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THE SECONDARY MORTGAGE MARKET—A CATALYST FOR CHANGE IN REAL ESTATE TRANSACTIONS

by
Robin Paul Malloy

The impact of the secondary mortgage market on real estate transactions is likely to be regarded as one of the most important developments in real property and finance law in the 1980s. Underlying the technical jargon and mechanical functions of this market is a process of interaction that will bring forth significant economic, social, and political change. The financial incentives propelling the dramatic growth of the secondary mortgage market are already changing the way that lenders, borrowers, developers, and investors in real estate interact. Likewise, the growth of the market is causing a reassessment of the proper role of state and federal governments in administering and developing the law of real property. Real property law is shifting from a matter of state and local concern to one of national concern so that the necessary resources of interregional, national, and international capital markets will continue to be available for real estate development.

The underlying forces at work in the secondary mortgage market also will dramatically affect the future of real estate transactions. The emergence of a successful secondary mortgage market is reshaping real estate transactions in a manner similar to the way that the emergence of the automobile changed society's view of distance. The automobile changed the manner in which people viewed the distances between home, work, and shopping and, at least in part, helped reshape the urban and suburban landscape of many metropolitan centers. Likewise, the secondary mortgage market is reshaping the goals, objectives, and economic incentives of parties to a real estate transaction.

This Article examines the secondary mortgage market and how that market acts as a catalyst for changing real estate transactions. In accomplishing this goal the Article considers: (1) the history of the secondary mortgage market; (2) the operation of the secondary mortgage market; and (3) the implications for change caused by the secondary mortgage market.

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I. History of the Secondary Mortgage Market

During the 1930s the economic depression had a devastating impact on real estate finance. The inability of homeowners to meet their payment obligations, under what we would today consider short-term mortgages, led to many foreclosures and to investors losing confidence in the mortgage lending system. In order to restore confidence in this sector of the economy and make home ownership more accessible, the federal government initiated a series of programs to develop both new mortgage instruments and a secondary market for mortgages.

A. Developing the Market

In 1934 Congress created the Federal Housing Administration (FHA) and provided for the development of mortgage insurance programs. FHA-insured loans were developed as a way to insure payment to a lender in the event of a borrower's default on a home mortgage. In 1944 Congress approved a similar program to provide loan guarantees for Veterans Administration (VA) loans. Both the FHA and VA loan programs, as they developed, supported new lending guidelines that led to smaller required downpayments and the acceptability of long-term (twenty to thirty years), fixed-rate mortgages. These programs improved lender confidence in real estate financing and made homeownership more accessible to home buyers.

Congress established the Reconstruction Finance Corporation (RFC) in 1935. One of the RFC's most successful programs involved the buying of FHA-insured and VA-guaranteed mortgages. This activity enhanced the liquidity of FHA and VA loans, made the loans more attractive to loan origi-
nators, and thereby assisted the development of mortgage markets.10

By 1938 Congress had created the Federal National Mortgage Association (FNMA or Fannie Mae), which joined with the RFC to develop the secondary mortgage market.11 The RFC, until its dissolution in 1948, concentrated primarily on the purchase of existing or seasoned mortgages on new houses in an effort to stimulate economic activity and new construction.12 The FNMA, on the other hand, used its buying and selling activities to advance a variety of policy goals.13 The FNMA supported, for instance, the continued marketability of FHA and VA loans with fixed interest rates. Fannie Mae also acted as a counterbalance to the cyclical effects of general business recessions and the monetary intervention of a more active federal government.14 The FNMA provided assistance for special housing projects that were unable to generate sufficient private investment, such as low income housing. Finally, Fannie Mae introduced new mortgage arrangements, including longer term financing with little borrower equity required at a time when such arrangements were otherwise untested in the private mortgage market.

In 1968 Congress divided the FNMA into two entities. One entity continued with the same name, but became a federally chartered corporation owned by private shareholders. The second entity, the Government National Mortgage Association (GNMA or Ginnie Mae), was a corporation established within the Department of Housing and Urban Development (HUD).15 As a result of the split the GNMA became primarily responsible for the government's special assistance and housing support programs. The

10. See id. at 118-19. The RFC quickly established the marketability of FHA mortgages by selling in 1936 all of the mortgages it acquired from loan originators in New York State to the comptroller of that state, at a profit. Id. at 118. By the end of 1937 the RFC had sold $6.5 million of FHA loans. Id.
11. O. JONES & L. GREBLER, supra note 3, at 118. The Federal Housing Administration issued a charter to the National Mortgage Association of Washington on February 10, 1938, which on April 5, 1938, was renamed the Federal National Mortgage Association (FNMA). Id. By the end of 1938 FNMA held more than $80 million in FHA-issued mortgages in its portfolio. Id.

14. The FNMA exerted this countercyclical influence by buying and selling loans from its mortgage portfolio and thereby affecting the amount of funds available to lenders. In times of "tight money," for instance, Fannie Mae would buy loans from lenders in order to provide them with cash for additional loans. When lenders had relatively more cash and fewer loan applications, the FNMA would sell loans to the lenders as investments.
15. FHLMC, THE SECONDARY MARKET, supra note 1, at 10-12 (Congress created GNMA in 1968 by partitioning the original FNMA in accordance with title III of the National Housing Act, 12 U.S.C. §§ 1716-1716b (1983)).
FNMA, on the other hand, began to concentrate on the secondary mortgage market activities of buying and selling loans for its portfolio, thereby increasing the liquidity and investment opportunities of loan originators.\(^6\)

As the FNMA and GNMA established a ready market for FHA and VA loans, conventional loans, which lenders primarily hold in their own portfolios, continued to be less liquid due to a lack of standard documentation and underwriting guidelines. As various regions of the country began to experience rapid growth and real estate development in the late 1960s, the illiquidity of conventional loans often left local lending institutions without sufficient funds.\(^7\) Although other areas of the country had excess funds, the secondary mortgage market was not yet broad enough to address completely the need for market reallocation of capital assets.\(^8\) Thus, in 1970 Congress created the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) in the Emergency Home Finance Act.\(^9\) The FHLMC, although authorized to purchase FHA and VA loans, focused primarily on conventional mortgages.\(^10\) At the same time, even though the FNMA was given new authority to purchase conventional mortgages, it remained active in FHA and VA loans.\(^11\) Together, the FHLMC and FNMA sought to increase the marketability of all mortgages by developing uniform standards to facilitate the purchase and sale of mortgages in the secondary mortgage market and thereby attract new sources of investment capital to the housing market.\(^12\)

By the 1980s the secondary mortgage market had become so successful and had reached such a level of volume and technological advancement that numerous private entities were entering the market.\(^13\) These private entities

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17. Id. at 12-13.
18. Id.
21. Id. at 10-11.
22. See Jensen, Mortgage Standardization: History of Interaction of Economics, Consumerism and Governmental Pressure, 7 REAL PROP. PROB. & TR. J. 397, 397-435 (1972) (discussing the contribution of FHA to standardization and the efforts of the FHLMC and FNMA to develop standardized forms to facilitate the secondary mortgage market and attract new capital assets to the housing market); see also O. JONES & L. GREBLER, supra note 3, at 45-49.
provided additional investment services and competed with the three major market entities, the FHLMC, FNMA, and GNMA.24

B. Recent Trends and Events

Recent events affecting the general economy have also had an impact on the developing secondary mortgage market. In the late 1970s and early 1980s market conditions proved to be unfavorable for mortgage lending institutions.25 The problem derived from the fact that most mortgage lending institutions borrowed funds for mortgage lending in the short-term credit markets, but held the mortgage loans in their portfolios as long-term investments.26 As interest rates reached higher and higher levels in the short-term credit markets, mortgage lenders were stuck with large portfolios of long-term, fixed-rate mortgages that provided a return that was less than their cost of funds.27 As the spread between the yield on their mortgage loan

1984] (market is so good that number of nongovernment related firms involved is "multiplying like rabbits").

