⁷⁴ Although one might not be willing to move to another state solely because of its real estate finance laws, political culture studies indicate that states' policies differ from each other in predictable and consistent patterns.¹⁷⁵ Therefore, one might have a sufficient incentive to move to a competing state for a bundle of services, taxes, and regulations that accord with one's preferences, even if one would not have moved for any one element of the package.¹⁷⁶

2. *Economies of Scale and Transaction Costs*

Varying state laws might also lead to inefficiency if they result in reduced economies of scale of production or generate substantial transaction costs. The effect of state law on economies of scale of production is particularly apparent in the field of product safety regulation.¹⁷⁷ States frequently enact product safety laws that vary greatly and are sometimes inconsistent with each other. Thus, manufacturers who wish to sell their products in all fifty states may have to produce goods that are customized for particular states' product safety laws. If the industry is one with a declining average cost function, producing different goods for different states might generate lost scale economies.¹⁷⁸ Preserving scale economies may, in some areas of commercial law, justify replacing divergent state laws with a uniform national standard.¹⁷⁹

tend to move to states with high welfare benefits and high levels of property taxes, whereas African-Americans tend to move to states with high welfare benefits. See Cebula, *Interstate Migration and the Tiebout Hypothesis: An Analysis According to Race, Sex, and Age*, 69 J. AM. STATISTICAL A. 876, 878 (1974).

174. See Mashaw & Rose-Ackerman, *supra* note 148, at 121.

175. See *infra* text accompanying notes 194-201.

176. In addition, even if interstate mobility were extremely limited, the existence of different packages of taxes, services, and regulation may permit residents to observe alternative state policies and pressure their own state to adopt them. See R. HOLCOMBE, *AN ECONOMIC ANALYSIS OF DEMOCRACY* 174 (1985).

177. See T. BOURGOIGNIE & D. TRUBEK, *CONSUMER LAW, COMMON MARKETS AND FEDERALISM IN EUROPE AND THE UNITED STATES* 41 (1987) (arguing that state consumer product laws might lead to lost scale economies).

178. See *id.*; cf. Wolman, *Decentralization: What It Is and Why We Should Care*, in *DECENTRALIZATION, LOCAL GOVERNMENTS AND MARKETS: TOWARDS A POST-WELFARE AGENDA* 29, 31 (R. Bennett, ed. 1990) ("[D]ecentralization to large numbers of small units may inhibit achievement of optimal levels of efficiency by not permitting economies of scale in some service provision.").

179. See Mashaw & Rose-Ackerman, *supra* note 148, at 118 ("Uniform national regulation frequently produces economies of scale for private firms in interstate commerce. Search costs are reduced; economies of national scale in production and distribution arrangements are maintained.").

The adoption of uniform national law has also been proposed to reduce transaction costs. Commentators have argued that different state laws require parties to commercial transactions to spend large sums of money complying with a wide variety of legal formalities. In particular, companies that transact business in more than one state are required to expend resources gathering information about the laws of each state and assessing their impact on the proposed transaction.¹⁸⁰ Indeed, in their Prefatory Note to the Uniform Land Transactions Act, the Commissioners on Uniform State Laws expressed the view that uniform state real estate finance laws would "encourage widespread lending by financial entities which presently may restrict their lending to a few states because of the difficulties and additional expense involved in dealing in other states with widely varying laws."¹⁸¹

Diverse state real estate finance laws are likely to have a minimal effect on economies of scale for thrifts and other financial institutions. The practice of originating mortgage loans is unlikely ever to reach the level of centralization and mass production achieved for many types of consumer credit. Data collected by the mortgage banking industry indicate that economies of scale are quickly exhausted with respect to mortgage loan origination.¹⁸² Due to the large size of the loan and the importance to the lender of the property securing the loan, lenders must evaluate carefully the economic risks of local real estate markets and appraise the value of each unique piece of real property securing every

180. See Davis, *Revamping Consumer-Credit Contract Law*, 68 VA. L. REV. 1333, 1341 (1982) (Multistate consumer lenders must keep up with state laws.); Phillips, *Secured Credit and Bankruptcy: A Call for the Federalization of Personal Property Security Law*, 50 LAW & CONTEMP. PROBS. 53, 65 (1987) (Substantial costs of legal research are attributable to state law.).

181. ULTA, Prefatory Note, 13 U.L.A. 469, 470 (1986).

182. See MORTGAGE BANKERS ASS'N OF AM., 2 TOWARD THE YEAR TWO THOUSAND: REAL ESTATE FINANCE IN THE DECADE AHEAD—RESIDENTIAL MORTGAGE FINANCE IN THE DECADE AHEAD 9-10 (1989) ("[T]he 1987 cost survey supports the contention that there are few economies of scale that can be realized in the retail production area . . . [.] loan origination is very much a local business."); Lasko, *Introduction*, in MORTGAGE BANKING: A HANDBOOK OF STRATEGIES, TRENDS AND OPPORTUNITIES 1, 11 (J. Lederman ed. 1989) ("In the loan production area, available data suggest that economies of scale are exhausted at a fairly low volume . . ."); Mara, *The New Economics of Mortgaging*, MORTGAGE BANKING, Mar. 1989, at 89, 94 ("Smaller firms can also originate profitably. They are better able to understand their local market."). Mortgage servicing, however, does seem to demonstrate significant economies of scale and has undergone significant consolidation. See Lott, *Strategic Overview of Mortgage Banking*, in MORTGAGE BANKING: A HANDBOOK OF STRATEGIES, TRENDS AND OPPORTUNITIES, *supra*, at 19, 26 ("In contrast to loan production, loan servicing operations are subject to economies of scale."); Cholewicki, *Economies of Scale and Profitability*, MORTGAGE BANKING, Mar. 1989, at 69 (economies of scale exist for servicing portfolios of up to 80,000 loans). *But cf.* Follain & Zorn, *The Unbundling of Residential Mortgage Finance*, 1 J. HOUSING RES. 63, 80 (1990) (arguing that no econometric study confirms economies of scale for mortgage servicing).

loan. Furthermore, unless the nation were to adopt a national system of land title registration, local counsel and title specialists would still be required. Although many mortgage originators operate in more than one state, many aspects of the mortgage origination process will likely remain localized.

Even if the process of loan origination were to become centralized, diverse state laws would not significantly impair the achievement of scale economies. The essential product, the home mortgage loan, would remain the same in every state. Although different legal documents would be required for each state, present use by secondary mortgage market agencies of state-specific loan forms indicates that the additional costs of customized documentation would be minimal.

The localized nature of much of the real estate loan origination process may also help to minimize the transaction costs of diverse state real estate finance laws. Since much of the origination process involves intra-state actors such as mortgage bankers, appraisers, and attorneys to render title opinions, incentives exist for these parties to develop knowledge and expertise regarding local economic conditions and state laws. Given the probability that many aspects of the loan origination process will remain local in nature, the existence of "local" law is unlikely to inhibit residential lending or increase transaction costs as much as it would for other types of multistate commercial transactions that can achieve a higher level of centralization.

Transaction costs attributable to diverse state real estate finance laws may be of more consequence in the secondary mortgage market. Out-of-state purchasers of mortgage loans may lack the incentive of local mortgage originators to acquire detailed knowledge of each state's mortgage law. Nevertheless, centralized sources of information about state mortgage law help minimize transaction costs. Several law firms across the nation specialize in mortgage foreclosures and have experience in all fifty states. In addition, detailed summaries and comparisons of state real estate finance laws are widely available.¹⁸³

Another source of transaction cost that figures prominently in other areas of state commercial law should be of relatively little consequence in real estate finance transactions. Commentators have observed that transaction costs attributable to divergent state laws are greatest in multistate transactions where legal issues involve complex choice of law questions.

183. See, e.g., D. JANKOWSKI, *THE NATIONAL MORTGAGE SERVICER'S REFERENCE DIRECTORY* (6th ed. 1989); M. SHERMAN, *MORTGAGE AND REAL ESTATE INVESTMENT GUIDE* (1988).

The resolution of conflict of law issues frequently requires significant expenditures of legal resources, and the uncertainty generated by this complex body of law may increase the risk of interstate transactions.¹⁸⁴ Choice of law questions for real estate finance transactions, however, are among the most simple. In most cases, the state law to be applied is the law of the state in which the real property is located.¹⁸⁵

In summary, economic efficiency will not be significantly enhanced if Congress or the states adopt a uniform national real estate finance law. Current differences in state laws governing real estate finance do not generate significant externalities and have not led to a destructive regulatory "race to the bottom" to attract capital. Those externalities now generated by the failure of secondary mortgage market agencies to price loans to reflect the costs imposed by differing state laws could easily be internalized by the adoption of a differential pricing policy. Varying mortgage laws are also unlikely to lead to a reduction in economies of scale, although they may generate transaction costs in the secondary mortgage market. These transaction costs, however, are likely to be comparatively modest due to the existence of centralized sources of information. Entrusting mortgage law to the states may even promote economic efficiency, at least at the margin, by establishing some market discipline over the regulatory process.

