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The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act

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I. INTRODUCTION

The Uniform Land Security Interest Act (ULSIA)¹ is an idea whose time has come. Political and market conditions now indicate that we will have universal private foreclosure laws across the nation in the relatively near future. There will be increasing pressure to have these laws “relatively” uniform. In fact, ULSIA is likely to be the “least uniform” approach to responding to the pressure for reform. If ULSIA is not seriously pursued by states with existing foreclosure practices that require judicial sale, it is quite possible that the Congress will make the change for them. Federally preemptive legislation likely will deprive the states of the discretion to tailor a private foreclosure bill that effectively balances political and economic interests in the given state or region. ULSIA, although written as a Uniform Act, need not be adopted precisely in uniform language. It should be the preferred alternative.

II. THE RATIONALE FOR UNIFORM LENDING PRACTICES

The basic argument for a uniform approach to foreclosures and other secured lender’s remedies has existed for a long time. It can be stated in two words: “Money talks.” It is the same argument that led every American state to adopt the Uniform Commercial Code, including Article 9, the Personal Property Financing Act. One wonders what is so special about real estate finance that the argument, to date, has not prevailed.²

1. U.L.S.I.A., 7A U.L.A. 220 (Supp. 1995). ULSIA is similar to provisions appearing as Article 3 of the Uniform Land Transactions Act, but in 1985 NCCUSL elected to establish a separate land security act and made certain amendments to the original Article 3 in formulating ULSIA. While the Uniform Land Transaction Act was initially intended to be a single, uniform statute embracing the whole of land law, by 1975 it was clear that a series of discrete statutes would better serve the states’ interests. In 1978 the National Conference created a Joint Editorial Board on Real Property Acts to provide coordinated oversight. Uniform regulation of real property acts was driven by the need to modernize and simplify the laws applicable to secured real property transactions consistent with the growth of the secondary market for real estate mortgages, to encourage increased primary lending, to benefit borrowers in our increasingly mobile society by providing uniformity, and to reduce cost to all elements of society upon foreclosure. U.L.S.I.A. prefatory note, 7A U.L.A. at 208-09; see also James M. Pedowitz, *Mortgage Foreclosure Under ULSIA (Uniform Land Security Interest Act)*, 27 WAKE FOREST L. REV. 495 (1992).

2. Although ULSIA has largely been enacted as the land security law of British Columbia, Canada, it has not been enacted in recognizable form in any American jurisdiction. It has influenced revisions of real estate laws in a number of states, particularly California and Virginia. It is now under active consideration by law reform groups in a number of states, including Connecticut, Minnesota, Illinois, Michigan, and Kansas.

The argument is one of competitive advantage for available capital. Money for real estate projects comes from national and international sources unrelated to the location of the project. Lenders who supply this money are more likely to lend it if they can readily predict the performance of their investment. The “babble” of real estate foreclosure provisions in American law is a significant impediment to making these predictions.³ One would assume, therefore, that fewer lenders would be willing to commit large sums to real estate lending, making the supply lower and thereby raising the cost.⁴

One would further assume that parties interested in attracting capital into the real estate marketplace and, necessarily, away from other investment choices, would work to provide the most uniform and predictable system of legal controls possible. There are other good arguments for uniformity: overall fairness, predictability of title, avoidance of misunderstandings, and application of collected wisdom. But the argument that this author expects will ultimately carry the day is the basic argument of economic efficiency.

Why then, have we not seen uniformity develop to date? One answer is, of course, that we have. There has been creeping uniformity in real estate lending practices over the past twenty-five years, ever since the private secondary market for housing loans got a “kick start” with the establishment of the Federal Home Loan Mortgage Corporation (“FHLMC”) and the reorganization of the Federal National Mortgage Association (“FNMA”) in the early 1970s.

But complete uniformity, similar to the UCC model, has not arrived. The explanation as to why development in this area is slower than in the areas regulated by the UCC lies in a whole variety of social institutions affected by real estate and not affected by other investment choices. Although there may be some argument as to the future, there is general agreement that in the past, land meant something special in our legal system. Beginning in 1066, the ownership of land meant holding of status in society; land ownership, *seizin*, was the essence of nobility. Since that era, and to

3. For a summary of the widely varying real estate foreclosure laws state-by-state, see SIDNEY A. KEYLES, *FORECLOSURE LAW & RELATED REMEDIES, A STATE-BY-STATE DIGEST* (1995).

4. As most commercial real estate lenders are also insurance companies who do business in various states, they are understandably reluctant to publicly criticize borrower-protective foreclosure laws in these states. They have voiced their concerns privately to the author, however, and have admitted that in some cases they either devalue a proposed loan or avoid making it at all because of the foreclosure laws that would govern a default. Some lenders have policies (again, unstated) of refusing to lend in given states for the same reasons.

some degree because of it, our legal system has treated land ownership and land transactions with special rules. Land today is more than a commodity; it is a home, a place; it is raw potential. It is privacy. To some, it is freedom.

As our country spread across the continental landscape, land laws in individual states developed to reflect the special political values that the citizens of those states held.⁵ Because they were pioneers, who chose to leave their homes to strike out to new territories, these citizens often had values that differed markedly from the values held by those who remained at home. Needless to say, the special economic needs of a developing frontier created the need for other unique laws, and as individual states developed, the interaction of these specialized laws, together with accidents of time and place, created other legal institutions and approaches that differed not only from the eastern states, but from those of other states in the same region as well.⁶

These specialized state laws spawned social conditions that made them resistant to out of state pressures for change. Specialized institutions grew to deal with transactions in land according to the special needs of individual state legal systems. Today, these institutions, including title insurers, local lenders, appraisers, and brokers, regard with suspicion and distrust proposals for sweeping reforms that would do away with the many specialized rules. Although, job security is an issue, one need not ascribe such crass motivations to those who oppose conversion to a uniform system. Even those who are most secure are nevertheless comfortable with what they have and suspicious of the unknown. Unlike UCC-style transactions, when people think of land, they do not just think of commerce. They have deeper, richer values at stake, and they are much less likely to accept change for the sake of commerce alone.