Technological advances have played a crucial role in developing private participation in the secondary mortgage market. LaGesse, Mortgage Networks Arrange Loans on Computers, AM. BANKER, Jan. 23, 1984, at 1 (electronic advances and computer applications are facilitating expansion and efficiency of market); Merrill Lynch's Richard Pratt Discusses the Secondary Mortgage Market, 123 TR. & EST. 15, 15-20 (1984) [hereinafter cited as Merrill Lynch's Richard Pratt]. This article also stated:

The mortgage is a much more transaction-intensive vehicle than a U.S. government bond. You have a transaction associated with a mortgage every month, while with a long-term bond the figure is every six months. Computers allow these to be handled at low cost, and it also permits a very complicated assemblage of portfolios and investors to be coordinated. . . . [T]he secondary market could not have developed without technology, and it is the technological foundation that underlies [the growth of the] whole market.

Id. at 19.


27. See M. MADISON & J. DWYER, supra note 25, ¶¶ 2.01(1)-(3) (1981), 2.02(3)(a)-(d) (Supp. 1984); Browne, supra note 26, at 179-83. The Assistant General Counsel for the FHLMC explained:

The fundamental problems of the thrift industry, which is the largest supplier of
portfolios and their cost of funds decreased, in some cases becoming negative, mortgage lending became less attractive.  

The problem that these economic events presented to mortgage lenders was twofold. First, lenders could not attract sufficient funds to use for additional mortgage lending, and the funds that they could attract carried a higher average cost. Most mortgage lenders, including banks, savings and loan institutions, and other thrifts, depended on customer deposits for a substantial portion of the funds that could be used to support their lending activities. Government regulation kept the amount of interest that lenders could pay to depositors around five percent. At the same time mutual funds and other investments became increasingly popular as safe alternatives for depositing personal savings. Because mutual funds and other investments could pay higher interest on deposits, many people who would otherwise have kept their money in a local bank or savings institution moved their money into these higher paying investments. This process diminished the ability of mortgage lenders to attract significant amounts of low-cost cash deposits and forced them to look to short-term, high-cost markets to meet their cash requirements.

The second major problem for mortgage lenders concerned the structure of their investment portfolios. Many mortgage lenders had loan portfolios consisting of long-term, fixed-rate mortgages that carried interest rates far below the current market rates. Even though a portfolio of thirty-year mortgages might have a much shorter actual payoff period, averaging approximately twelve years, mortgage lenders still viewed such mortgages as unfavorable long-term investments.

Further aggravating the unfavorable

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home mortgage loans, have resulted from the practice of lending on a long-term basis with funds borrowed on a short-term basis, or "borrowing short and lending long." This practice has been particularly troublesome during times of high interest rates.

Id. at 181 (footnotes omitted).


29. See M. MADISON & J. DWYER, supra note 25, ¶ 2.01(1)-(3) (1981 & Supp. 1984). The consumer or household saver represents the most important source of net savings, representing between 66% and 80% of the gross national savings. Id. ¶ 2.01(1)(a). For these savings to flow into the mortgage market, the consumer or household sector must deposit them into the financial intermediaries such as banks, savings and loan institutions, life insurance companies, pension trusts, and real estate investments trusts. Id.

30. See Cowan & Foley, supra note 28, at 1075-78; Comment, supra note 26, at 95-102.

31. Cowan & Foley, supra note 28, at 1076 (other instruments included treasury bills and corporate debt).

32. Between 1980 and 1982, for example, the Dreyfus Liquid Assets no-load mutual fund investment account was providing returns of between 10% and 16%.

33. This outflow of investment or savings from low yielding investments is known as disintermediation. When disintermediation resulted in an outflow of funds from mortgage lenders, it reduced the amount of funds available for mortgage financing. See generally M. MADISON & J. DWYER, supra note 25, ¶ 2.01(1)-(3) (1981 & Supp. 1984) (discussing investment trends in relation to cash flow requirements); Browne, supra note 26, at 182.

34. See M. MADISON & J. DWYER, supra note 25, ¶ 2.20(3)(a)-(d) (Supp. 1984); Cowan & Foley, supra note 28, at 1075-78.

35. See Sloane, Your Money—New Version of Ginnie Mae, N.Y. Times, Apr. 30, 1983,
yield prospects for the mortgage lender's portfolio was the trend of state lawmakers and courts to declare due-on-sale clauses in mortgages unenforceable. The due-on-sale clause allows lenders to call the full amount of an outstanding loan due and payable or to adjust the interest rate on an old loan up to current market rates when a mortgaged property is transferred. The increasing inability to enforce the due-on-sale clause contained in outstanding mortgages meant that mortgage lenders were forced to wait longer periods of time to restructure already poorly performing loan portfolios. Specifically, the average thirty-year, fixed-rate mortgage with a below market rate of interest would likely stay on the books for a longer period of time. All of these factors added to the poor liquidity position of mortgage lenders and made their financial future appear rather bleak.

In responding to these market events, regulatory efforts addressed both the high cost of funds and the low yield on loan portfolios. With respect to the ability to attract funds, new regulations allowed mortgage lenders to phase out the cap on interest rates that they could pay depositors and also allowed lenders to develop new accounts and services that would appeal to a broader range of potential customers. These changes were designed to

§ L, at 30, col. 1. For example, with 30-year mortgages, anticipated yields on Ginnie Maes are quoted on the basis of a 12-year life span, rather than a 30-year life span, because of prepayments, defaults, and other causes that statistically reduce the life of a portfolio. Even with a 12-year projected life, however, these long-term, fixed-rate mortgages were proving unprofitable to lenders as a result of market changes in the 1970s and 1980s. *Id.*