B. "ONE NATION . . ."

Admittedly, diverse state mortgage laws are likely to generate modest transaction costs.¹⁸⁶ If the existence of state lawmaking authority over residential real estate finance generated no benefits, it would be difficult to argue against federal preemption. Nevertheless, allowing each state to develop its own mortgage laws is preferable under the utilitarian principle that government actions should satisfy the greatest possible number of individual preferences. As long as tastes for various forms of government intervention can be expected to vary across states or regions

184. Day, *The National Conference of Commissioners on Uniform State Laws*, 8 U. FLA. L. REV. 276 (1955) (The need for uniformity is greatest when the steps required to complete transactions take place in more than one state, necessitating the consideration of different laws or raising difficult questions of conflict of law.); cf. Burbank, *supra* note 96, at 767-68 (The costs of uncertainty, including those resulting from choice of law questions, support uniform federal preclusion laws.).

185. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 229 (1971) ("The method for the foreclosure of a mortgage on land and the interests in the land resulting from the foreclosure are determined by the local law of the situs.").

186. See *supra* text accompanying note 183.

and government actions do not generate significant spillover effects,¹⁸⁷ decentralized lawmaking will maximize utility. In particular, if the responsibility for policy generation and legal rulemaking is located at the state level, citizens who constitute a majority at the state level but are in the minority at the national level will be able to satisfy their preferences at no cost to the rest of the nation.¹⁸⁸

Federal preemption of state law, however, has occasionally been justified on the ground that meaningful differences no longer exist among the states. A more modest version of this argument does not suggest that people and economic conditions are homogenous across the nation, but instead asserts that with respect to the particular subject matter of the regulation, there are no meaningful differences among states.¹⁸⁹

There is little doubt that with the growth of national commercial markets, local economies are no longer as distinct as they once were.¹⁹⁰ In addition, given the relatively high level of interregional mobility of American households and the existence of national television networks, cultural barriers among regions and states have diminished in importance throughout the twentieth century.¹⁹¹ Nevertheless, it would be a grave error to conflate the trend of increasing national homogeneity with the conclusion that meaningful differences among states no longer exist.¹⁹² On the contrary, the economies of states such as Idaho and

187. If a state policy has significant effects on the citizens of other states, however, the utility maximization objective might support federal preemption. *See supra* text accompanying notes 140-54.

188. *Cf. Tullock, Federalism: Problems of Scale*, 6 PUB. CHOICE 19, 22 (1969) ("[T]he individual will suffer less cost from governmental activities of which he disapproves the smaller the government."). Implicit in this analysis is the assumption that, at least with respect to most issues of commercial law, citizens of State A will be indifferent about the laws affecting citizens of State B, provided that the citizens of State A are not financially disadvantaged by State B's legislation. To the extent that citizens of State A wish to impose their moral or ethical viewpoint on citizens of State B, however, state lawmaking may not necessarily maximize aggregate utility. *Cf. Wolman, supra* note 178, at 29, 35-36 ("National interests" such as civil rights, adequate education for the future workforce, and minimum levels of welfare do exist.).

189. *See, e.g., Davis, supra* note 180, at 1349 (arguing in favor of federal preemption of consumer credit law on the ground that the "fundamental relationship between consumer and creditor is the same everywhere.").

190. *But cf. Brace, Isolating the Economies of States*, 17 AM. POL. Q. 256, 269 (1989) (data show that "states became more economically autonomous in the period studied [1968-1985].").

191. *But cf. Schill, supra* note 137, at 887 (discussing the rise of regionalism in 1970s and 1980s).

192. *See Macey, Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public-Choice Explanation of Federalism*, 76 VA. L. REV. 265, 281 (1990) ("The fifty states that comprise the union differ dramatically in history, demography, economic orientation, and natural endowment.").

Wyoming bear very little resemblance to those of New Jersey and Delaware. Some state economies depend upon natural resources, while other states have employment concentrated in such areas as financial services, agriculture, and technology.¹⁹³

Besides economic factors, states continue to vary along racial, religions, and cultural dimensions. Some states have large numbers of racial or ethnic minorities, while others are racially or culturally homogenous. Among states with large minority populations, the ethnic and cultural composition of the minority population varies dramatically from state to state. Large Hispanic populations live in California, Florida and the Southwest, while African-American households make up a significant proportion of the population in the South and certain northeastern states. Kansas and Oklahoma remain in the Bible Belt whereas Jews still cluster in states with large urban populations.

The continued diversity among states along economic, population, and cultural dimensions has effects that extend beyond the jobs at which people work, the languages they speak, and the foods they consume. Political scientists have repeatedly found that differences among states lead to distinctive political cultures and attitudes that, in turn, affect public policy and law. Most research on state political culture can be traced to the work of Elazar. In 1966, Elazar identified three distinct political cultures spread by settlers of the United States as they migrated throughout the nation: the moralistic culture, the traditionalistic culture, and the individualistic culture.¹⁹⁴ The moralistic culture of many northern states views politics and government as a positive instrument for promoting social and economic welfare. Typically, moralistic political cultures favor decentralized, local government intervention over centralized, federal action.¹⁹⁵ In contrast, the political culture of the traditionalist

193. See Gray, *The Socioeconomic and Political Context of States*, in *POLITICS IN THE AMERICAN STATES* 3, 24 (V. Gray, H. Jacob & R. Albritton, eds. 5th ed. 1990) (“[T]he states’ economies vary in size, in which economic sector is most important (manufacturing, services, financial, mining, etc.), and in the major goods produced.”).

194. D. ELAZAR, *AMERICAN FEDERALISM: A VIEW FROM THE STATES* 86-94 (1966).

195. See D. ELAZAR, *AMERICAN FEDERALISM: A VIEW FROM THE STATES* 118 & 145 n.10 (3d ed. 1984) (Moralists may oppose federal government programs, but favor identical local initiatives.); D. ELAZAR, *CITIES OF THE PRAIRIE: THE METROPOLITAN FRONTIER AND AMERICAN POLITICS* 263-64 (1970) (Moralists “channel the interest in government intervention into highly localistic paths so that a willingness to encourage local government intervention to set public standards does not necessarily reflect a concomitant willingness to allow outside governments equal opportunity to intervene.”); Johnson, *Political Culture in American States: Elazar’s Formulation Examined*, 3 *AM. J. POL. SCI.* 491, 505 (1976) (Presenting an empirical study that shows inoralism is negatively related to centralized government decisionmaking and positively related to local administration.).

states, many of which are located in the south, typically entails skepticism about both political participation and activism in the public sector.¹⁹⁶ Government is viewed as useful in maintaining traditional ways of life. The political culture of individualist states lies somewhere between the moralistic and traditionalistic cultures.¹⁹⁷ Political participation is useful as a means to improve one's social and economic position. Limited government intervention is approved of to achieve utilitarian objectives.

In recent years, political scientists have transformed Elazar's observations about political culture into verifiable hypotheses. Numerous empirical studies demonstrate that the political culture of a state is a reliable predictor of many forms of political participation and policy output.¹⁹⁸ For example, Sharkansky developed a scale of political culture ranging from moralism to traditionalism and found that high traditionalism scores were correlated with low voter participation, less developed government bureaucracies, and reduced levels of taxes, government expenditures on public services, and public-employee salaries.¹⁹⁹ Although commentators differ as to the cause of the relationship between state political culture and public policy,²⁰⁰ virtually all agree that state public policies differ based upon political culture.²⁰¹

196. D. ELAZAR, *AMERICAN FEDERALISM*, *supra* note 195, at 118-19.

197. *See id.* at 115-17.

198. *See* T. ANTON, *AMERICAN FEDERALISM AND PUBLIC POLICY* 56 (1989) ("[C]areful students of state politics, from journalists to systematic empirical researchers, agree that state boundaries continue to define important differences of substance as well as style in American politics.").

199. *See* Sharkansky, *The Utility of Elazar's Political Culture: A Research Note*, 2 *POLITY* 66 (1969). Sharkansky found that the effect of political culture on politics and policy existed even when the researchers controlled for regional and socioeconomic characteristics. *Id.* at 68-72.

200. *Compare* Joslyn, *Manifestations of Elazar's Political Subcultures: State Public Opinion and the Content of Political Campaign Advertising*, 10 *PUBLIUS: J. FEDERALISM* 37, 54-55 (1980) (Variation in public opinion among states "matches up extremely well" with subcultural patterns observed by Elazar.) *with* Lowery & Sigelman, *Political Culture and State Public Policy: The Missing Link*, 35 *W. POL. Q.* 376, 381 (1982) ("[T]he performance of the political culture variables as predictors of attitudes related to political participation and the desired scope of government activity is modest at best."). Lowery and Sigelman suggest that public policies may be influenced more by political elites who adhere to the political culture of their state than by mass public opinion. *Id.* at 383. Erikson, McIver, and Wright found that interstate differences in political culture account for more of the variation in political ideology and partisanship than do demographic variables. Nevertheless, they were unable to explain what caused the pattern of political culture demonstrated by their study. Erikson, McIver & Wright, *State Political Culture and Public Opinion*, 81 *AM. POL. SCI. REV.* 797, 808 (1987).