Nevertheless, change has come, and change will continue. The demands of commerce simply are too strong. In fact, perhaps the special nature of real estate in our society also is disappearing. Both as a cause and effect of the securitization movement described below, land increasingly is becoming regarded as a commodity.

5. See Frank S. Alexander, *Federal Intervention in Real Estate Finance: Preemption and Federal Common Law*, 71 N.C. L. REV. 293, 299-307 (1993).

6. See Patrick B. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection Over Credit*, 71 IOWA L. REV. 1, 6, 12-14 (1985).

III. UNIFORM LENDING INSTRUMENTS: THE FIRST PHASE

Faced with the reality that vested interests in every state had strong reasons to "protect their turf" and resist changes in their individual jurisdiction's real estate practices, and lacking, at the time, the convincing economic evidence of an established investor's pool, the "true believers" who started the private secondary market worked instead to bring about uniformity of contract.

The story has been told many times,⁷ and the punch line is something that we all know quite well. Almost ninety percent of the home mortgages written in the United States today are written on the uniform mortgage instruments promulgated jointly by FNMA and FHLMC. These instruments spurred the development of a vast international financial web that delivers money from, say, an Arab oil sheikdom to the buyers of a two bedroom cottage in Peoria, all because uniform instruments make it possible for financial intermediaries to assure the sheikdom of a reasonably predictable (and therefore secure) investment performance. Because the sheikdom is in the market, the Peoria buyers gets money when they want it at terms they can afford. They lose their right to bargain over various contract terms they probably do not understand anyway and likely would not have bargained over if they could.⁸

Why did we not see a development of uniform lending practices in the commercial lending market parallel to those in the housing market during the same time frame? Initially, it could be said that the commercial loans were more difficult to standardize. However, the difference probably was due to the involvement of the federal government in housing loans. As part of the New Deal, the federal government became deeply involved in housing finance, with the objective of maintaining stability in housing opportunity,

7. See, e.g., Raymond A. Jensen, *Mortgage Standardization: History of Interaction of Economics, Consumerism and Governmental Pressure*, 7 REAL PROP. PROB. & TR. J. 397 (1972); James E. Murray & Henry L. Judy, *The Federal National Mortgage Association and Federal Home Loan Mortgage Corporation Uniform Multifamily Mortgage Instruments*, 33 BUS. LAW. 2302 (1978); Patrick A. Randolph, Jr., *The FNMA/FHLMC Uniform Home Improvement Loan Instruments: A Commentary and Critique*, 16 Real Prop. Prob. & Tr. J. 546 (1981); Robin P. Malloy, *The Secondary Mortgage Market: A Catalyst for Change in Real Estate Transactions*, 39 SW. L.J. 991 (1986).

8. See generally, Arthur W. Liebold, Jr., *Uniform Conventional Mortgage Documents: FHLMC Style*, 7 REAL PROP. PROB. & TR. J. 435, 436 (1972); James E. Murray, *The Developing National Mortgage Market: Some Reflections and Projections*, 7 REAL PROP. PROB. & TR. J. 441, 443-45 (1972); Diana G. Browne, *The Private Mortgage Insurance Industry, the Thrift Industry and the Secondary Mortgage Market: Their Interrelationships*, 12 AKRON L. REV. 631, 644 (1979).

which it saw as a key to a healthy and optimistic consumer class. First, the Federal Housing Administration (“FHA”), and later the Veteran’s Administration (“VA”), loan programs became dominant factors in housing finance. In fact, the federal government even established the “thrift” industry as a vehicle to carry out these housing subsidy programs. Later, of course, the thrifts and the banks moved to conventional lending as well. It is likely that private lenders, the banks and thrifts that processed insured loans with relatively standard provisions, tended to follow the same basic contract format in preparing documents for conventional housing loans. They therefore were receptive to the development of uniform lending instruments for use in the secondary market.

The government has not been involved with commercial loans in the same way it has been involved with housing. Consequently, different lenders, primarily major commercial banks and insurance companies, made most of the commercial real estate loans. Each individual loan represented a significant economic risk to the lender, and therefore, the lender worked hard to limit risk and adopted lending practices with which it felt most comfortable. There was no particular need for uniformity, and there were no established formats to use as guides. Consequently, the commercial real estate market was not as readily adaptable to the requirements of the “money talks” argument as the housing market.

Many commercial lenders in the late 70s and early 80s argued that commercial real estate lenders were too idiosyncratic to ever be bottled in standard formats. There really was nothing about the variety of laws among the various states that prevented commercial lenders from doing the same thing that housing lenders did. They just did not see it in their individual interests to do so.

Another important obstacle to the development of the commercial secondary market was the lack of data about the performance of commercial loans. Major lenders regarded this information as proprietary, as it gave them the ability to make risk/return decisions in a competitive market that others, lacking the same data, might not be able to make. In the housing arena, of course, the dominance of FHA and VA lending, and the readily available data as to the performance of those loans, made it possible for market makers to predict performance more readily.

Then came the late 80s, and the cozy, closeted world of commercial lending came tumbling down. Whether the root cause was deregulation, economic “cowboys,” tax reform, or just endemic carelessness finally showing through, all lenders in all segments were devastated. The good projects were taken down by the bad ones. No one survived unscathed. In

this bleak landscape, there was room for new ideas to bloom. And we saw the development of the "securitized" commercial mortgage.

One important source of product in the securitized lending market was the very economic devastation that gave it room to grow. The Resolution Trust Company ("RTC") came to market with major securitized lending packages as a strategy to liquidate its far flung inheritance of commercial loans. The huge RTC offerings both defined and legitimized the securitized mortgage market by providing enough economic activity to permit trading institutions to develop. Once they developed, these institutions were able to approach other institutions who had survived the 80s, but only barely, and had a surfeit of loans, many of them under-performing, that they needed to "cash out" in order to move ahead whether or not they intended to remain in real estate lending.