38. M. MADISON & J. DWYER, *supra* note 25, ¶ 2.02(3)(a)-(e) (Supp. 1984). Important in this area were the following: (1) The authorization under the Economic Recovery Tax Act of 1981 of All-Savers certificates, which allowed lenders to attract deposits at below market rates of interest by allowing depositors a $1000 exclusion from gross income (I.R.C. § 28 (1982)); (2) Under the Depository Institutions Deregulation and Monetary Control Act of 1980 the regulated ceiling on interest rates payable on deposits was phased out and new accounts such as NOW accounts were authorized to pay market rates of interest while other provisions allowed for expanded services such as credit card issuing by federal savings and loan institutions (12 U.S.C. § 3503(a) (1982)). M. MADISON & J. DWYER, *supra* note 25, ¶ 2.02(3)(e); see Gurn, *Competitor in the Financial Sector*, OUTLOOK FED. HOME LOAN BANK SYS., Nov. 1984, at 6; Hermel, *The Future of the Federal Home Loan Bank System*, OUTLOOK FED. HOME LOAN BANK SYS., Nov. 1984, at 27 ("Overall, the asset size of the industry has grown at a rate of 19% a year since December, 1982, when the money market deposit account was authorized, effectively deregulating interest rates on most savings institution liabilities. In part, this substantial catch-up rate of growth reflects a catch-up from the artificially depressed growth rates of the early 1980's, which resulted both from disintermediation attributable to rate controls and the earning squeeze of that period."); How Thrifts Use Garn-St. Germain, OUTLOOK FED. HOME LOAN BANK SYS., Mar./Apr. 1984, at 14, 14-16; see also CONGRESSIONAL BUDGET OFFICE, THE HOUSING FINANCE SYSTEM AND FEDERAL POLICY: RECENT CHANGES AND OPTIONS FOR THE FUTURE 7 (1983) (discussing an administrative approach to meeting changing market needs).
bring deposits back into the lending institutions and provide an available source of funds for future loans.

Allowing lenders to pay higher rates to attract and retain new deposits would have served no purpose if the lenders could not afford to pay the higher market rates. The major roadblock to the lenders' ability to pay market rates of interest to depositors was the low yield on loan portfolios. Mortgage lenders needed to develop new mortgage instruments that could respond to long-term interest rate changes and thus improve their yield. Consequently, mortgage lenders developed a series of new mortgage instruments that featured adjustable rates of interest and resulted in a sharing of future interest rate risk between the borrower and the lender rather than having the lender assume all risk of interest rate change.

In conjunction with making mortgage interest rates more responsive to market conditions, federal legislation preempted state usury rate restrictions and due-on-sale clause prohibitions. Congress acted on the theory

40. See M. Madison & J. Dwyer, supra note 25, ¶ 2.02(3)(a)-(e) (Supp. 1984); Browne, supra note 26, at 179-224; Cowan & Foley, supra note 28, at 1075-96; Freeman, Alternative Mortgage Instruments and Potential Mortgage Enforcement Problems, 14 URB. LAW. 760, 760-64 (1982); Izeman, Alternative Mortgage Instruments: Their Effect on Residential Financing, 10 REAL EST. L.J. 3, 3-28 (1981); Marois, The Shake Out in Alternative Mortgage Instruments, 13 REAL EST. REV. 29, 29-33 (1983); Parks, Adjustable-Rate Mortgages—New Regulations for National Banks and Federal Savings and Loan Associations, 70 ILL. B.J. 126, 126-30 (1981); Comment, supra note 26, at 95-128. All of these above-referenced materials provide explanation of various new mortgage instruments, how they work, and what their effect is likely to be in the market place. See also THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING 150-52 (1982) [hereinafter cited as PRESIDENT'S COMMISSION] (recognizing the need to encourage the development and use of alternative mortgages in addition to the use of the fixed rate, long-term mortgage); Gutten tag, supra note 25, at 232-42 (identifying the potential variety of adjustable rate mortgages).


42. See Nelson & Whitman, Congressional Pre-emption of Mortgage Due-On-Sale Law: An Analysis of the Garn-St. Germain Act, 35 HASTINGS L.J. 243, 243-312 (1983). This article provides an excellent overview of the Garn-St. Germain Depository Institution Act of 1982 (Pub. L. No. 97-320, 96 Stat. 1469 (1982)). The authors discuss the enforceability problems of due-on-sale clauses, the types of lenders and loans covered by the federal preemption provisions of the Act, and the operation of a "window period" for preemption in the various states. Id. at 260-309. The Act leaves some room for individual states qualifying for a "window period" of exemption to extend the exemption from federal preemption, but in no case can a state absolutely prohibit enforcement of the due-on-sale clause. Id. at 296. See also Barad & Layden, Due on Sale Law as Pre-empted by the Garn-St. Germain Act, 12 REAL EST. L.J. 138, 138-50 (1983) (discussing the implications of federal preemption of due-on-sale state laws); Berryhill, supra note 36, at 35-116 (identifying the factors that must be considered when preparing to litigate a due-on-sale clause case); Blocher, supra note 36, at 49-99 (discussing the due-on-sale clause and the secondary mortgage market); Herron, Federal Home Loan Bank Board: Pre-Emptive Rights or Unbridled Powers?, 12 CAP. U.L. REV. 529-43 (1983) (examini-
that if only adjustable and competitive mortgage interest rates could keep mortgage lenders profitable and thereby assure the availability of loanable funds for home buyers, then artificial caps on interest charges needed to be reduced, as did the barriers to loan liquidity caused by the reluctance of individual states to enforce the due-on-sale clause.

Federal efforts were necessary in these areas of state real property law, usury rates, and mortgage due-on-sale clauses because the developing national mortgage markets and the integrated national housing markets required enhanced uniformity for market efficiency rather than diversity and fragmentation. The secondary mortgage market should play an important role in keeping individual states supportive of these federally legislated measures because the goals of these measures are to assist mortgage lenders and thus, ultimately, real estate developers, investors, and home buyers that depend on financially healthy lending institutions. Through the buying and selling of mortgages and mortgage-related securities, the secondary market can direct funds in or out of states with divergent local law, such as states that fail to enforce the due-on-sale clause. In this way the market will reward or punish states for the way in which their local law corresponds to investor desires and expectations at a national level. Consequently, pressure for national standardization and uniformity of real property law, designed to expand and facilitate, rather than hinder, the activity of the market has increased. Increased standardization and uniformity should improve market efficiency, provide mortgage lenders with greater liquidity and profitability, and reduce mortgage costs to homebuyers.

43. See generally Flick, Mortgage Markets and Mortgage-Related Securities: Developments and Implications, 44 Mortgage Banking 54, 64 (1984) (discussing how structural changes within mortgage lending system influenced 1983 housing boom); note 162 infra (for further discussion).

44. See generally President's Commission, supra note 40, at 173-56 (discussing need to use different types of mortgages).