201. *See, e.g.*, T. ANTON, *supra* note 198, at 55, 60; J. TREADWAY, *PUBLIC POLICYMAKING IN THE AMERICAN STATES* 63 (1985); Lowery, Gray & Hager, *Public Opinion and Policy Change in the American States*, 17 *AM. POL. Q.* 3, 13 (1989).

Political culture studies show that despite their growing interdependence, American states retain their importance and vitality as distinctive forums for policy generation and legal rulemaking.²⁰² In the context of real estate finance law, states with cultures that favor an activist government are more likely to support legal rules that protect mortgagors from the adverse effects of foreclosure and default.²⁰³ In addition, varying state economies might lead states to adopt different laws to govern the mortgage foreclosure process. The risk of mortgage default and foreclosure is not uniform throughout the United States.²⁰⁴ In states with undiversified economies²⁰⁵ or economies subject to unexpected disruptions,²⁰⁶ homeowners might be especially inclined to demand laws such

202. In addition, empirical studies demonstrate that state policy choices concerning a wide variety of issues remain varied. See, e.g., Kemp, *Nationalization of the American States: A Test of the Thesis*, 6 AM. POL. Q. 237, 241-42 (1978) (Relative variation in state spending for welfare, education, highways and health remained stable from 1958-74; absolute variation of expenditures increased.). See also T. DYE, *supra* note 167, at 41-42 (Coefficients of variation for revenues and expenditures for various public goods and services have remained unchanged over the past three decades.); J. WILSON, AMERICAN GOVERNMENT 69 (4th ed. 1989) ("There remains more political and policy diversity in the United States than one is likely to find in any other large industrialized nation.").

203. A comparison of Elazar's classification of state political cultures with the states that have adopted statutory rights of redemption and anti-deficiency judgment legislation demonstrates that states with predominantly moralistic political cultures have adopted these laws with much greater frequency than states with individualistic or traditionalistic cultures. Fifty-nine percent of moralistic states give a home mortgagor a statutory right of redemption when the mortgagee forecloses its mortgage using the predominant method of foreclosure. Only 35% of individualistic states and 38% of traditionalistic states provide similar protections. Thirty-five percent of moralistic states prohibit a mortgagee from obtaining a deficiency judgment when it uses the predominant method of foreclosure to foreclose a home mortgage loan. Only 12% of individualistic states and 6% of traditionalistic states provide similar protection against deficiency judgments. See D. ELAZAR, AMERICAN FEDERALISM, *supra* note 195, at 136 (classifying state political cultures); Schill, *supra* note 75, at 510 (describing the process for identifying states with mortgagor protection laws). A recent econometric study indicates that moralistic states are more likely to enact consumer protection legislation than states with individualistic or traditionalistic political cultures. See Sigelman & Smith, *Consumer Legislation in the American States: An Attempt at Explanation*, 61 Soc. Sci. Q. 58, 66-68 (1980).

204. See Ogden, Rangan & Stanley, *Risk Reduction in S&L Mortgage Loan Portfolios Through Geographic Diversification*, 2 J. FIN. SERV. RES. 39, 42 (1989) (Regional variations in economic conditions lead to a broad range of standard deviations of mortgage foreclosure rates in 12 FHLBB districts.).

205. See Clauretje, *Regional Economic Diversification and Residential Mortgage Default Risk*, 3 J. REAL EST. RES. 87, 92 (1988) (State mortgage foreclosure rates are negatively related to increased levels of economic diversification.); Steimbach, *supra* note 159, at 64 ("Type of employment and the degree of economic diversification are extremely important in the overall market evaluation to determine appropriate underwriting.").

206. Macroeconomic forces are a leading cause of mortgage default and foreclosure. Studies show that default is significantly related to rising levels of unemployment and falling housing prices. See Campbell & Dietrich, *The Determinants of Default on Insured Conventional Residential Mortgage Loans*, 38 J. FIN. 1569, 1578 (1983) (showing the relationship between default and unemployment); Waller, *Residential Mortgage Default: A Clarifying Analysis*, 7 HOUSING FIN. REV. 321, 323

as statutory rights of redemption to enable them to retain their homes until the economic downturn subsides.²⁰⁷ As the wave of foreclosures that hit the Farm Belt and the Southwest in the 1980s demonstrates, real estate values and mortgage defaults are more closely tied to local than to national conditions.²⁰⁸ As long as this relationship exists, meaningful differences among states will continue with respect to the desirability of various forms of legal intervention to regulate the relationship between mortgagors and mortgagees.²⁰⁹

C. LEGISLATIVE PROCESS

Several commentators have argued for federal preemption of state commercial law based in part on their belief that federal legislative

(1988) (Residential mortgage default is caused by a decline in property value or by the inability of the borrower to support mortgage payments.); Holloway & Rosenblatt, *Problem Loans: Trends, Causes and Outlook for the Future 25* (unpublished draft, Apr. 1990) (showing relationship between unemployment and home prices). Economies subject to unexpected downturns, such as those dependent upon agriculture and natural resources, might have a heightened risk of mortgagor default.

207. Indeed, the correlation between the length of a state's statutory redemption period and the proportion of its workforce employed in agricultural jobs is .45, which is statistically significant at the 95% confidence level. Agricultural economies are especially vulnerable to boom and bust cycles attributable to rising and falling commodity prices. In addition, farmers and their employees are vulnerable to unexpected droughts and floods. I am not suggesting that states that are especially prone to unexpected or deep economic downturns would enact laws only during periods of distress. Instead, citizens of these states are likely to want these laws to remain in effect, in good times as well as bad, as a form of insurance against the adverse effects of foreclosure. See Schill, *supra* note 75, at 498-500 (comparing mortgagor protections to insurance); cf. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit*, 71 IOWA L. REV. 1, 63 (1985) (Since 1860, Iowa's foreclosure law has been less sensitive to economic cycles.).

208. At the same time that foreclosures in farm states and energy-dependent states rose, states in the Northeast experienced a real estate boom. See *Despair, Violence Down on the Farm*, U.S. NEWS & WORLD REP., Jan. 17, 1983, at 13 (discussing wave of foreclosures in farm states); *A Nationwide Real Estate Crash Is Not in the Cards; But Regional Economic Problems Are a Reality*, SAVINGS INSTITUTIONS, Oct. 1988, at 41, 43 (comparing soaring house prices in the Northeast to the housing crash in the Energy Belt). As the 1990s begin, the Northeast housing market is showing weakness. Schmitt, *Collapsing Housing Market Is Taking an Emotional Toll*, N.Y. Times, Apr. 13, 1990, at B1, col. 3 (describing falling house prices and rising foreclosure rates in the New York metropolitan region).

209. In theory, Congress could take into account the diverse political, cultural, and economic conditions throughout the nation and enact legal rules to govern the relationship between mortgagors and mortgagees that vary among the states. Nevertheless, the considerable costs of collecting information about preferences and conditions in each of the fifty states as well as the political costs of enacting these laws would likely make such an approach infeasible. See Krier, *Comparative Environmental Policy in Federal Systems* (Book Review), 11 HARV. ENVTL. L. REV. 593, 602 n.22 (1987) ("An ideally tailored policy that varies in such a way as to satisfy all the states might be possible in principle, but ideally tailored policies are costly to develop."); Mashaw & Rose-Ackerman, *supra* note 148, at 117 ("[D]iversity within wholly federal regulatory programs has proved politically difficult to achieve in practice.").

processes are superior to those of states.²¹⁰ State legislatures and law-making have long been criticized. In the 1960s and early 1970s, states came under especially harsh attack. Journalists asserted that state legislatures were "superfluous,"²¹¹ "inefficient and corrupt."²¹² Blue ribbon commissions characterized state governments as "unresponsive and ineffective."²¹³ Even a former governor alleged that governors were weak and state legislatures ineffective.²¹⁴

Evaluating whether state legislative processes are inferior to those of the federal government presents daunting methodological problems. First, such an appraisal presumes the existence of a theory to indicate which legislative processes are "good" and which are "bad." Thus far, political scientists have been unable to develop such a theory to guide the inquiry into comparative legislative competence. However, even if an underlying normative theory of the legislative process were to gain wide acceptance, there is a second obstacle to evaluating the comparative competence of state legislatures and Congress: Virtually no empirical studies exist that systematically compare federal and state legislative processes. One reason for the absence of comparative research on the legislative process is the absence of a normative theory of the legislative process. In addition, it is difficult to make generalizations about state legislative processes because of the wide diversity of experiences among the fifty states.