Due to the special nature of the circumstances which gave the securitized lending movement its greatest push, the mortgage loans that traded in these transactions have not been written on uniform documents. But now that market institutions have been formed, the push for predictable performance has taken over. The "securitized" mortgage permits far less negotiation. There probably is less uniformity at present than there will be in the future because market factors have yet to work completely. But securitized loans are more and more meeting uniform standards. Perhaps securitized loans would not have been able to compete effectively with the comfortable relationships and well-established and varied practices of traditional commercial lenders. But many of those lenders are out of the business, and others are just returning. There has been adequate time for growth of an independent securitized commercial mortgage market, even without the significant presence of the federal government that sheltered the securitized home mortgage market in its infancy.

IV. THE ARGUMENT FOR PRIVATE FORECLOSURE REMEDIES

The arguments in favor of private, non-judicial foreclosure are many and have been made before.⁹ All four arguments can be summarized as follows. First, the cost of private foreclosure is about one-tenth the cost of

9. See, e.g., Norman Geis, *Escape from the 15th Century: The Uniform Land Security Interest Act*, 30 REAL PROP. PROB. & TR. J. 289 (1995) (attacking on what the author views as ill conceived and antiquated state mortgage laws); Jo Anne Bradner, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971, 993-1003 (1987).

judicial foreclosure.¹⁰ We should evaluate this argument carefully from the perspective of practical reality in the marketplace. Most real estate defaults are “worked out.” Either the borrower transfers the property “in lieu of foreclosure” in exchange for avoidance of deficiency, or the borrower actually avoids loss of the property entirely by restructuring the debt. This is true of both commercial and residential financing. In the “bad times” of the 1980s, however, actual foreclosure of troubled real estate investments became necessary in far greater numbers than had been the case for some time. Lenders started to take a serious look at the additional cost such foreclosures added to the bottom line. Judicial foreclosures require far more of an attorney’s time and, of course, generally take longer. Both of these tend to run up costs.

Lenders complain that these increased costs of foreclosure are ultimately passed on to borrowers.¹¹ The author candidly doubts that this is really the case.¹² The number of foreclosures is really a very small percentage of real estate loans in place, and surely many other factors control the pricing of these loans to a far greater degree than the tiny increment of costs associated with foreclosures. Further, in many jurisdictions, costs of foreclosure are recoverable as part of the debt. Finally, the preforeclosure sale cost is probably only a relatively small factor in the overall cost of dealing with defaulted property. Cost of management of the “real estate owned” department and costs of resale, which would be the same either in a judicial foreclosure or nonjudicial foreclosure state, probably are far greater than foreclosure costs themselves.

Although lenders may not be able to pass the costs of judicial foreclosures directly to borrowers, there is little doubt that they exist, and the costs are borne by more than the lenders. All of us, through our support of the court system, are called upon to supply the judges, bailiffs, clerks, sheriffs, and courtrooms involved in the judicial foreclosure practice. Again, these costs may be small when compared to court costs overall, but they

10. See Geis, *supra* note 9, at 300 and authorities cited.

11. Kahn & Yavas, Office of Real Estate Research, The Economic Role of Foreclosure (ORER Paper No. 90) (Nov. 1991) (unpublished manuscript, on file with University of Illinois at Urbana-Champaign).

12. For an economic analysis consistent with the author's views on this issue, see Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489 (1993). The author does not necessarily endorse Professor Schill's conclusion that strong mortgagor protections serve the salutary function of driving risk averse lenders to acquire mortgage insurance — thus more properly distributing the risk of a borrower's default among all participants in the mortgage market. The author believes that borrowers should be held responsible for the payment of their contracted debts.

clearly exist. And they may in fact be paying for a system that is unneeded and leads to greater economic waste of other kinds.

Second, judicial foreclosure takes more time than private foreclosure, leading to waste.¹³ In most jurisdictions, judicial foreclosure will take four months at a minimum, and often as long as eight months to a year.¹⁴ Delays arise primarily due to calendaring difficulties at the courthouse, not because the issues at stake require elaborate discovery and motion practice.

The "waste" concern here represents more than economic waste to the lender itself, although that is certainly part of the lender's concern. The community at large has a significant concern about the economic viability of each plot of real estate, as each plot represents an important piece of the overall capital available to the economic society in the community. If buildings deteriorate, if landscaping disappears, if fires occur, if "crack houses" arise, the community at large is directly affected. The longer a foreclosure property languishes in the hands of a defaulted borrower, the more likely it becomes that these kinds of things will happen.

Lenders have the option, of course, of seizing property through receivership to prevent this kind of waste. But receiverships add additional costs that lenders might not be willing to incur. And the concern here is not simply about lenders. It is more difficult for society at large to protect itself from deterioration, even though it may pay the ultimate price.

We should remember that, typically, a borrower faced with foreclosure has already exhausted many avenues that might lead to the cure of the problem. The borrower is virtually at the end of the rope. Shortening the remaining length of the rope is unlikely to make a dramatic difference to the borrower, but it may make a significant difference both to the lender and others with an interest in the property. If the borrower truly had a significant chance at rehabilitation, it is very likely the lender would not be foreclosing. Lenders do not want foreclosure property, they want healthy borrowers.

Third, where there is a significant borrower's interest, the borrower can force a judicial proceeding. Persons supporting judicial foreclosure frequently make the argument that borrowers who are concerned with uncertainty as to the appropriateness of foreclosure, or other parties who wish to challenge priorities, are deprived of a significant opportunity to do so because of the rapid and summary nature of the foreclosure process.

13. This has been a particularly popular argument with parties supporting preemptive federal foreclosure legislation. See, e.g., Bradner, *supra* note 9, at 995-1000.

14. See Geis, *supra* note 9, at 321-23.

Lenders respond that such borrowers have the right to enjoin the foreclosure and raise the issues in a lawsuit.

In fact, the process of enjoining a private foreclosure can be a very expensive process in many jurisdictions.¹⁵ Sometimes a borrower is required to post a rather extensive bond. As the borrower may also be faced with attorney's fees, and as the borrower likely would not be in the situation in the first place if the borrower had extensive assets, an injunction likely would be impossible as a practical matter even in cases where it would be appropriate.