II. THE OPERATION OF THE SECONDARY MORTGAGE MARKET

Analysis of the operation of the secondary mortgage market requires discussion of major market participants, major market offerings, current efforts to expand the market, and reasons for participating in the market. In order to discuss these elements of the market's operation, a definition of what is meant by the secondary mortgage market is also required. For the purposes of this Article, the secondary mortgage market is to be understood as that wide range of mortgage loan activities consisting of packaging, pooling, buying, selling, and reselling of whole loans, loan participations, or bonds or securities backed by mortgages. The development of futures trading or of an organized exchange in trading whole loans, loan participations, or bonds or securities backed by mortgages is also relevant to the definition because such activity makes the secondary mortgage market more accessible and acceptable to investors.46 This broad, comprehensive definition provides a most useful approach, for the objective of this Article is not to belabor the mechanics of technical asset and liability accounting, but rather to provide a critical evaluation of the manner in which the secondary mortgage market is changing the structure and definition of real estate transactions.47 Such a definition focuses broadly on the nature of the secondary financial and economic activity. This overview provides a thorough background from which to observe that the economic incentives of the secondary mortgage market are changing the way that developers, mortgage lenders, borrowers, and sellers

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holding long-term mortgages); *Shattering Traditions*, supra note 24, at 2-11 (secondary mortgage market allows for greater liquidity, profitability, and for hedging investments against inflation).

46. *See President's Commission*, supra note 40, at 55-56 (discussing traded options and futures markets); Cahnman, Kamradt & Otto, supra note 45, at 11-16 (discussing futures trade on the Chicago Board of Trade); *A Commercial Mortgage Rating System*, 17 LAND USE DIG., Dec. 15, 1984, at 3 [hereinafter cited as *Rating System*] (discussing a commercial mortgage rating system by Standard & Poor's Corporation); Labuszewski & Meisner, *Controlling Mortgage Pipeline Risk*, 44 MORTGAGE BANKING 45, 45-50 (1983) (discussing futures trade on the Chicago Board of Trade); *A Mortgage Exchange*, 18 LAND USE DIG., Feb. 15, 1985, at 2 (a national mortgage exchange similar to the New York Stock Exchange has been proposed by the chairman and president of FNMA).

47. My definition of the secondary mortgage market is more comprehensive than definitions offered by others who have written in the area. For instance David F. Seiders has said:

Our definition of secondary market requires that mortgage assets change hands because there is a fundamental difference between sales of assets and borrowing to finance holdings of assets; the definition requires exchanges of mortgage assets for cash because this paper . . . is concerned primarily about flows of funds to mortgage borrowers. These two requirements exclude . . . (1) "swaps" of mortgages by private institutions for Fannie Mae—or Freddie Mac—guaranteed pass-through securities that represent ownership interests in the same mortgages; and (2) issues of mortgage-backed bonds and resales of these bonds. . . . [S]waps increase the quality and liquidity of mortgage assets . . . but the swaps (per se) are irrelevant from a flow-of-funds point of view. Mortgage-backed bonds . . . [are] a form of borrowing rather than a sale of assets. *Seiders, The Future of Secondary Mortgage Markets: Economic Forces and Federal Policies*, 3 HOUSING FIN. REV. 319, 322-23 (1984) (footnote omitted); see also O. Jones & L. Grebler, *supra* note 3, at 4-5 (these authors define the secondary mortgage market as not including loan activity when an advance commitment is in place for another lender to purchase the originator's future loans before they are made).
interact and altering the way in which we, as a society, view the respective roles of state and federal government.

**A. Major Participants**

The major participants in the secondary mortgage market include the GNMA, FNMA, and the FHLMC. Certain private entities are also heavily involved, but the GNMA, FNMA, and FHLMC remain responsible for most of the activity in the secondary mortgage market.48

1. **GNMA.** The GNMA was created by Congress in 1968 and through its secondary mortgage market activities supplies mortgage credit for government housing objectives in that segment of the housing market for which conventional financing is not readily available.49 The GNMA primarily deals with the purchase of subsidized and unsubsidized single-family and multi-family FHA and VA mortgages.50 The GNMA also guarantees pass-through mortgage-backed securities that are issued by HUD-approved mortgagees and that represent interest in FHA, VA, and FmHA (Farmers Home Administration) mortgages.51 The GNMA is a wholly owned government corporation within HUD, and its mortgaged-backed securities carry the full faith and credit of the United States.52

2. **FNMA.** Congress created the FNMA in 1938 as a wholly owned government corporation, but in 1968 Fannie Mae became owned by private shareholders.53 The FNMA purchases single-family and multi-family FHA, VA, and conventional mortgages.54 The parties from whom the FNMA buys consist primarily of mortgage companies, mutual savings banks, commercial banks, credit unions, savings and loan institutions, and for second mortgages, finance companies.55 The FNMA issues guaranteed Mortgage-Backed Securities (MBSs), which are backed by loans in its own portfolio as

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48. See Mortgage-Related Securities, supra note 24, at 1 (“The three quasi-public secondary mortgage market agencies—FNMA, GNMA, and FHLMC—accounted for 95% of the mortgage-backed securities volume transacted by the end of 1983.”); Shattering Traditions, supra note 24, at 2, 4 (in 1983 the FHLMC, FNMA, and GNMA accounted for over 61% of the secondary mortgage market); Wantuck, supra note 24, at 32-35.

49. FHLMC, THE SECONDARY MARKET, supra note 1, at 11 (GNMA was created by Congress in 1968 in conformance with title III of the National Housing Act, 12 U.S.C. §§ 1716-1716b (1978)).

50. FHLMC, THE SECONDARY MARKET, supra note 1, at 10 (in 1968, in conformance with title III of the National Housing Act, 12 U.S.C. §§ 1716-1716b (1978), FNMA was partitioned into GNMA and FNMA); see supra note 15 and accompanying text.

51. Id.

52. Id. As of December 1982 GNMA had guaranteed more than $143 billion of GNMA securities. Id.

53. FHLMC, THE SECONDARY MARKET, supra note 1, at 11.

54. Id.

55. Id.; Leibold, Uniform Conventional Mortgage Documents: FHLMC Style, 7 REAL PROP. PROB. & TR. J. 435, 438 (1972) (FNMA's traditional market has been with mortgage bankers who typically roll over mortgages very quickly).
well as by participations in loans that are pooled or packaged through other lenders.\textsuperscript{56} Even though FNMA stock is publicly traded, the FNMA is subject to the regulatory authority of the Secretary of HUD, and the U.S. Treasury stands behind FNMA obligations with discretionary authority to purchase up to $2.25 billion of FNMA debt.\textsuperscript{57} As a result, the FNMA is considered by the credit markets as having "agency status."\textsuperscript{58}

3. \textit{FHLMC}. Congress created the FHLMC in 1970 primarily to provide liquidity for mortgage lenders by developing and maintaining the secondary mortgage market in conventional residential mortgages.\textsuperscript{59} The FHLMC buys conventional, FHA, and VA single-family and multi-family loans as well as home improvement loans.\textsuperscript{60} Sellers to the FHLMC consist primarily of savings and loan institutions, but also include mortgage bankers and commercial banks.\textsuperscript{61} The FHLMC sells mortgage-backed securities, issues other securities that are debt obligations secured by conventional mortgages, and operates a guarantor program.\textsuperscript{62} Because the FHLMC is a corporation whose stock is wholly owned by the twelve Federal Home Loan Banks,\textsuperscript{63} the FHLMC is able to elevate its securities to the status of obligations of the United States.\textsuperscript{64}

4. \textit{Private Entities}. Several private entities buy, package, and sell mortgages and mortgage-related securities.\textsuperscript{65} For the most part, these private entities concentrate on pools of individual mortgages that exceed the statutory limits on loans that the FHLMC and FNMA can purchase.\textsuperscript{66} Private

\textsuperscript{56} \textit{FHLMC, The Secondary Market}, supra note 1, at 10-11; see \textit{infra} note 104 and accompanying text.