In this section I examine two aspects of state legislative processes: the institutional capacity of state legislatures and the responsiveness of state legislatures to constituent opinion. I have selected these two criteria for several reasons. Critiques of state legislators and legislatures are usually based on allegations that state legislators are unable to engage in deliberative lawmaking and are unresponsive to their constituents.²¹⁵ In addition, to the extent that any consensus exists about the most valued

210. See, e.g., Crandall, *It Is Time for a Comprehensive Federal Consumer Credit Code*, 58 N.C.L. REV. 1, 51 (1979) ("There is a better balancing of concerns at the federal level."); Davis, *supra* note 180, at 1349 ("[S]tate-to-state regulatory variations are fortuitous and arbitrary rather than responsive to local needs."); Knippenberg & Woodward, *supra* note 58, at 2526 ("State legislatures have not shown great success in keeping their statutes current.")

211. Jencks, *Why Bail Out the States?*, NEW REPUBLIC, Dec. 12, 1964, at 8, 9.

212. F. TRIPPETT, *THE STATES: UNITED THEY FELL* 3 (1967).

213. COMMITTEE FOR ECONOMIC DEV., RESEARCH AND POLICY COMMITTEE, *MODERNIZING STATE GOVERNMENT* 15 (1967); see also J. BURNS, *CITIZENS CONFERENCE ON STATE LEGISLATURES, THE SOMETIME GOVERNMENTS: A CRITICAL STUDY OF THE 50 AMERICAN LEGISLATURES* viii (2d ed. 1973) (State legislatures are "marked by wholesale corruption at worst and mediocrity at best.")

214. T. SANFORD, *STORM OVER THE STATES* 33 (1967).

215. See *supra* text accompanying notes 213-14.

attributes of democratic political systems, legislator responsiveness to constituent opinion is usually mentioned.²¹⁶ Furthermore, the responsiveness of legislators to constituent opinion is central to most normative justifications of state decisionmaking authority. State legislative authority is frequently justified on the ground that citizens in different parts of the nation will demand varying levels of taxation, services, and regulations because of geographically unique economic and social conditions and political and cultural beliefs.²¹⁷ Therefore, if state legislators were unresponsive to constituent opinion, state legislation would not necessarily be preferable to federal legislation. A final reason for examining legislative capacity and responsiveness is the existence of recent empirical evidence measuring state performance on these two criteria.

1. *Legislative Capacity*

Over the past two decades, the institutional capacity of state governments has increased dramatically. Critics of state governments have frequently argued that lengthy and outmoded state constitutions limit the ability of governors and state legislators to respond to modern problems.²¹⁸ Since the mid-1960s, however, just under forty states have adopted new constitutions or have substantially revised existing ones; the constitutions of many states have been radically shortened and simplified.²¹⁹ These constitutional revisions removed burdensome limitations on state officials and increased the capacity of all branches of state government.²²⁰ Many states have also increased the length and frequency of legislative sessions by abolishing constitutional provisions that limited sessions to short annual meetings or meetings once every two years.²²¹ Gubernatorial terms have been lengthened and limitations on successive terms have been abolished in many states.²²²

216. See *infra* text accompanying notes 230-81.

217. See *supra* text accompanying notes 186-209.

218. See COMMITTEE FOR ECONOMIC DEV., *supra* note 213, at 15; T. SANFORD, *supra* note 214, at 28.

219. See A. BOWMAN & R. KEARNEY, *THE RESURGENCE OF THE STATES* 13 (1986).

220. See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *THE QUESTION OF STATE GOVERNMENT CAPABILITY* 45-49 (1985).

221. See *id.* at 76-77 (As of 1985, 36 states formally provided for annual legislative sessions); Reeves, *The States as Politics: Reformed, Reinvented, Resourceful*, 509 ANNALS 83, 88 (1990) (States have adopted annual meetings.).

222. See Beyle, *The Governor as Innovator in the Federal System*, 18 PUBLIUS: J. FEDERALISM Summer 1988, at 131, 138 (Since 1955, the number of governors able to serve four year terms increased from 29 to 47; the number of states that preclude successive gubernatorial terms decreased from 17 to 3.).

The institutional resources of legislators have also improved significantly in recent years.²²³ For example, the salaries of state legislators increased substantially.²²⁴ In addition, many legislatures now provide individual lawmakers with professional staffs to assist them in handling casework and legislative drafting.²²⁵ Finally, research facilities and legislative libraries facilitate the flow of information.²²⁶ Similar reforms have also increased the institutional capacity of governors.²²⁷

The increased capacity of state legislatures and governors has generated what one commentator has recently characterized as a "renaissance of state policy activism."²²⁸ As the federal government cut spending over the past decade, many states enacted a wide variety of programs to pick up the slack. State initiatives in health care, economic development, housing, public assistance, urban redevelopment, and education have transformed state governments from legislative backwaters into the "driving force in domestic policy innovation."²²⁹

223. See M. JEWELL & S. PATTERSON, *THE LEGISLATIVE PROCESS IN THE UNITED STATES* 274-76 (4th ed. 1986) (discussing professionalization of state legislatures).

224. See Rosenthal, *The Legislative Institution: Transformed and at Risk*, in *THE STATE OF THE STATES* 69, 73-75 (C. Van Horn ed. 1989).

225. See J. HENIG, *PUBLIC POLICY AND FEDERALISM* 40 (1985).

226. *Id.* at 40; Reeves, *Look Again at State Capacity: The Old Gray Mare Ain't What She Used to Be*, in *AMERICAN INTERGOVERNMENTAL RELATIONS TODAY: PERSPECTIVES AND CONTROVERSIES* 143, 147 (R. Dilger ed. 1986). Additional reforms that increased state legislative capacity include the streamlining of committees and the use of computers. See A. BOWMAN & R. KEARNEY, *supra* note 219, at 85-86.

227. See generally L. SABATO, *GOODBYE TO GOODTIME CHARLIE: THE AMERICAN GOVERNORSHIP TRANSFORMED* (2d ed. 1983) (describing and analyzing recent changes in the role of state governors). Although my focus in this part of the Article is on the legislative process, the judicial branch of state government also plays a role in the creation and interpretation of real estate finance law. Many of the same trends that increased the institutional capacity of state legislatures and governors also improved the capacity of judges. See A. BOWMAN & R. KEARNEY, *supra* note 219, at 97-104; Jacob, *Courts*, in *POLITICS IN THE AMERICAN STATES: A COMPARATIVE ANALYSIS* 222, 226-27 (V. Gray, H. Jacob, & K. Vines eds. 4th ed. 1983); Van Horn, *The Quiet Revolution*, in *THE STATE OF THE STATES*, *supra* note 224, at 1, 4.

228. Conlan, *Politics and Governance: Conflicting Trends in the 1990s?*, 509 *ANNALS* 128, 136 (1990).

229. See Van Horn, *supra* note 227, at 7; see also T. CONLAN, *NEW FEDERALISM: INTERGOVERNMENTAL REFORM FROM NIXON TO REAGAN* 229 (1988) (discussing policy activism of states); D. OSBORNE, *LABORATORIES OF DEMOCRACY: A NEW BREED OF GOVERNOR CREATES MODELS FOR NATIONAL GROWTH* (1990) (discussing state economic development, welfare and education policies); Briffault, *supra* note 154, at 448 (discussing innovative policies adopted by modernized and reapportioned state legislatures and governments); Nathan, *The Role of States In American Federalism*, in *THE STATE OF THE STATES*, *supra* note 224, at 15, 18-19 (discussing policy initiatives of states). With respect to the development of coherent commercial law, state legislators may possess an advantage over Congress. State legislators have developed a certain level of expertise over the years concerning the structure of complex commercial transactions. Members of Congress, however, are frequently thought to lack knowledge about matters of commercial law. See Mooney, *Federalization of the U.C.C.*, in *THE EMERGING UNIFORM COMMERCIAL CODE* 69, 75 (ALI-ABA,

2. *Legislative Responsiveness*

One commentator has suggested that the reforms that have increased the legislative and administrative capacity of state lawmakers have also increased their responsiveness to constituent opinion.²³⁰ Legislative responsiveness is a concept of ambiguous meaning and normative content. Responsiveness of legislators to constituents is a central element in a longstanding debate among political theorists over the meaning of representative government. Are legislators merely supposed to be agents of their constituents or are they instead free to ignore popular opinion and follow their own judgments as to what is in the interest of the people they represent?²³¹ In a widely cited volume,²³² Pitkin addresses some of the theoretical problems posed by the concept of representation and rejects both of these extreme alternatives.²³³ Rather than merely reflecting popular opinion accurately, even if such a task were possible,²³⁴ or acting in a manner independent of the views of one's constituents, Pitkin argues that responsiveness is the key to representation:

[R]epresenting here means acting in the interest of the represented, in a manner responsive to them. . . . [D]espite the resulting potential for conflict between representative and represented about what is to be done, that conflict must not normally take place. The representative must act in such a way that there is no conflict, or if it occurs an explanation is called for. He must not be found persistently at odds with the wishes of the represented without good reason in terms of

1989) ("The most commonly-expressed skepticism about a federal U.C.C. is the perception that Congress (including its staff) is woefully ignorant and incompetent in matters of commercial law and, therefore, is likely to produce 'bad law.'").