The author believes that states moving toward private foreclosure may want to rethink the standards for injunction of such foreclosures in order to provide a more realistic right to contest foreclosures when there is just cause. But there is another "brake" on inappropriate foreclosures, the right of a borrower to sue a lender for wrongful foreclosure or even to contest the validity of the title created by the foreclosure sale.

States considering enactment of private foreclosure statutes might give consideration to these adjustments to the current state of affairs relating to injunctions and other remedies for wrongful foreclosures. Although justice would be served by providing reasonable remedies here, the number of cases in which a wrongful foreclosure is likely to arise is a small percentage of overall foreclosures, most of which are uncontested as a practical matter. Consequently, concerns in this area should not justify avoiding the private foreclosure remedy altogether.

Fourth, private foreclosure can be tailored to avoid inappropriate deficiency claims. We should differentiate between a rightful foreclosure, where title is sold in satisfaction of a debt claim, and the deficiency claim that follows such a foreclosure. The real concern of many who support judicial foreclosure is the concern that borrowers may be exposed to an inappropriate deficiency judgment by a rapid, inadequately noticed or managed sale, without appropriate judicial supervision.¹⁶ When such persons resist moving to private foreclosure formats entirely as a response to concern about deficiency judgments, their aim is askew.

Most lenders who foreclose on real estate have little or no expectation of having meaningful deficiency claims, and, in states where the law so requires, cheerfully forfeit deficiency rights in exchange for the opportunity

15. The procedures are summarized and criticized in GRANT S. NELSON & DALE A. WHITMAN, *REAL ESTATE FINANCE LAW* 535-38 (3d ed. 1994).

16. See Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosures Sales*, 53 S. CAL. L. REV. 843 (1980).

to have a fast, final, and inexpensive private foreclosure.¹⁷ If lenders believe that the borrower has the capacity to respond to a deficiency claim, they always have the option to foreclose judicially. No state requires private foreclosure as the sole remedy available to lenders. Judicial foreclosure is always available.¹⁸

Certainly, any state moving to a private foreclosure format would have the option, consistent with ULSIA or any other statutory format, to restrict deficiency judgments by requiring judicial review of any proposed judgment to ascertain that the property sold at private foreclosure for a "fair value" or to even prohibit deficiency judgments.¹⁹ ULSIA, for instance, prohibits deficiency claims against homeowners who are foreclosed privately,²⁰ as do many private foreclosure statutes around the country.

Although lenders have lobbied in some states to protect their deficiency rights in private foreclosure situations,²¹ the fact is that the trade of unlimited deficiencies for private foreclosure is a political exchange that most lenders would find quite palatable.²²

In short, looking at the overall pattern of mortgage loan failures and the practices of mortgage lenders nationwide, the cost of judicial foreclosure is

17. See Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosures in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151 (1982); John Mixon, *Deficiency Judgments Following Home Mortgage Foreclosure: An Anachronism That Increases Personal Tragedy, Impedes Regional, Economic Recovery, and Means Little to Lenders*, 22 TEX. TECH. L. REV. 1 (1991). Examples of statutory schemes that bar deficiency judgments following private foreclosure include: ALASKA STAT. § 34.20.100 (1990); ARIZ. REV. STAT. ANN. § 33-814(E) (1990); CAL. CIV. P. CODE § 580(d) (Deering 1972 & Supp. 1996); WASH. REV. CODE ANN. §§ 61.24.010, .040 (West 1990 & Supp. 1996).

18. It should be noted that a few states, like ULSIA, bar deficiency judgments absolutely in the case of purchase money mortgages against owner occupied residential property, see, e.g., ARIZ. REV. STAT. ANN. § 33-729(A) (1990); N.C. GEN. STAT. § 45.21.38 (1991); OR. REV. STAT. 88.070 (1995); S.D. CODIFIED LAWS ANN. §§ 44-8-20 to -25 (1983 & Supp. 1995), or in cases of purchase money mortgages of any kind, CAL. CIV. P. CODE § 580(b).

19. For an exhaustive summary of the many devices used to control deficiency judgments, most of which do or could apply to private or judicial foreclosures equally, see NELSON & WHITMAN, *supra* note 15, at 579-609.

20. U.L.S.I.A. § 511(b); see John Mixon & Ira B. Shepard, *Antideficiency Relief for Foreclosed Homeowners: ULSIA Section 511(b)*, 27 WAKE FOREST L. REV. 455 (1992).

21. In a recent attempt to adopt ULSIA in Connecticut, for example, an important stumbling block was the last minute opposition by mortgage lenders who were unwilling to accept even the limited restrictions on "protected party" deficiency judgments provided for under the Act.

22. Such a "trade" has already been made in a number of states. See, e.g., ALASKA STAT. 34.20.100 (1990); ARIZ. REV. STAT. ANN. § 33-814(E) (1990); CAL. CIV. P. CODE § 580(d); WASH. REV. CODE ANN. §§ 61.24.010, .040.

far out of proportion to the number of borrowers truly protected from unfair or overreaching foreclosure practices. The interests of these borrowers could be protected adequately by “fine tuning” private foreclosure practices to permit practical injunctions, suits for wrongful foreclosure, and meaningful protection against unfair deficiency claims.²³ With these protections in place, there are few policy grounds justifying the continued cost and delay to the system of judicial foreclosure.

V. FEDERAL INTERVENTION IN THE INTERESTS OF UNIFORMITY

A. *Early Intervention*

Federal involvement with private finance dates back to Alexander Hamilton. There has always been a strong government interest in the well being of the lending climate in the nation. In recent history, however, the most dramatic federal intervention in private money markets occurred in the 1930s with the “New Deal” activity.²⁴ As described above, the primary involvement of the federal government in private real estate markets at this time was in the housing finance area. Institutions created at that time have continued to influence the character and development of the private real estate economy ever since.