\textsuperscript{57} \textit{FHLMC, The Secondary Market}, supra note 1, at 11.

\textsuperscript{58} \textit{Id.}

\textsuperscript{59} \textit{Id.} at 9 (FHLMC was created by Congress in 1970 in conformance with title III of the Emergency Home Finance Act of 1970, 12 U.S.C. §§ 1451-1459 (1978)).

\textsuperscript{60} \textit{FHLMC, The Secondary Market}, supra note 1, at 9.

\textsuperscript{61} \textit{Id.}; \textit{Leibold, supra} note 55, at 438 (traditionally the FHLMC market has primarily consisted of savings and loan associations).

\textsuperscript{62} \textit{FHLMC, The Secondary Market}, supra note 1, at 9-10; \textit{Strine, supra} note 52, at 1023.

\textsuperscript{63} \textit{FHLMC, The Secondary Market}, supra note 1, at 9-10; \textit{Strine, supra} note 52, at 1023.

\textsuperscript{64} \textit{See} \textit{Merrill Lynch's Richard Pratt, supra} note 23, at 15; \textit{Wantuck, supra} note 24, at 34.

\textsuperscript{65} \textit{See supra} note 23.

\textsuperscript{66} \textit{FHLMC, The Secondary Market, supra} note 1, at 8; see \textit{Wantuck, supra} note 24, at 33, 35. At the time the statutory limit was $108,300 and private parties had unsuccessfully objected to efforts to raise that limit to facilitate financing to high-cost regions of the country. The objectors argued that such areas were not relevant for federal intervention since a $108,300 loan required a family income of $60,000. \textit{Id.} at 33, 35. In essence the objectors claimed that the private market could accommodate these loans and that people in this income range were not the type of people in need of federal assistance. \textit{Id.} at 35.

The new loan limits, effective for mortgage purchases on or after Jan. 1, 1985, are as follows: $115,300 for mortgages of single family homes; $147,500 for mortgages on two-family homes; $178,200 for mortgages on three-family homes; $221,000 for mortgages on four-family homes. These maximum loan limits are 50\% higher for homes in Alaska, Hawaii, and Guam for FNMA and in Alaska and Hawaii for FHLMC since these areas are considered high-cost housing areas. In second mortgages on a one-to-four family home the FNMA and FHLMC limit is $57,650 and in Hawaii it is $86,450. If both the first and second mortgage on a prop-
entities concentrate their activities in this area because the government relationship attributed to the GNMA, FNMA, and FHLMC allow those entities a better reception in the credit markets for their mortgage-related securities. Private entities thus are hindered more by higher costs than are GNMA, FNMA, and FHLMC in the competition for the same mortgages.

Private mortgage insurance companies (PMICs) are important to the successful market operation of private entities in the secondary mortgage market. PMICs insure the obligations of the underlying conventional mortgages in a fashion similar to the FHA insurance provided in FHA loans. PMICs and the FHA differ, however, in that the FHA will insure a lender for the full amount of an outstanding loan in the event of default by a borrower, but the PMIC typically will insure only the top twenty-five to thirty percent of a loan. This limitation is significant if a borrower defaults and the property is sold at a foreclosure sale for less than the amount that is owed on the outstanding loan. With insurance provided by a PMIC, the lender will be insured against the shortfall only to the extent of the PMIC exposure level of twenty-five to thirty percent. Any shortfall in foreclosure sale proceeds beyond the insured level will be borne by the lender. In addition to this insurance function, PMICs can provide a modified guarantee for mortgage-related securities that are issued by private entities and act as conduits for groups of primary mortgage lenders that individually lack a sufficient volume to participate in the secondary mortgage market.

**B. Major Offerings**

The major offerings in the secondary mortgage market that will be discussed in this Article include: the private sale of whole loans or participations; Ginnie Mae Securities; Mortgage-Backed Securities (MBSs) issued through the FNMA; Participation Certificates (PCs) and Collateralized Mortgage Obligations (CMOs) issued through the FHLMC; Swap programs run by the FNMA and FHLMC; and mortgage-backed bonds. The growth of activity in the secondary market offerings has been dramatic: an estimated sixty-five percent to seventy-five percent of all new loans are presently sold through the market. As the secondary mortgage market matures and ex-

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67. Lance, supra note 45, at 430-34; Wantuck, supra note 24, at 32-35.

68. Lance, supra note 45, at 430-34 (because private entities need to provide a higher return to investors, their offerings are, in essence, more costly); Wantuck, supra note 24, at 32-35.

69. FHLMC, THE SECONDARY MARKET, supra note 1, at 8-9; P. Goldstein, supra note 2, at 308-10 (FHA insurance provided 100% coverage on the loan amount whereas PMI generally insures the top 25% of value on a loan not exceeding 95% of the property's value that is securing the loan).

70. See Kanner, Financing Ideas, 10 REAL EST. L.J. 344, 346 (1982); Lance, supra note 45, at 427; Strine, supra note 52, at 1012-13, 1040.

71. FHLMC, THE SECONDARY MARKET, supra note 1, at 8-9.

72. Shattering Traditions, supra note 24, at 2, 5; see also Brendsel, Home Mortgages Learn to Compete in the Capital Markets, TR. & EST., July 1984, at 35, 37 (illustrating the dramatic growth in sale of securitized mortgage pools, the article identifies an increase in sales from 50
pands, mortgage-related securities are becoming more competitive with corporate securities in the investment market.\textsuperscript{73}

In considering specific market offerings two concepts must be defined. The first concept is mortgage pooling or packaging. Single home loans are not sold individually into the secondary mortgage market; they must be "pooled" or "packaged." For purposes of this Article, the terms "pooling" and "packaging" refer to the process whereby primary mortgage lenders, also known as originators, group similar loans together to create a sufficient basis for investment. The resulting pool or package of loans is sold to investors or used as the security for the offering of a mortgage-backed security.\textsuperscript{74}

The second concept is that of a pass-through security. The sale of a loan participation or of a mortgage-backed security is said to be a pass-through security when the monthly payments of principal and interest on each of the underlying mortgages merely passes from the party servicing the loans, less a fee for servicing, to the investor.\textsuperscript{75} With a straight pass-through security, the investors get only their respective share of the funds actually collected on the loans. Thus, if some of the borrowers do not make their monthly payments, the investors receive less for that month.