230. See Chubb, *Institutions, The Economy, and the Dynamics of State Elections*, 82 AM. POL. SCI. REV. 133, 142 (1988). See also *infra* text accompanying notes 259-60 (discussing effect of reforms on legislators).

231. See R. PENNOCK, *DEMOCRATIC POLITICAL THEORY* 323-32 (1979) (discussing delegate and trustee theories of representation).

232. See H. PITKIN, *THE CONCEPT OF REPRESENTATION* (1967).

233. Pitkin's work is generally recognized among political scientists as an important contemporary starting point on the theory of representation. See, e.g., M. JEWELL, *REPRESENTATION IN STATE LEGISLATURES* 10 (1982); Eulau & Karps, *The Puzzle of Representation: Specifying Components of Responsiveness*, 2 LEGIS. STUD. Q. 233, 237 (1977).

234. Legislators who view their role as reflecting popular opinion in their districts may encounter serious obstacles. On many issues, constituents may have no opinions either because they don't care about the particular matter or because they lack sufficient information to develop a view. Even if citizens do have opinions about legislative issues, legislators face a difficult task in accurately perceiving those opinions. See *infra* note 263. Furthermore, not all opinions are shared with the same level of intensity. Should representatives give special weight to the opinions of people who care deeply about an issue or should they weigh all opinions equally?

their interest, without a good explanation of why their wishes are not in accord with their interest.²³⁵

As long as representatives are "potentially responsive" to the wishes of their constituents, they need not always act according to constituent desires.²³⁶ Nevertheless, Pitkin carefully qualifies this statement with the proviso that representatives' actions should not normally be in conflict with their constituents' wishes.²³⁷ Eulau and Karps expand on Pitkin's definition of representation by examining what it means for legislators to be responsive to their constituents. They argue that responsiveness is not limited to "policy responsiveness," that is, the manner in which the representative and represented interact with respect to the formation of public policy.²³⁸ Legislators also perform acts unrelated to lawmaking that provide benefits to members of their districts. For example, "service responsiveness" involves work by legislators to obtain advantages and benefits for individual constituents.²³⁹ "Allocation responsiveness" consists of efforts by legislators to maximize their districts' share of the benefits of state projects and programs.²⁴⁰ Lastly, Eulau and Karps describe "symbolic responsiveness" as symbolic undertakings by legislators to mobilize the trust and confidence of their constituents. This may include expressions of sympathy or congratulations and the introduction of bills on matters of ideological or symbolic importance.²⁴¹

Although no systematic comparisons of federal and state legislative responsiveness exist,²⁴² recent changes in state legislative capacity and composition have dramatically improved state performance on all four of Eulau's and Karps's criteria.²⁴³ Enlarged staffs significantly increase the

235. H. PITKIN, *supra* note 232, at 209-10.

236. *See id.* at 222.

237. *See id.* at 233 ("It is incompatible with the idea of representation for the government to frustrate or resist the people's will without good reason, to frustrate or resist it systematically or over a long period of time.").

238. *See Eulau & Karps, supra* note 233, at 242.

239. *See id.* at 243-45.

240. *See id.* at 245-46.

241. *See id.* at 246-47.

242. One 1983 study found that the level of congruence between public opinion and policy is greater for state government than the federal government. The authors, however, attribute this finding to the high salience and visibility of the state policy issues selected for study. *See Page & Shapiro, Effects of Public Opinion on Policy*, 77 AM. POL. SCI. REV. 175, 183 (1983). *See also* T. DYE, *supra* note 167, at 96 ("State and local government is generally more responsive than the federal government to the fiscal preferences of taxpayers.").

243. High levels of legislator responsiveness are neither the only criteria by which to judge legislators nor, for that matter, unambiguously positive indicators of legislative performance. Several commentators have observed that although members of Congress are responsive on all of Eulau's & Karps's criteria, Congress as an institution acts irresponsibly. *See, e.g., M. FIORINA,*

service responsiveness of legislators. Casework and constituency services are now a much more important part of the legislator's job today than at any time in the past.²⁴⁴ Allocation responsiveness is also increasingly evident as legislators vie for committee assignments that will enable them to obtain benefits for their districts.²⁴⁵ In addition, if public opinion surveys are any indication, state legislators are also successful in convincing the public through symbols and actions of their responsiveness. A 1989 survey of American households shows that when asked which level of government responds best to their needs, 40% selected local government, 21% state governments, and 18% the federal government.²⁴⁶ Similarly, a 1980 survey indicates that 69% of Americans expressed a "great deal" or a "fair amount" of confidence in state government as compared to 61% for the federal government.²⁴⁷

The policy responsiveness of state legislators is particularly important in determining whether the states can be relied upon to enact real estate finance laws that correspond to the needs and desires of their citizens. In their empirical examinations of legislative responsiveness, political scientists have usually focused on whether legislators, individually and as a group, act according to the desires of their constituents.²⁴⁸ Studies that examine the "congruence" of legislative actions and public opinion capture only some aspects of policy responsiveness. As Pitkin

CONGRESS: KEYSTONE OF THE WASHINGTON ESTABLISHMENT 68, 93 (2d ed. 1989) (Policy responsiveness has increased at the same time the ability of members of Congress to enact coherent laws has declined.); G. JACOBSON, *THE POLITICS OF CONGRESSIONAL ELECTIONS* 216-17 (2d ed. 1987) (discussing the fundamental flaw of congressional representation: "great individual responsiveness, equally great collective irresponsibility").

244. See M. JEWELL, *supra* note 233, at 8; Rosenthal, *supra* note 224, at 82.

245. See Abney & Lauth, *Parochialism in the State Appropriations Process*, 20 *STATE & LOCAL GOV'T REV.* 113, 114 (1988); Rosenthal, *supra* note 224, at 89; Thompson, *Bringing Home the Bacon: The Politics of Pork Barrel in the North Carolina Legislature*, 11 *LEGIS. STUD. Q.* 91, 93 (1986).

246. See *ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, CHANGING PUBLIC ATTITUDES ON GOVERNMENTS AND TAXES* 4 (1989). The survey, conducted by the Gallup Organization, also showed that respondents had greater trust and confidence in the federal government than states when it came to cleaning up air pollution, fighting drugs, and helping the homeless. Respondents had more confidence in the states than the federal government with respect to managing urban development, improving schools, and recycling trash. See *id.* at 9. In addition, 22% of the citizens polled thought the states needed more power, whereas only 5% felt that the federal government needed additional authority. Similarly, 61% of the respondents said that the federal government had too much power while only 9% indicated that states were too powerful. See *id.* at 6.

247. See Reeves, *Public Opinion and Federalism, 1986*, *PUBLIUS: J. FEDERALISM*, Summer 1987 at 55, 56.

248. See, e.g., Miller & Stokes, *Constituency Influence in Congress*, 57 *AM. POL. SCI. REV.* 45 (1963); see also *infra* notes 252-58 and accompanying text (discussing results of various surveys of state public opinion).

observed, a legislator may act contrary to the wishes of constituents (at least occasionally) and still be responsive to them as long as the legislator acts in their interest. Nevertheless, congruence studies can be used to measure some aspects of policy responsiveness.²⁴⁹ Where legislative actions correspond to constituent demands, a presumption exists that the legislator or legislature is acting responsively.²⁵⁰ In addition, although it might be only one aspect of Pitkin's concept of representation, congruence between legislative action and public opinion has special normative significance in a political system that recognizes and respects the primacy of individual preferences in the development of public policy and law.²⁵¹

Studies of the policy responsiveness of state legislatures are impeded by the absence of public opinion data at the state and local level. Nevertheless, two recent empirical studies that utilize different estimates of state opinion suggest that state legislation is surprisingly responsive to public opinion. Using the proportion of the 1972 presidential vote garnered by George McGovern as an indicator of liberal state public opinion, Nice examined the relationship between public opinion and several state policies.²⁵² His regression analysis indicates that state policies in the fields of education, welfare, and tax effort are "clearly associated" with varying levels of liberal public opinion.²⁵³

A 1987 study by Wright, Erikson, and McIver used, as a more reliable indicator of state public opinion, surveys that asked Americans

249. Congruence studies may also be the only feasible method of empirically testing legislative responsiveness. Commentators have observed that Pitkin's formulation of responsiveness is difficult to test and may in some respects be tautological. Karps & Eulau, *Policy Representation as an Emergent: Toward a Situational Analysis*, in *THE POLITICS OF REPRESENTATION: CONTINUITIES IN THEORY AND RESEARCH* 207, 215 (H. Eulau & J. Wahlke eds. 1978).

250. See *id.* at 215. The absence of a correspondence between public opinion and legislative action does not, of course, preclude the possibility that legislators or legislatures are acting in a manner that is responsive to the interests of their constituents. Indeed, it is also possible that legislators who merely reflect public opinion are not acting in their constituents' best long-term interests.