B. *1980s Preemption Activity*

As the secondary market became more of a success in delivering housing money across the nation, it became apparent that certain state laws were not only a drag on the system, they became actual bars to its functioning. The answer was simple. The federal government had already committed hugely to the development of a successful housing finance market, so it was easy to make the argument to Congress that it should preempt inconvenient local laws that were major impediments. After all, the “American Dream” was at stake.

The “breakthrough” legislation was certainly the Depositor Institutions Deregulation and Monetary Control Act of 1980 (“DIDIMAC”),²⁵ which

23. NELSON & WHITMAN, *supra* note 15, at 579-609.

24. For a summary of the twentieth century history of federal intervention, see Alexander, *supra* 5, at 310-23. Alexander contends that there was virtually no direct federal involvement in real estate lending until the Twentieth Century. There has, of course, always been a profound federal presence in banking regulation, from which most real estate finance sources emanate. *Id.*

25. Pub. L. No. 96-221, § 501, 94 Stat. 132, 161-62 (codified at 12 U.S.C. § 1735f-7a).

preempted dramatically all state usury laws on institutional first lien residential mortgage loans and made significant changes to other usury restrictions as well.²⁶

DIDIMAC “opened the floodgates” in many jurisdictions for secondary market money to flow in. It was enacted at an historically high point in interest rates, caused at least in part by the Arab Oil Embargo of the 70s. Money simply was not available within the limits set by many state statutory and constitutional lending limits. But money was certainly available to be loaned at higher rates, vast stores of it resting in bank accounts controlled by foreign beneficiaries of the oil crisis, among others, who were looking for new investment opportunities.

Although local lenders might have been able to “stunt,” to develop special devices to get around the usury laws to keep money flowing, or to partially rollback the usury laws to a level they could work with, they lacked the funds to service the need. And the money straining for release from secondary market sources could not be loaned through “stunts.” There had to be a uniform, predictable flow to make the market work.

The argument worked with Congress, which in one fell swoop did away with a century of carefully worked out state debtor protections in the housing market. Of course, Congress was told that this really was the will of the state legislatures, but they lacked the political will to cast what might be seen as an “anti-consumer” vote. But they welcomed Congressional intervention. Although states had the power to “re-preempt” DIDIMAC’s limitations, few, if any, did.²⁷

Flushed with that success, the national and international managers of the American housing finance markets then turned to another set of nagging problems, the infamous state regulation of the “due on sale” clause. Lenders, of course, hated the “anti-clause” state statutes and cases because they cost lenders valuable opportunities to upgrade their mortgage return when property turned over. But the variety of enforcement practices concerning this clause was a problem in and of itself. Loan “packagers”

26. It has been argued that DIDIMAC was in turn influenced by Congress’ earlier intrusion into the real estate finance market in the enactment of the Truth in Lending Act and the Real Estate Settlement Procedures Act. Alexander, *supra* note 5, at 313-15. Although DIDIMAC, in fact, uses for convenience some definitions adopted in those acts, DIDIMAC represents an economic control designed to assist lenders, not borrowers, and as such represents a distinct new move in federal legislative policy concerning real estate.

27. For a summary of the impact of federal preemption of mortgage laws, with an identification of the remaining “loopholes,” see Patrick A. Randolph, *Home Finance in the Shadow World: Unsolved Missouri Usury Problems Affecting Adjustable Rate and Wraparound Loans*, 51 U. MO. KAN. CITY L. REV. 41 (1982).

were unable to combine loans from “pro-clause” states and “anti-clause” states. Again, in one deft stroke, Congress rewrote the law of a score of states to clear out the impediment. As part of the omnibus Garn-St. Germaine Act,²⁸ Congress again established uniform federal lending laws to serve secondary market needs.²⁹

A less noticed, but potentially equally important aspect of the Garn-St. Germaine Act was the Alternative Mortgage Instruments Parity Act,³⁰ which created the possibility of uniform federal regulation of “economic factors” of adjustable rate loans and virtually every other variety of housing loan other than long term fixed rate loans.

The crisis of the late 1980s and the infamous “bail out” of the lending industry caused Congress to be a bit more circumspect about assuming what was good for lenders was good for the country. Therefore, other efforts to get helpful new legislation have not been as successful. But in another quarter, tracks were being laid for an additional Congressional intrusion on state laws: preemptive federal foreclosure statutes.

C. *Federal Intervention in Mortgage Foreclosure*

The arguments favoring national uniformity in private housing finance were not lost on federal policy makers involved in more direct federal lending activities. The same impediments to efficient collection processes that many state foreclosure statutes imposed upon private lenders were also a thorn in the side of the United States Department of Housing and Urban Development (“HUD”) and the Small Business Administration (“SBA”), and other federal agencies when they attempted to foreclose on direct mortgage loans made to carry out discrete federal policies, such as low income housing.

These lenders commonly argued to local courts that inconvenient local foreclosure protections got in the way of “uniform” federal lending programs, and therefore should be brushed aside under the Supremacy Clause of the United States Constitution. They enjoyed some limited degree of success with this tactic. But in 1979, in *United States v. Kimbell Foods, Inc.*,³¹ the United States Supreme Court concluded that a government agency, without express Congressional authority, could not preempt local

28. 12 U.S.C. § 1701j-3 (1994).

29. NELSON & WHITMAN, *supra* note 15, at 311-26.

30. 12 U.S.C. § 3801-3806 (1994).

31. 440 U.S. 715 (1979). For a thorough discussion of *Kimbell Foods* and its somewhat unpredictable progeny, see Alexander, *supra* note 5.

laws just because they made government lending activity more expensive. The government would have to demonstrate in the particular program a clear need for national uniformity and demonstrate how this need outweighed state concerns.

Perhaps it was due to this decision that HUD was able to push through Congress the following year a preemptive federal foreclosure statute for multi-family low income housing projects.³² This statute, of course, threatened to be a template for other uniform federal foreclosure provisions, but in and of itself, did not implicate too many adverse local interests. Subsidized low income housing projects were the unique province of the federal government, which fed them from many directions, and closely regulated their behavior. Although private interests were involved, these interests had clearly entered the "federal kitchen" and ought to "stand the heat." Further, it took the federal government many years to develop regulations to carry out the statute, and many simply forgot that it existed.