Pass-through securities can also be fully or partially modified. A fully modified pass-through security involves an arrangement in which the monthly pass-through of principal and interest is fully guaranteed by an entity such as the GNMA, FNMA, or FHLMC.\textsuperscript{76} The guarantee means that investors will receive a stated amount each month even if some borrowers

\textsuperscript{73} See Bogdanich, \textit{Funds that Buy Ginnie Maes Are Luring Investors}, Wall St. J., Apr. 24, 1985, at 35, col. 2 (Ginnie Maes securities are becoming increasingly popular investments); Monroe, \textit{supra} note 23, at 23, col. 3 (Henry Kaufman, Chief Economist for Salomon Brothers, Inc., says that the market for mortgage-related investments has become so successful that it may pose a threat to the corporate bond market; he is concerned that there may be a crowding-out of the corporate borrower in the market place); \textit{Mortgage-Related Securities, supra} note 24, at 1 (mortgage-related securities are viewed as serious competition to other investments by Kenneth Leventhal & Company).

\textsuperscript{74} See generally Kanner, \textit{supra} note 70, at 344-46 (similar type mortgages are packaged together to provide an investment opportunity with a greater and more predictable cash flow and life expectancy; packages also are designed to make investment supervision by the investor more manageable than trying to deal with numerous individual loans).

\textsuperscript{75} See Lance, \textit{supra} note 45, at 427; Strine, \textit{supra} note 52, at 1012-13, 1040. Servicing a loan involves the process of collecting the monthly payments from the borrowers, keeping the books, and remitting the pass-through amount to investors. Some loan organizations continue to service their loans for the fee income it generates, but others contract away the servicing responsibilities. (One savings and loan institution in Lubbock, Texas, informed me through their accounting department that they received 5% of collections plus any prepayment penalties and all origination fees when they serviced loans sold to investors through the secondary mortgage market.) In packaging arrangements the actual mortgages themselves are typically held by a trustee or custodian for the benefit of the payment guarantor or for the benefit of the holder of the security. \textit{See id.} at 1012-13.

\textsuperscript{76} See Lance, \textit{supra} note 45, at 427; Strine, \textit{supra} note 52, at 1040.
fail to make their monthly payments. A partially modified pass-through security generally involves a guarantee by a PMIC to insure against a shortfall in actual collections relative to the expected pass-through amount, usually five or ten percent. This partial guarantee means that the PMIC will make up for any shortfall in actual monthly payments from borrowers up to the predetermined level of five or ten percent. Any shortfall beyond the insured amount represents a reduction in return to the investors.

1. **Private Sales.** Private sales typically consist of the sale of whole loans or loan participations to private investors without using a government agency as an intermediary. The private sale of whole loans is a significant if not major part of the secondary market; in 1982 such sales amounted to approximately $35 billion. In addition to selling whole loans to other investors, loan originators also sell loan participations, which allow investors to purchase a share in the expected return on the mortgage pool. In arranging these sales, the loan originator may negotiate directly with the investor or the lender may choose to use a conduit, such as a PMIC, to package the loans or issue pass-through securities to investors.

Lenders generally sell their whole loans and participations to insurance companies, pension funds, commercial banks, mutual savings banks, or savings and loan institutions. The sale or participation agreement contains loan and performance requirements and establishes a servicing arrangement. When whole loans are sold the servicing function is frequently transferred as well, but when a loan participation is sold the loan originator almost always continues to service the loans.

If the mortgages are converted to pass-through securities to be issued by private entities rather than by governmental entities, then compliance with

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77. See Kanner, supra note 70, at 346 (as to the use of PMI to insure the pool); Lance, supra note 45, at 427; Strine, supra note 52, at 1040.


79. See FHLMC, The Secondary Market, supra note 1, at 22.

80. See id.; Nelson, Special Report 1983, supra note 23, at 18-20, 71. The private conduits or entities that get involved in the secondary mortgage market generally assist in the sale of whole loans, loan participations, or mortgage-related securities that are not readily salable to the government-related entities, GNMA, FNMA, and FHLMC. Id. For a discussion of the activities of private entities, see supra notes 65-71 and accompanying text.

81. FHLMC, The Secondary Market, supra note 1, at 22; see also Ramzy, A Secondary Market for Privately Held Purchase Money Mortgages?, 13 REAL EST. REV. 84, 84-88 (1983) (indicating a growing market potential for individuals as sellers and investors in private purchase money mortgages).

82. See FHLMC, The Secondary Market, supra note 1, at 22. Matters of specific negotiation will include the following: (1) whether whole loans or participations are sold; (2) yield to the investor; (3) total dollar amount of a transaction; (4) fees paid to the purchaser at time of commitment; (5) whether or not servicing is released; (6) type of properties; (7) location of properties; (8) maximum and minimum loan amounts; (9) loan-to-value ratios on the underlying mortgages; (10) method of monthly remittance to investor; (11) coupon rate of loans in package; (12) whether funding shall be immediate or in the future; (13) underwriting standards to be applied; and (14) type of loan documents used. Id.

83. See id.
the regulations of the Securities and Exchange Commission is required. Generally, the pools include only single-family conventional mortgage loans on owner-occupied residences. Lenders typically base these mortgages on a loan-to-value ratio of eighty percent or less, but this ratio can be higher if private mortgage insurance is used on the underlying mortgages. Standard & Poor's provides a rating service for these private issues. The size of a pool of loans supporting such an issue may vary, but is usually a minimum of $20 million for a public offering of the securities and $10 million for a private placement of the securities. When a lender has less than these minimum amounts, it can use a PMIC to pool its loans with the loans of other lenders.

2. Ginnie Maes. Ginnie Mae issues three basic types of securities: (1) straight pass-through securities, in which the GNMA guarantees the payment of principal and interest as collected; (2) fully modified pass-through securities, in which the GNMA guarantees the full payment of interest and principal whether or not it is actually collected; and (3) bonds that provide semi-annual interest payments and periodic redemption and are subject to call. Generally, the loans in the pool that supports any given Ginnie Mae security must have the same lender and must be of similar type with respect to interest rate, the type of property (single-family or multi-family) that secures the loan, and maturity. In 1983, however, the GNMA introduced a new security known as the Ginnie Mae II. This security can be backed by a pool of mortgages with different individual interest rates. The Ginnie Mae II works on the concept of jumbo pools, which combine mortgages from many different lenders into a single package. Larger pools offer the opportunity for regional diversification of loans within a package and should provide a better statistical basis for projecting actual prepayment schedules. All of the GNMA guarantees are backed by the full faith and