251. See R. PENNOCK, *supra* note 231, at 266 (1979) ("Individualism . . . comes closest to embracing the ideal of responsiveness as the sole test of good government, for it insists that the role of democratic government should be to respond to individual preferences."); cf. Schill, *supra* note 75, at 515 n.85 (Prohibitions on consensually agreed upon contract terms narrow freedom of contract and require special justification.).

252. See Nice, *Representation in the States: Policymaking and Ideology*, 64 *Soc. Sci. Q.* 404 (1983).

253. See *id.* at 409-10. States with higher levels of support for McGovern tended to have higher public assistance benefits, higher levels of education spending, and greater tax effort. *Id.* at 406.

whether they would consider themselves liberal, moderate or conservative.²⁵⁴ The authors examined the relationship between the level of liberalism reflected in the surveys and state policies concerning education, public assistance, consumer protection, tax progressivity, crime, gambling, and equal rights. The results of the study show that state public opinion strongly correlates with the liberal or conservative content of state policies.²⁵⁵ The authors conclude that “[s]tate political structures appear to do a good job of delivering more liberal policies to more liberal states and more conservative policies to more conservative states.”²⁵⁶ The results of these studies are corroborated by recent observations of several political scientists that state governments are quite responsive to citizen opinion.²⁵⁷

The relatively high level of responsiveness found by political scientists contrasts markedly with the criticism of state legislatures expressed in the 1960s and early 1970s.²⁵⁸ Several theories might explain the apparent increase in policy responsiveness. Many of the institutional reforms of the past two decades have effectively transformed the position

254. See Wright, Erikson & McIver, *Public Opinion and Policy Liberalism in the American States*, 31 AM. J. POL. SCI. 980, 985 (1987).

255. See *id.* at 996.

256. See *id.* at 999. See also Erikson, Wright & McIver, *Political Parties, Public Opinion, and State Policy in the United States*, 83 AM. POL. SCI. REV. 729, 743 (1989) (State political parties respond to public opinion and promote policy responsiveness.).

257. See, e.g., T. DYE, *supra* note 167, at 59 (Data show that 41 states are responsive to demands for education.); H. INGRAM, N. LANEY & J. MCCAIN, A POLICY APPROACH TO POLITICAL REPRESENTATION: LESSONS FROM THE FOUR CORNERS STATES 183 (1980) (Surveys of state legislators in Arizona, New Mexico, Colorado, and Utah show that “state legislators are potentially responsive to the public on issues within a number of important issue clusters.”); Rosenthal, *supra* note 224, at 71 (“[L]egislatures generally have fashioned policies that are responsive to their various publics.”); Shapiro & Jacobs, *The Relationship Between Public Opinion and Public Policy: A Review*, 2 POL. BEHAV. ANN. 149, 154-56 (1989) (discussing “compelling” conclusions of a study that found state legislatures responsive).

258. See *supra* text accompanying notes 211-14. Several empirical studies analyzing data from the 1960s suggested that state legislators were less responsive than the recent studies discussed *supra* text accompanying notes 252-57 indicate. See, e.g., Jones, *Competitiveness, Role Orientations, and Legislative Responsiveness*, 35 J. POL. 924, 931-933 (1973) (Interviews with Texas state legislators indicate that the legislators’ own attitudes were more important than perceptions of constituent views in determining voting behavior.); Weber & Shaffer, *Public Opinion and American State Policy-Making*, 16 MIDWEST J. POL. SCI. 683, 699 (1972) (State legislators are more responsive to public opinion in some public policy areas, such as public accommodations and parochial school aid, than with respect to right-to-work laws, teacher unionization, and gun control.). *But see* Adams & Ferber, *Measuring Legislator-Constituency Congruence: Liquor, Legislators and Linkage*, 42 J. POL. 202, 205 (1980) (presenting a re-examination of Texas legislators finding high level of congruence on issue of liquor-by-the-drink).

of state legislator into a desirable career.²⁵⁹ For obvious reasons, legislators who wish to remain in office are much more likely to want their votes on legislative issues to be consistent with the opinions of their constituents.²⁶⁰ Increased responsiveness may also be attributable to the reapportionment of legislative districts and the enfranchisement of minorities that is mandated by federal law.²⁶¹ In addition, reforms that opened the legislative process to public scrutiny such as "sunshine laws" may have increased the accountability of state lawmakers.²⁶²

259. The increase in the number of state legislators who wish to make their jobs a career is evident in reduced turnover rates. See M. JEWELL, *supra* note 233, at 25 ("One of the most significant trends in American legislatures is the declining rate of turnover."). Nevertheless, the apparent adoption by state legislators of careerist roles might be short-lived if states follow California's lead and adopt term limitations for legislators. On November 6, 1990, California voters adopted Proposition 140, which limited members of the state assembly to three two-year terms and members of the senate to two four-year terms. See Mydans, *The 1990 Elections: California Politicians Reel After a Vote Limiting Terms*, N.Y. Times, Nov. 11, 1990, at A-26, col. 5. President Bush has voiced his support for a constitutional amendment limiting the terms of members of Congress. See Oreskes, *Bush Backs Move for Limiting Terms of U.S. Lawmakers*, N.Y. Times, Dec. 12, 1990, at A1, col. 6.

260. See Chubb, *supra* note 230, at 142.

261. Reapportionment and the protections afforded by the Voting Rights Act of 1965, Pub. L. No. 89-110, § 2, 79 Stat. 437 (codified as redesignated and amended at 42 U.S.C. 1973 (1988)), have increased the representation of citizens from urban areas as well as the poor and minorities. State legislatures today mirror the populations of their states more than at any time in the past. The number of African-American legislators rose from 168 in 1969 to 384 in 1985; the number of women increased from 305 to 1,067. See A. BOWMAN & R. KEARNEY, *supra* note 219, at 17. As a proportion of their legislature's membership, African-Americans and women are better represented in state legislatures than in the United States Congress. In 1989, women and African-Americans each constituted 4.6% of the membership of Congress. See UNITED STATES BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1990 at 257 (110th ed. 1990). In 1985, women and African-Americans respectively constituted 14.4% and 5% of all state legislators. See A. BOWMAN & R. KEARNEY, *supra* note 219, at 17. State legislatures are also no longer as unresponsive to the needs of central cities as they once were. In fact, recent studies demonstrate that state intergovernmental aid appropriations are quite responsive to the needs of urban areas. See Dye & Hurlley, *The Responsiveness of Federal and State Governments to Urban Problems*, 40 J. POL. 196, 204 (1978) (State grants-in-aid are generally more responsive to the needs of cities than grants from the federal government.); Pelissero, *State Aid and City Needs: An Examination of Residual State Aid to Large Cities*, 46 J. POL. 916, 931 (1984) (Residual state aid is "very responsive to some common indicators of city need."); Pelissero, *Welfare and Education Aid to Cities: An Analysis of State Responsiveness to Needs*, 66 SOC. SCI. Q. 444, 451 (1985) (From 1962 to 1976, state education funding became more responsive to the needs of some very large American cities; the responsiveness of welfare aid programs is more uncertain.). But see Ward, *The Measurement of Federal and State Responsiveness to Urban Problems*, 43 J. POL. 83 (1981) (criticizing the methodology used by Dye & Hurlley, *supra*). At the same time as state legislatures have become more responsive to urban dwellers, the disproportionate influence of rural populations over state policy has waned. See Rose-Ackerman & Evenson, *The Political Economy of Agricultural Research and Extension: Grants, Votes, and Reapportionment*, 67 AM. J. AGR. ECON. 1, 8 (1985) (Regression analysis shows that reapportionment reduced farmers' power to affect the level of agricultural spending.).

262. Virtually all the states have adopted sunshine laws to permit public access to legislative proceedings. In addition, over half of all state legislatures permit television coverage of legislative

Increased legislative capacity and the rather high level of responsiveness of state legislatures weakens one of the major justifications for preempting state real estate finance law in favor of national law. Unfortunately, no empirical studies compare the capacity and responsiveness of state legislatures to Congress. Considering the widespread variation among state legislatures, even after the reforms of the 1970s and 1980s it is likely that members of Congress have more resources at their disposal than state legislators. As for responsiveness, the picture is less clear. Congress is much more closely scrutinized than state legislatures, primarily because of greater media coverage. Increased information about the activities of members of Congress may facilitate the efforts of constituents to monitor legislators and thereby assure that the legislators are accountable. On the other hand, legislative responsiveness is also more likely if legislators can accurately perceive the opinion of their constituents, and state legislators may have an advantage in this area.²⁶³ Studies have shown that legislators are more apt to perceive opinion correctly if their districts are homogenous.²⁶⁴ Due to their smaller size, state legislative districts are much more likely to be composed of people with similar cultural backgrounds and economic conditions than are congressional districts.²⁶⁵

sessions. See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 220, at 250-55.