After HUD got around to issuing its regulations and conducting a few foreclosures under them, and after a few test cases were resolved "blessing" the federal procedure, federal policy makers decided to reach further.

In 1994, HUD again shepherded through Congress a preemptive federal foreclosure bill, this time for all HUD single family mortgages.³³ Again, the bill passed the Congress with barely a word from the real estate industry. Most, perhaps, assumed that HUD was focussing on that relatively small group of direct loan mortgages that represent a healthy government subsidy to low and moderate income owners. The federal interest in such loans is strong. The borrowers are not part of the conventional finance marketplace, and represent a small number of people who likely otherwise would not own a home at all. This may have explained the lack of interest in the national real estate community.

What few realized (outside of the select federal regulators who drafted the bill), however, was that the 1994 Act potentially could reach a wide range of conventional housing borrowers. One group of loans covered by the 1994 Act includes FHA guaranteed loans. Although FHA does not guarantee the high proportion of the American home loans that it once did, it necessarily is a significant factor in the first loan market. Further, it is a major guarantor in home improvement loans. The borrowers in these cases were standard "Joe and Jill America." They could afford to buy their own home and, although they likely benefitted from the presence of FHA

32. Multifamily Mortgage Foreclosure Act of 1981, Pub. L. No. 97-35, 95 Stat. 422 (current version at 12 U.S.C. §§ 3701-3717 (1994)).

33. Single Family Mortgage Foreclosure Act of 1994, 12 U.S.C. §§ 3751-3768 (1994).

insurance, they would not have viewed themselves as “federally subsidized.” More to the point, they represented a substantial segment of the home-owning public; a segment that did not really expect that it would be treated any differently from other citizens of the state if and when they should have difficulty paying their mortgage.

But, in fact, in most states, the treatment would be radically different. The 1994 Act provided for preemption of all state foreclosure requirements, beginning with the requirement for judicial foreclosure, but hardly ending there. All statutory redemption³⁴ was preempted, as well as many important notice and cure provisions, which are particularly common in consumer statutes addressed to junior lien home improvement loans. Under the 1994 Act’s provisions, Joe and Jill could be out of their house, without recourse, and with only minimal notice, within less than a month of the day they missed their loan payment.

Of course, federal regulators point out that the foreclosure statute is only the “endgame,” that HUD mortgage loan procedures in fact involve a heavy dose of counseling, notice, and various other devices. In the typical case, HUD would foreclose only as a last resort. Unfortunately, anyone who has ever been swept up in a blind bureaucratic net can testify that there is scant guarantee that one will be treated as “the typical case.” Consider, for example, the experience that many individuals have had dealing with federally guaranteed student loan programs, not to mention the IRS. If Joe and Jill are not ready to believe that the government is simply “here to help,” they may be very unhappy to know that the government will not be kept under the same controls that other mortgage lenders face if and when there is a mortgage default.

Buoyed by their 1994 success, in late 1995 the Department of Justice attempted to engraft another statute to the federal budget bill that would, in essence, create a single federally preemptive foreclosure law for all federal agency mortgages. This bill retroactively preempted all anti-deficiency legislation, provided limited notice to junior lenders, and as before, a token notice period (by the standards of most state laws) prior to foreclosure. This

34. Statutory redemption laws appear in about twenty states, and generally extend the period of foreclosure following judicial foreclosure. The primary purposes were to give farmers a “third chance” to salvage their property from redemption and to prevent “cheap foreclosure sales” that created unfairly large deficiency judgments. The statutes arose from the depressions of the late nineteenth century, largely in agricultural states. Modernly, many such statutes have been amended to apply to residential and farm property only, and can be avoided by waiver of deficiency (i.e., California) or use of a private foreclosure device that, by terms of other statutes, does not result in a deficiency.

time, however, someone was watching, and at present, the new federal foreclosure law is not in a "live bill." It has, however, passed the House of Representatives and is likely to be the subject of Senate hearings this spring. Numerous organizations, including the American College of Real Estate Lawyers and the American Bar Association Section on Real Property, Probate and Trust Law, have requested the opportunity for review and comment.

VI. EVALUATING FEDERAL PREEMPTION AS THE PROCESS OF UNIFORMITY

There are only a few in the home finance industry who would criticize the federal preemption of home mortgage usury limits under DIDIMAC. Clearly, usury laws at the time were an obstacle to the efficient flow of funds across state lines and the operation of the secondary market. Also, it was clear that state legislatures would have difficulty expunging these laws entirely. Even if they had altered the laws, they likely would have enacted piecemeal modifications that would have created similar obstacles to the marketplace.

As discussed above, there is increasing pressure for a movement toward private foreclosure procedures. If we accept the notion that the national real estate market would benefit from a non-judicial foreclosure, is it also appropriate to conclude that the federal preemption of mortgage foreclosure laws is also the best way to get to a desired result? Certainly existing and proposed federal agency foreclosure laws would provide a template for a uniform preemptive foreclosure statute. In fact, if the most recent proposed legislation passes, and federal agency foreclosures are conducted pursuant to its requirements, then state institutions dealing with real property might be forced to realign their procedures to deal with the federal model, making it easier for them to convert the balance of their practices to that model as well.

The author concludes that federally preemptive foreclosure laws are not the answer. There are better ways to reach the goal of a uniform private power of sale procedure that will satisfy the needs of the developing secondary market and remain consistent with the diversity of views that states may have regarding the appropriate balance of mortgage lenders and borrowers. The authors even conclude that the proposal for federal agency foreclosures should not be enacted, in part because of the disruptive impact such an enactment would have on title and other real property issues in many states.

Although the United States is no longer an expanding frontier, with dramatic differences between developed and undeveloped states, it is still a country with a vast geography that compels distinct differences in values. Diversity of state laws is not something that ought to be abandoned easily. The differences in state laws continue to reflect not only value differences but differences in the way in which business is conducted. Massive change to a uniform foreclosure approach will create dissonances in systems which have grown up around established foreclosure methodologies. It is impossible to anticipate, and therefore to resolve, all of the conflicts that might arise. What is the relationship, for instance, of foreclosure practices to homestead laws? What is the relationship to marital property laws? Or to probate laws and practices?