84. See id. at 30.
85. See id. Seasoned loans, loans that are one year or more old, and variable rate loans can be included. Id. Special pools may also be formed to offer mortgage-backed securities when all of the underlying mortgages are on multi-family housing units or are all second mortgages.
86. See id.
87. See id. General requirements for the pool will be set by the agency that issues the security and will include 5% mortgage guarantee insurance and 1% special hazard insurance in order to get an AA rating from Standard & Poor's. Id.
88. See id.
89. See id. at 30-31.
90. Miller, Regulation of Trading in Ginnie Maes, 21 DuQ. L. REV. 39, 42 (1982). This article provides a detailed background to Ginnie Maes.
91. FHLMC, THE SECONDARY MARKET, supra note 1, at 29.
92. Sloane, supra note 35.
93. Id. The original Ginnie Mae I represented a pool of about 50 FHA or VA mortgages generated by a single lender. Id. The new Ginnie Mae II pools are much larger and, although they typically require the pooling of mortgages from several different lenders, a sole issuer with a large volume of loan originations may generate the entire pool. Id.
94. Id. Ginnie Maes have a maximum life of 30 years, but their anticipated yields are quoted on a 12-year life. Id.
credit of the United States.95

If a lender wants to hold Ginnie Maes in its portfolio or sell them, it must assemble a pool of mortgages and complete required documentation in order to obtain approval from the GNMA for a guarantee.96 Subject to favorable review, the GNMA issues a commitment to guarantee and assigns a pool number.97 When the GNMA issues a guarantee the underlying mortgages are delivered to a custodian under a custodial agreement.98 Under that agreement, the custodian holds the mortgages for the benefit of the GNMA and upon default, which is the failure of the lender to meet the continuing terms of the GNMA guarantee agreement, endorses the mortgages and delivers them to the GNMA.99

The individual lenders continue to service the loans and to remit monthly interest and principal payments to Ginnie Mae certificate holders.100 For the Ginnie Mae II securities, servicers collect the principal and interest payments and deliver them to Chemical Bank in New York.101 Chemical Bank, acting as central paying agent, then pays each Ginnie Mae II certificate holder through a single monthly check regardless of the amount of securities purchased.102 This innovation saves time and money by eliminating the prior practice of issuing separate individual checks for each pass-through security. This device, along with the introduction of book entry transfers in 1985, has also enhanced the volume of transactions that can be handled in the market.103

The typical lender involved in issuing Ginnie Maes is a mortgage banking company, but some savings and loan institutions, savings banks, commercial banks, and credit unions also issue Ginnie Maes.104

3. MBSs and PCs. The FNMA may purchase whole loans or participations on which Mortgage-Backed Securities (MBSs) are issued and offered to investors, or for a fee it may issue MBSs to be returned to the portfolio of the original lender or originator.105 Likewise, the FHLMC may purchase whole

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95. See Strine, supra note 52, at 1013-14.
96. FHLMC, The Secondary Market, supra note 1, at 29; Strine, supra note 52, at 1014-15.
97. See FHLMC, The Secondary Market, supra note 1, at 29; Strine, supra note 52, at 1015.
98. See FHLMC, The Secondary Market, supra note 1, at 29; Strine, supra note 52, at 1016.
99. See Strine, supra note 52, at 1016.
100. See FHLMC, The Secondary Market, supra note 1, at 29.
101. See id.
102. See id. (using the central paying agent reduces paperwork for the investors receiving monthly payments because they receive one total check for their investments rather than numerous checks); see also Pierce, Ginnie Mae's Success Story How 54 People in Washington Attract Billions to the Mortgage Market, Outlook Fed. Home Loan Bank Syss., Nov. 1984, at 8, 10 (referring to the use of the central paying agent and also stating that the value of trades in Ginnie Maes at present is approximately $3.6 billion a day).
104. See FHLMC, The Secondary Market, supra note 1, at 29.
105. See id. at 26-28, 33-34.
loans or participations on which its Participation Certificates (PCs) are issued, or for a fee it may issue PCs for return to the portfolio of the original lender.\textsuperscript{106} PCs and MBSs, whether sold directly to investors by the FNMA or FHLMC or simply returned to the portfolio of the originating lender, each offer purchasers a guarantee providing for a fully modified pass-through security,\textsuperscript{107} and each represents an undivided interest in conventional and seasoned FHA and VA mortgages.\textsuperscript{108}

Each entity, the FNMA and FHLMC, has its own procedure and guidelines for sales, participations, and issuing of securities.\textsuperscript{109} If the issues are packaged and returned to the lender or loan originator, they can be held in portfolio as a more liquid asset than the previously held mortgages.\textsuperscript{110} The loan originators generally retain responsibility for servicing the loans.\textsuperscript{111}

In addition to these activities, the FHLMC and FNMA offer a swap program that involves the exchange of a lender’s mortgages for the FHLMC’s PCs or the FNMA’s MBSs.\textsuperscript{112} When the lender receives the PCs or MBSs, it generally sells them to market investors.\textsuperscript{113} This process provides liquidity for mortgage lenders while creating an infusion of new loanable funds that can provide many additional home loans for homebuyers.\textsuperscript{114} The swap program is not inconsequential and amounted to as much as $32.84 billion in 1982 and $24.57 billion in 1983.\textsuperscript{115}

4. CMOs. Collateralized Mortgage Obligations (CMOs) are mortgage-backed securities that the FHLMC pioneered.\textsuperscript{116} In the first three months of 1984 CMOs constituted approximately one-third of the amount raised by all

\textsuperscript{106} See id. at 23-25, 31-33. FHLMC also issues a security known as the Guaranteed Mortgage Certificate, which is likewise backed by mortgages but pays investors semi-annually. Id. at 50; Strine, supra note 52, at 1023-25.

\textsuperscript{107} See FHLMC, THE SECONDARY MARKET, supra note 1, at 9, 11, 21.

\textsuperscript{108} See id. at 21.

\textsuperscript{109} See id. at 23-25, 26-28, 31-34 (setting out the procedures and guidelines).

\textsuperscript{110} See, e.g., id. at 50.

\textsuperscript{111} See id. at 23-25, 26-28, 31-34.

\textsuperscript{112} See Flick, supra note 43, at 58.

\textsuperscript{113} See, e.g., Mortgage Swapping Creates $10 Billion in New Funding, Washington Post, Sept. 10, 1983, at E28, E30, col. 2 (Financial Corp. of America arranged to make several swaps with FHLMC starting with a $2.6 billion swap in which it intended to sell the PCs to investors and use the cash to make additional home loans).

\textsuperscript{114} Id. (The $2.6 billion initial swap between Financial Corp. of America and FHLMC is expected to fund about 32,500 new homes).

\textsuperscript{115} Flick, supra note 43, at 58. The FHLMC accounted for $21.94 billion in 1982 and $15.54 billion in 1983; FNMA accounted for $10.9 billion in 1982 and $9.03 billion in 1983. Id. These activities are in addition to other programs, including the direct cash purchase programs, designed to add loans to the FHLMC or FNMA loan portfolio in order to provide assured liquidity and new cash for continued lending by primary mortgage lenders. These other programs amounted to $2.2 billion in 1982 and $4.2 billion in 1983 for FHLMC, and to $3.1 billion in 1982 and $4.3 billion in 1983 for FNMA. Id.