263. Empirical studies, however, show that the ability of state legislators and members of Congress to perceive accurately the opinions of their constituents is mixed. See Erikson, Luttbeg & Holloway, *Knowing One's District: How Legislators Predict Referendum Voting*, 19 AM. J. POL. SCI. 231, 237 (1975) (Florida legislators were able to predict accurately their constituents vote on two of three referenda.); Hedlund & Friesema, *Representatives' Perceptions of Constituency Opinion*, 34 J. POL. 730, 741 (1972) (Iowa legislators' predictions of constituent opinion were relatively accurate on two of four referenda.); McCrone & Kuklinski, *The Delegate Theory of Representation*, 23 AM. J. POL. SCI. 278, 289 (1979) (Data show that California legislators were "reasonably accurate" in their predictions of constituency opinion.); Miller & Stokes, *supra* note 248, at 56 (Surveys of members of Congress and constituents indicate that a typical Representative has "very imperfect information about the issue preferences of his constituency."); Uslander & Weber, *U.S. State Legislators' Opinions and Perceptions of Constituency Attitudes*, 4 LEGIS. STUD. Q. 563 (1979) (State legislators misperceive public opinion.).

264. See R. BINGHAM, *STATE AND LOCAL GOVERNMENT IN AN URBAN SOCIETY* 144 (1986); M. JEWELL, *supra* note 233, at 84; M. JEWELL & B. PATTERSON, *supra* note 223, at 208-09.

265. See M. JEWELL, *supra* note 233, at 95 ("[S]tate legislative districts are smaller and more homogenous [than congressional districts], with fewer conflicting interests."). Two additional factors may affect the comparative responsiveness of state legislatures and Congress. Many states provide an additional check against legislators acting contrary to majority public opinion. Over twenty state constitutions provide for legislative referenda and initiatives. Citizens, dissatisfied with state actions or inaction, may place matters of public policy on the election ballot, provided a sufficient number of voters sign petitions. The processes of legislative referenda and initiative do not exist at the federal level. See Bibby, Cotter, Gibson & Huckslam, *Parties in State Politics*, in *POLITICS IN THE AMERICAN STATES*, *supra* note 193, at 59, 61. State legislative responsiveness may be hampered, however, by relatively low levels of voter turnout for legislative elections. D. BERMAN,

The effect of interest groups on legislative responsiveness is also unclear. One of the recurrent complaints about state legislatures has been that special interest groups wield too much influence over the policymaking process.²⁶⁶ Special interest groups may impede the responsiveness of legislators to constituent opinion because of collective action problems. Narrowly focused special interest groups have an advantage over diffuse majorities in influencing government.²⁶⁷ Frequently, individual voters who favor a government policy that would benefit a large number of citizens lack the incentive to organize and expend the resources necessary to collect information and lobby public officials. Typically, the costs associated with organizing large numbers of only moderately interested voters are enormous. Since benefits cannot be limited to those who organize, but must instead be shared among a large number of citizens, each individual voter has an incentive to leave the expensive and time consuming task of political organization to others and free ride on their efforts. Small groups of intensely interested citizens, however, have much lower organizational costs and are likely to have a disproportionate impact on the legislative process. Special interest groups can use this organizational advantage to influence the political process and increase their wealth at the expense of the majority.

The pedigree for most arguments that special interest groups pose a greater problem at the state, as opposed to the federal, level is especially distinguished. In *Federalist 10*, James Madison argued in favor of a federal government on the ground that smaller governmental units, such as states, would be particularly susceptible to influence by factions.²⁶⁸ In theory, because the federal government is composed of a greater number

STATE AND LOCAL POLITICS 11-12 (2d ed. 1978) (State and local elections have lower turnout than elections for federal offices.). Low voter turnout may result in the election of legislators who do not represent the interests of the majority of a state's population.

266. See, e.g., D. HERZBERG & J. UNRUH, *ESSAYS ON THE STATE LEGISLATIVE PROCESS* 5 (1970) (The absence of individual participation in political process leads to interest group influence.); G. MCCONNELL, *PRIVATE POWER AND AMERICAN DEMOCRACY* 191-92 (1966) (Special interest groups have filled the vacuum created by the absence of effective two party competition in state legislatures.); Crandall, *supra* note 210, at 50-51 (Creditors probably have a better chance to get what they want at the state level than at the federal level.).

267. See M. OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965); Schill, *Privatizing Federal Low Income Housing Assistance: The Case of Public Housing*, 75 *CORNELL L. REV.* 878, 884-85 (1990).

268. *THE FEDERALIST* NO. 10, at 83 (J. Madison) (C. Rossiter ed. 1961) ("Hence, it clearly appears, that the same advantage which a republic has over a democracy, in controlling the effects of faction . . . is enjoyed by the Union over the States composing it.").

of interests, it should be better able to withstand interest group pressure.²⁶⁹ In addition, because the legislative process is less visible at the state level and thus less subject to close scrutiny by the public, special interest groups may have increased opportunities to influence the state policymaking process.

Special interest groups may, however, enjoy certain advantages at the federal level.²⁷⁰ One of the reasons interest groups have influence greater than their numbers is the cost of organizing diffuse majorities.²⁷¹ Since the costs of organizing diffuse moderately interested majorities is even greater at the national than at the state level, the special interest group's organizational advantage is magnified at the federal level.²⁷² Interest groups may also prefer rent seeking at the federal level because the costs incurred will be more widely dispersed than at the state level, and therefore more likely to elude public detection.²⁷³ Furthermore, recent state legislative reforms such as open meeting laws, lobbyist regulation, and legislator financial disclosure laws have lowered the protective veil that interest groups once enjoyed at the state level.²⁷⁴ At the same time, commentators have increasingly noted the pervasive influence of special interest groups on members of Congress.²⁷⁵

269. See *id.*; D. BERMAN, *supra* note 265, at 90 (Interest group influence at the national level is thinned out by the number of groups that must compete for influence.).

270. Empirical studies indicate that "state legislators and members of Congress appear to lean upon information and take cues for decisions from interest groups in roughly the same measure." M. JEWELL & S. PATTERSON, *supra* note 223, at 197.

271. See *supra* text accompanying note 267.

272. See Elliot, Ackerman & Millian, *Toward a Theory of Statutory Evolution: The Federalization of Environmental Law*, 1 J.L. ECON. & ORG. 313, 329 (1985) (It is easier for environmental groups to organize at the state level.); Rapaczynski, *From Sovereignty to Process: The Jurisprudence of Federalism After Garcia*, 1986 SUP. CT. REV. 341, 386 (The "federal government may be a more likely subject of capture by a set of special minoritarian interests, precisely because the majority interest of the national constituency is so large, diffuse and enormously difficult to organize."); cf. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 407 (1977) ("As governmental complexity increases, majority sentiment on any single issue is less likely to prevail; organized minorities become ever more able to engage in logrolling and to take advantage of majority disorganization.").

273. See R. HOLCOMBE, *supra* note 176, at 174.

274. Forty-one states have enacted laws requiring legislators to disclose their finances and avoid conflicts of interest. In addition, all states have adopted lobbyist registration and disclosure rules. See ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, *supra* note 220, at 109; A. BOWMAN & R. KEARNEY, *supra* note 219, at 89.

275. See M. FIORINA, *supra* note 243, at 24-29 (discussing the influence of political action committees ("PACs") on Congress); G. JACOBSON, *supra* note 243, at 193-96 (discussing the growth of PACs and their influence on government); Hedlund, *Lobbying and Legislative Ethics*, in REPRESENTATION AND RESPONSIBILITY: EXPLORING LEGISLATIVE ETHICS 89-107 (B. Jennings & D. Callahan eds. 1985) (same). PACs may be better positioned to influence members of Congress than state

Questions about the comparative strength of interest groups at the state and federal levels cannot be resolved on the basis of theory. Instead, interest group influence will vary according to the subject matter of public regulation and the market structure of the industries involved.²⁷⁶ Frequently, industries will seek preemptive legislation from Congress as a way of avoiding more stringent regulation by state legislatures.²⁷⁷ In other cases, special interest groups may be better able to convince state legislatures to adopt regulatory schemes that benefit the groups.

Proponents of national real estate finance law face enormous difficulties in justifying the preemption of state law on the ground that state legislative responsiveness is compromised by the influence of special interest groups. Proponents of federal preemption are generally motivated by the desire to eliminate laws that protect mortgagors from the adverse effects of default. To the extent that organized interest groups would be involved in the issue, they would most likely consist of lending institutions opposed to state mortgagor protection laws.²⁷⁸ These institutions have formed several sophisticated trade organizations to represent their interests at both the state and federal levels. Since lending groups

legislators because of the higher cost of running a political campaign for Congress. Since state legislative districts are usually considerably smaller than congressional districts, state legislative candidates can rely on relatively inexpensive face-to-face campaigning to a much greater degree than congressional candidates. See T. DYE, *POLITICS IN STATES AND COMMUNITIES* 141 (6th ed. 1988).

276. See Mashaw & Rose-Ackerman, *supra* note 148, at 136 ("The political economy of federal and state regulation cannot be understood without taking into account the market structure of the affected industries and the supply and demand conditions in both input and output markets.").