Perhaps even more significant from a policy standpoint, one might ask why the federal government should be in the business of forcing all borrowers and lenders in all states into a common mold. If there is a likelihood that gross differences in foreclosure practices can be resolved, so that private foreclosure becomes the norm, and the time and cost of foreclosure is substantially the same throughout the land, does it matter whether all states march in lockstep?

If the Kansas Legislature believes that there should be judicial review of a foreclosure sale before a deficiency judgment is ordered, this may be because Kansas farmers, from hard experience, understand that farm foreclosures are subject to manipulation due to massive market fluctuations, and unsophisticated farm borrowers can easily be exposed to ruinous judgments by inappropriate foreclosure practices even when the borrowers have equity in their farms. These same concerns may not be true in Rhode Island or New Jersey.

If Illinois requires foreclosure notice to junior interest holders at the "last known address," rather than placing the burden on the interest holders to maintain an accurate notice address of record, perhaps this reflects conditions about the public records or the availability of address information in Illinois that would not be true of, say, Missouri.

If Alaska believes that foreclosure title should be conclusively presumed final, notwithstanding the danger of a failure of notice or a defect in the sale process, but Arizona does not agree, yet is willing to make a certificate executed by the trustee presumptive evidence of good title, why should either state have to alter its perception of fundamental fairness? Even if we were to establish a "lockstep" approach to foreclosure, is the best forum in which to design this uniform foreclosure process the United States Congress? Or the United States Department of Justice?

The authors propose that a device exists by which differing state values can be accommodated and even preserved, while still achieving the uniformity necessary to meet the needs of the secondary mortgage market in home loans and commercial loans. The device is the Uniform Land Securities Interest Act, a product of the National Commissioners on Uniform State Laws.

VII. THE UNIFORM LAND SECURITY INTEREST ACT

A. *Benefits of the Uniform State Law Approach*

ULSIA provides for a rapid, clean foreclosure has been available for state consideration for over a decade. No state has adopted it fully, but it has influenced the thinking of a number of states as they have considered and revised their mortgage laws since ULSIA was adopted. Basically modeled after the UCC, but with significant changes to accommodate the special nature of real estate transactions, ULSIA provides for a quick, efficient foreclosure process, with clear notice provisions and good title. It protects homeowners from deficiencies judgments resulting from private foreclosures, but provides the option to lenders to proceed with judicial foreclosure where appropriate.

The process by which ULSIA was developed insured that the competing values of various states were taken into account. The National Commissioners include representatives from every state, frequently persons who themselves are or have been legislators and who are familiar with the political values of their local legislatures. Uniform laws are designed to be fair and balanced, but also to pass in all state legislatures.

Persons familiar with the process of uniform law adoption know that there is a "little secret" that makes it possible to achieve widespread adoption of many of the Commissioner's products: the secret is that states do not really have to adopt the exact uniform language. Although, of course, uniformity is the goal, the Commissioners recognize, as they must, that each state has its idiosyncracies that will prevent it from accepting every "uniform" pronouncement completely. In fact, the Commissioners build some choice of nonuniform exceptions into their laws. ULSIA, for instance, expressly permits states to include agricultural landowners within the class of "protected parties" entitled to special notice and anti-deficiency protection. It also provides for some flexibility with respect to particular notice requirements. Further, in the process of deliberation by state legislatures, advocates for uniform laws often propose further nonuniform amendments to achieve substantial uniformity goals while still accommodat-

ing special state concerns. Persons familiar with the UCC are quite aware that there is wide variation among the states as to many provisions of the UCC, even though we do enjoy substantial uniformity.

The process of adoption for uniform state laws takes into account the richness and diversity of our legal system and tries to adapt that system to the needs of the modern international marketplace without destroying completely the fundamental fairness that each state legislature can best provide to its own constituents.

Further, as each state legislature processes a proposed uniform law, it is in the best position to make an evaluation as to how that law will impact on other elements of the state's legal framework. Thus, instead of a preemptive federal blunderbuss shredding the overall system while achieving a limited uniform result, the uniform state laws approach permits an evaluative process that achieves necessary compromises both in the uniform law and parallel adjustments in other state laws and practices to insure a workable framework.

B. *If ULSIA Has Not Succeeded Yet, Why Will It?*

ULSIA has succeeded in achieving significant movement in state foreclosure laws in a number of jurisdictions, and even in Canada. A number of state law reform groups have recommended ULSIA for adoption, and it is under active consideration in several state legislatures today. But no state has enacted a version of ULSIA that is similar enough to the uniform act language to permit it to be called "uniform."

As indicated above, there is considerable resistance to reform of real estate laws in many jurisdictions. Without a very good reason to do so, the institutions that work with and protect the existing system of laws in a given state will oppose change. These institutions are far more entrenched in the real estate industry than, for example, in the areas of commerce governed by the UCC. It is easy, therefore, to understand why ULSIA has not enjoyed the acceptance that financing sections of the UCC enjoyed.

Further, in prior times, advocates for ULSIA in some state legislatures pushed harder for uniform language adoption in the belief that uniformity was a significant enough priority that ULSIA should stand or fall on its precise language. This, of course, was a strategy that made adoption far more difficult, even if the basic premise were sound. In recent years, advocates of ULSIA have adopted a more moderate posture. A particular sticking point has been ULSIA's notice provisions, which did not give assured notice to junior interests to which practitioners in judicial foreclosure states have been accustomed. A Joint Editorial Board for Uniform

State Laws formed under the aegis of the Commissioners has devised alternative language that states might view as an acceptable compromise in this area.