277. See Elliot, Ackerman & Millian, *supra* note 272, at 330-33 (The threat of strict state regulation led the automobile and soft coal industries to seek federal preemptive legislation.). See also Macey, *supra* note 192, at 271-72 ("[O]btaining a federal law will be the strategy of choice for most interest groups seeking to obtain wealth transfers.").

278. Industry groups for mortgage bankers and lending institutions have supported other efforts to preempt state laws protective of borrowers. See, e.g., *Administration's 1973 Housing Proposals, Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 93d Cong., 1st Sess. 173, 180 (1973) (statement on behalf of Mortgage Bankers Association in support of Federal Mortgage Foreclosure Act); *Housing and Community Development Legislation-1973, Hearings Before the Subcomm. on Housing of the House Comm. on Banking and Currency*, 93d Cong., 1st Sess. 1659, 1663 (1973) (statement on behalf of National Association of Mutual Savings Banks in favor of Federal Mortgage Foreclosure Act). The advantages of the federal forum have not been lost on the mortgage banking industry. See MORTGAGE BANKERS ASS'N OF AM., *supra* note 182, at 204 ("[S]tate legislators tend to be more consumer-oriented [than congressmen] and less concerned about the effects their actions may have on the mortgage lending business."). The influence of consumers at various levels of government may vary depending upon the subject matter of the regulation. Cf. T. SULLIVAN, E. WARREN & J. WESTBROOK, *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* 28-30, 44 n.23 (1989) (Among the 35 state legislatures that opted out of the federal bankruptcy provisions concerning exempt property, most permit debtors to retain fewer assets than they would have been entitled to retain under federal law.).

have an organizational advantage over borrowers and have been unsuccessful in removing mortgagor protection laws at the state level, there is no reason to believe that state legislative processes are being unduly influenced by these interest groups.²⁷⁹ To the contrary, the current controversy involving enormous losses to the federal government on account of the insolvency of much of the savings and loan industry, as well as scandals involving thrift contributions to members of Congress,²⁸⁰ demonstrate the influence wielded by proponents of preemption in the federal legislative process. If fear of interest group influence were to guide the choice between state and federal real estate finance law, state law might well be preferable.²⁸¹

279. Empirical evidence of the influence of depository institutions at the state level is contradictory. According to one state-by-state inventory of "significant pressure groups," banks, savings and loans, and similar financial institutions are a significant force in only sixteen of the fifty states. See S. MOREHOUSE, *STATE POLITICS, PARTIES AND POLICY* 108-12 (1980). Another fifty-state survey found that bankers' associations were among the most effective interest groups in twenty-eight states. See Thomas & Hrebemar, *Interest Groups in the States* in *POLITICS IN THE AMERICAN STATES*, *supra* note 193, at 123, 144.

280. See J. MENTZINGER, J. HOWELL & C. O'DAY, *IT'S A WONDERFUL LIFE: S & L INVESTMENTS ON CAPITAL HILL 1* (1990) ("During the 1980's, when savings and loans were engaged in activities that led to the current \$300 billion scandal, S & L interests gave at least \$11,669,499 in campaign contributions to congressional candidates and political party committees."); Rosenbaum, *A Financial Disaster with Many Culprits*, N.Y. Times, June 6, 1990, at A1, col. 2 ("As the crisis developed, Congress seemed to be in the pocket of the savings and loan industry, passing laws the lobbyists wanted, tying up bills they opposed, and hectoring regulators relentlessly to ease up."). See also Williams, *Regulation and Economic Development*, in *POLITICS IN THE AMERICAN STATES*, *supra* note 193, at 479, 504 (State chartered savings and loan institutions shifted to federal charters to escape state regulators who were perceived as "overly sensitive to the wishes of consumer groups.").

281. Differences in the relative strength of political parties may also affect the susceptibility of state and federal legislative processes to interest group influence. Strong party organizations and interparty competition serve as a counterweight to special interest groups. To be successful, political parties must reach out to diverse majority interests rather than limit their appeal to narrowly focussed minority interests. See E. SCHATTSCHNEIDER, *PARTY GOVERNMENT* 188-89 (1967); F. SORAUF, *PARTY POLITICS IN AMERICA* 408 (4th ed. 1980); Fitts, *The Vices of Virtue: A Political Party Perspective on Civic Virtue Reforms of the Legislative Process*, 136 U. PA. L. REV. 1567, 1604 (1988); Ladd, *Party Reform and the Public Interest*, in *ELECTIONS AMERICAN STYLE* 222, 227 (A. Reichley ed. 1987). In addition to curbing the influence of special interest groups, political parties may promote policy responsiveness by providing voters with programmatic choices, simplifying and clarifying policy issues and enfranchising lower income and less educated citizens. See W. CROTTY, *AMERICAN PARTIES IN DECLINE* 281 (2d ed. 1984); Fitts, *supra*, at 1607-1609; Ladd, *supra*, at 227-28. On policy responsiveness grounds, one might prefer federal or state lawmaking if the level of party cohesion and competition were significantly greater at one level than the other. Nevertheless, the enormous variation in political party interaction in the fifty states renders such a generalization close to impossible to make. Although commentators have observed increasing levels of minority party strength in recent years, party competition is almost nonexistent in a substantial number of states. See T. DYE, *supra* note 275, at 123 (Parties in one-half of the states have a reasonable chance of election); M. JEWELL & S. PATTERSON, *supra* note 223, at 41 (One party dominates 19 states.); J. TREADWAY, *supra* note 201, at 27 (One-half of the states are competitive for both political parties.).

CONCLUSION

Over the past ten years, pressures to make the law of real estate finance uniform have increased due to the creation of national mortgage markets. After the experience of the 1970s and 1980s, it is now apparent that if uniform real estate finance law is to be achieved, it will be a result of federal preemption. In this Article, I examined potential arguments for uniformity and preemption with respect to mortgage law and found each to be unconvincing. Economic efficiency rationales for federal preemption are quite weak. Spillovers attributable to different state mortgage laws are small and could be eliminated at modest cost. Transaction costs and lost scale economies are also likely to be quite small. Furthermore, differences among states justify customized legal rules with respect to the law governing the relationship between mortgagors and mortgagees. Finally, a preference for federal, as opposed to state, law attributable to doubts about the adequacy of state legislative processes seems without foundation. Over the past two decades, state legislative capacity has dramatically increased. State legislatures, for the most part, are responsive institutions with adequate institutional resources to promulgate coherent law.

The debate over state real estate finance law is one component of a larger set of issues regarding the future of commercial law. The twentieth century witnessed the creation of national markets for most goods and services. As this progressive integration of the American economy took place, scholars and policymakers often devalued the virtues of legal diversity in favor of uniformity. Although in some instances legal uniformity was achieved voluntarily, increasingly it is taking place coercively.²⁸² In this Article, I argued that we should not automatically link

In many other state legislatures, however, the level of party cohesion and competition exceeds the levels exhibited in the United States Congress. See T. DYE, *supra* note 275, at 174-75 (Party voting in several states may be higher than in Congress.); M. JEWELL & B. PATTERSON, *supra* note 223, at 224 (Among states with competitive party systems, Congress ranks at or slightly below the average in terms of party cohesion.); D. PRICE, BRINGING BACK THE PARTIES 82-85 (1984) (Party voting rates for Congress range between 29% and 53%, whereas rates in states range between 35% and 65%; with respect to the "index of cohesion," almost every state legislature shows greater partisan unity than Congress.); J. WILSON, *supra* note 202, at 634 ("[T]he legislatures of many of the bigger, industrialized, northern states tend to be more partisan, more highly organized, and more tightly led than Congress, whereas legislatures in small, rural, and southern states tend to be somewhat less structured than Congress.").

282. A recent study by the Advisory Commission on Intergovernmental Relations demonstrates the dramatic increase of federal preemption in recent years. According to the Commission, since the nation's founding Congress has passed 350 statutes that explicitly preempt state law. Over half of these acts have been passed since 1970. See Advisory Comm'n on Intergovernmental Relations, Federal Preemption of State and Local Authority 2 (unpublished draft 1990). See also C. REITZ,

the development of national markets to uniform national law. In some instances, the efficiency gains of uniform law may provide a strong justification for sacrificing diversity. In other instances, such as mortgage foreclosure law, uniformity will generate few benefits.

Diverse state laws often reflect the health of our political system, rather than its infirmity. Different state laws may demonstrate competition among jurisdictions for the set of public policies that will best meet the needs and aspirations of their citizens. Diversity may also reflect the flexibility and experimentation made possible by decentralized government institutions. Perhaps even more importantly, diverse state laws may demonstrate that states continue to function as meaningful forums for political participation and action. Under our system of government, the states serve an important role in checking the power of the national government and preserving individual liberty. In order to continue to carry out this function the states must not become irrelevant. Yet irrelevance will surely be the result if we automatically equate national markets with national law.