But the most significant new factor that may lead to many states reconsidering ULSIA is the new pressure for movement toward private foreclosure that the commercial mortgage secondary market will produce. This pressure is new, far beyond any impact that might have existed when the only true secondary market was in home mortgages. Home mortgages have infinitesimally small foreclosure rates. Further, any one mortgage is a tiny part of a whole mortgage package. As a consequence of these two facts, delays in foreclosure resulting from variations in state foreclosure laws were unlikely to have a significant impact on the overall performance of mortgage portfolios. Secondary market purchasers were content with uniform instruments, and not particularly concerned about uniform state laws except in cases where portfolio performance would be directly affected, such as in the case of the due on sale clause.

There is about to be a change, however, in the message that states receive from commercial lending sources. Individual commercial mortgages, of course, constitute considerably larger commitments of mortgage dollars than home mortgages, and any one mortgage will be a more significant part of a given portfolio. Most traditional commercial lenders have been cognizant of the major differences in foreclosure cost and delay between private foreclosure and judicial foreclosure states, and have taken those considerations into account in pricing their mortgage loans. But although insurance company loan underwriters will admit privately to these considerations, and even sometimes confess that they have avoided certain states entirely because of difficulties in foreclosure statutes, these lenders have been unwilling to take a uniform stance in opposition to judicial foreclosure practices. Such confrontations were "not the style" of the insurance companies who typically made major commercial loans, particularly because the same companies were interested in selling their insurance products in the same states that provided difficult lending climates.

Modern "securitizers" are primarily in the business of placing and collecting mortgage loans. They will have fewer compunctions about letting loan originators know about the market view of their "slow foreclose" commercial loans. Indeed, several major rating agencies even now are developing matrices of factors to standardize the evaluation of loan portfolios, and foreclosure delay will be a quantifiable factor in these evaluation models. Even today, it is possible, if securitizers were willing to disclose their practices, to identify the precise increase in interest rate that borrowers under securitized mortgages will pay in judicial foreclosure states

versus private foreclosure states. But to date, industry participants have been unwilling to disclose this information, partly for competitive and partly for political reasons.

If commercial lending follows the model of home lending, the bulk of commercial loans will trade as securitized loans within a decade. The economics of the industry eventually will lead commercial borrowers in judicial foreclosure states to recognize the higher price they pay for their special foreclosure protections. To most such borrowers, this is a price that they will be unwilling to pay, and they will so inform their state legislatures.

Thus, market institutions in judicial foreclosure states are likely, within the next decade, to seriously evaluate their past resistance to private foreclosure methods. In evaluating what type of private foreclosure process to adopt, many such states are likely to view ULSIA as a useful, integrated approach that solves the problem and is most likely to provide the necessary degree of uniformity with other state practices to insure the broadest acceptance on the secondary market.

In fact, it is likely that if states do not recognize that their best interests are served by moving to some form of private foreclosure, the United States Congress, goaded by the same interests that persuaded it to preempt state due on sale regulations and state usury laws, will impose a private foreclosure system on them. States should view the proposals for a uniform federal mortgage foreclosure statute, even one limited to federal agency mortgages, as a distinct threat to their independent judgments about the best balance between mortgage borrowers and lenders. By moving to ULSIA, tailored appropriately to their own special needs, states can achieve a state-centered foreclosure approach that meets the need for uniform and efficient foreclosure, but preserves special state values and is consistent with existing state practices.

C. *The Special Problem of "State Action" Foreclosures and Notice*

One problem with ULSIA in its present form is the possibility that it would not provide adequate "due process" notice if the statute is measured by Constitutional standards. Although most decided cases have found that an ULSIA-style private foreclosure would not constitute state action, there are still some concerns. First, of course, there is the possibility that at some future time courts would find that foreclosures involved state action. Second, there is the reality that most courts have viewed foreclosure of certain government owner mortgages as state action, and the uniform commissioners ought to have a statute that would be available for foreclo-

sure of such interests. Finally, there is a concern that notice to parties with real interests is more than a technical requirement, it represents fundamental fair treatment and ought to be part of any foreclosure statute.

The new Joint Editorial Board on Uniform Real Property Laws recognizes these concerns, and has drafted a "non uniform" amendment to ULSIA that is an acceptable amendment for states considering adoption of ULSIA. This amendment is designed to provide full and fair mailed notice to all parties with a significant interest in the property. The Joint Editorial Board stands ready to work with state legislatures who are considering ULSIA to formulate this amendment or some other amendment to address the real concern of notice.

There is a secondary concern, of course, as to whether a "hearing" must be required before any "due process" foreclosure. There is no definitive answer to this question, although the author's view is that "some form of hearing" certainly is required. ULSIA does not provide for such a hearing, instead it relies upon the right of a borrower, or other party seeking to avoid foreclosure, to seek an injunction. Government agencies who are foreclosing their own mortgages can likely satisfy any requirement for a hearing by providing one as part of their preforeclosure procedures. The members of the Joint Editorial Board, like the Commissioners, have not viewed the likelihood that private foreclosures will generally be regarded as "government action" to be so high that a hearing provision is warranted as part of every private foreclosure. And, unlike with respect to the notice issue, the Joint Editorial Board does not regard a separate hearing to be necessary to ensure "fundamental fairness" in foreclosure practice.

VIII. SUMMARY AND CONCLUSION

Private foreclosure is cheaper, surer, and ultimately better for the vast majority of mortgage borrowers as well as mortgage lenders. The small degree of extra protection provided by complex judicial foreclosure provisions is not worth the increased cost and delay.

A developing international marketplace for mortgage money is going to bring the harsh judgment of the marketplace to bear upon judicial foreclosure procedures in ways that states have not experienced in the past. When states see that lenders are likely to pass directly to their state's borrowers the cost of judicial foreclosure delays, they will seek alternative modes of foreclosure that make possible full participation in the secondary market.

The Uniform Laws approach afforded by ULSIA is a device that permits states to make their own state-tailored decision about foreclosure methods but still come to a result that fits the need for efficiency and

uniformity dictated by the marketplace. Forces are now at work that will drive states to accept a move to private foreclosure whether they like it or not. Federal preemption is a real threat. Judicial foreclosure states are well advised to consider taking control of their own destiny by resisting politically, movements toward federal preemption and by considering a uniform private foreclosure law like ULSIA.