\textsuperscript{116} See Brendsel, supra note 72, at 35; Maller, The Collateralized Mortgage Obligation: The Latest Phase in the Evolution of Mortgage-Backed Securities, 13 REAL EST. L.J. 299, 299-314 (1985) (good background discussion of the CMO); see also 4 FREDDIE MAC REP., Jan. 1986, at 4 (the success of the FHLMC CMO has brought private companies into the market, such as American Savings and Loan, which issued a $220 million CMO in December of 1985).
SecondarY mortgage market

Corporate debt issues. In addition to bringing billions of dollars into the primary mortgage markets, CMOs are given credit for lowering the cost of home mortgages by twenty-five basis points or one-quarter percent between June and December of 1983. Unlike other pass-through securities, the CMO does not provide monthly payments to investors. Instead, the issuing entity makes interest payments at the coupon rate on the outstanding principal balance in the same manner that payments are made on corporate bonds.

The FHLMC designed CMOs to make investments in mortgage-backed securities more manageable and thus more appealing to investors. Mortgagors on the underlying mortgages in a mortgage pool tend to prepay or default on their loans faster as interest rates fall and to repay more slowly as interest rates rise. Consequently, the actual life and yield of an investment in a mortgage-backed security is unpredictable.

Freddie Mac developed the CMO in an attempt to deal with these problems. A single pool of mortgages provides a payment stream that is allocated serially to several classes of securities. Each class has its own yield, and investors can invest in the particular class of their choosing. All investors receive semiannual interest payments in accordance with the coupon rate for their class. Principal payments on the underlying mortgage loans are combined and paid first to the holders of the shortest-maturity bonds. When the first class is fully retired, all of the principal is paid next to the holders of the intermediate-maturity bonds. The longest-maturity bonds do not receive principal until all other classes are retired.

By dividing the pool into these various investment classes, investors can more easily predict payment and yield on their investment. As a result CMOs have been able to attract investors at lower interest rates than other mortgage-backed securities. The ability to attract investors at lower yields means that the CMO can be offered at a lower cost or rate, and the savings can ultimately be passed on to homebuyers in the form of reduced mortgage rates.

117. See Brendsel, supra note 72, at 35.
118. See id.; CMOs and the Secondary Markets, Tr. & Est., July 1984, at 39. This cost reduction of 1/4% is attributed to CMOs by analysts at the National Association of Realtors. Id.
120. See Brendsel, supra note 72, at 35.
121. See id.
122. See id.
123. See id.
124. See id.
125. See id.; Maller, supra note 116, at 307 (such a series might be classified as fastest maturity of 3.2 years; intermediate maturity of 8.6 years; and slowest maturity of 20.4 or more years).
126. See Brendsel, supra note 72, at 35.
127. Id.
128. Id.
129. Id. at 36.
130. Id.
5. **Bonds.** Private issuers in the secondary mortgage market issue two basic types of bonds: (1) mortgage-backed bonds (MBBs); and (2) pay-through bonds. These bonds represent a debt obligation of the issuer that is collateralized by mortgage loans. The holders of the underlying loans for both types of bonds do not sell the loans, but rather pledge them to repay the debt. The loans cannot be used for any other purpose until the holders repay the debt represented by the bonds.

Typically, MBBs are used by institutional lenders with respect to old and very low interest rate loans that are not marketable for use with mortgage-backed securities. For this reason, they are generally over-collateralized to the extent of 150 percent to 200 percent of the indebtedness. The bonds generally have a maturity of five to ten years with the total amount of debt due and payable at maturity. The MBB pays interest to investors semiannually. The pay-through bond, on the other hand, is a modified pass-through security that provides monthly payments to investors. Payments from the underlying mortgages are thus distributed to the investors, but unlike a standard pass-through security, investors have not purchased an ownership interest in the underlying mortgages. The mortgages simply collateralized the contractual debt obligation of the issuer.

Issuers of these types of bonds include homebuilders, commercial banks, PMICs, savings and loan institutions, and investment banks. Homebuilders have recently found the pay-through bond attractive and have used it to raise additional funds for their construction activities. Using the pay-through bond, small homebuilders have successfully pooled their purchase money mortgages on homes that they have built and sold bonds in order to increase cash flow and compete with larger volume builders.

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133. FHLMC, The Secondary Market, supra note 1, at 35.
134. Id.: “The collateralization must be maintained at some established percentage of indebtedness through the addition of loans, as the outstanding principal balance of the collateral loan balances is reduced through amortization and payoffs.” See also Maller, supra note 116, at 303-04: “This overcollateralization is attributable to several investor concerns about (1) repayment of principal between valuation dates, (2) possible impairment of the value of the collateral due to increases in interest rates, and (3) receiving protection against defaults of the mortgages.” Id. at 304 (footnote omitted). Investors also require over-collateralization because these bonds are debt obligations of the issuer and, therefore, raise concerns about the creditworthiness of the issuer. Id. at 303-04.
135. FHLMC, The Secondary Market, supra note 1, at 35.
136. Id.
137. Id.
138. Id.
139. Id.
140. Id.
142. See Maller, supra note 116, at 305:

The pay-through enables homebuilders to raise capital by realizing the bond value of their collateral. At the same time, the builder preserves its ability to use installment sale tax accounting (and thereby defer taxation on a portion of its
C. Expanding the Market

The success of the secondary mortgage market in bringing funds into the housing market has prompted action to expand the availability of capital assets in several other areas of real estate development. For instance, a secondary market and mortgage rating system have developed for commercial loans. A secondary market now exists for conventional loans on manufactured housing or mobile homes. Legislation that would encourage a secondary market for industrial mortgages is being considered as part of the national drive to make American industry more competitive. The emergence of mutual funds that invest in mortgage-related securities is, at least indirectly, enhancing investor involvement in the secondary mortgage market. In addition, a new practice of using PCs, MBSs, and Ginnie Maes to collateralize commercial paper is giving some primary mortgage lenders access to a broader investor base that could provide even greater capital infusion for real estate development.
The current operation of the secondary mortgage market is also the focus of considerable attention. Efforts to enhance the current operation of the secondary mortgage market are being made on all fronts. Proposals for major tax code revision would allow better treatment for investments in mortgage-related securities. \(^{148}\) Proposals to revise federal securities law regulations would simplify compliance for mortgage-related securities issued by private entities and reduce the burden of various state law requirements through federal preemption. \(^{149}\) Proposed revisions to laws restricting pension fund investment in mortgage-related securities would permit a greater percentage of the estimated $800 billion of pension fund assets to be directed to real estate transactions. \(^{150}\) Finally, discussion is focusing on the need to reduce the number of divergent state real property law issues that hinder the free flow and marketability of secondary mortgage market securities because of their impact on the underlying mortgage documentation and enforceability. \(^{151}\)

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\(^{148}\) See President's Commission, supra note 40, at 137-42, 145-46 (tax code can be used to influence investments, and investments in activities that benefit residential mortgages should be encouraged); Liles, supra note 142, at 123-28 (discussing various tax-related issues including those related to Trusts for Investment in Mortgages (TIMs) and Real Estate Investment Trusts (REITs)); Martell, Taxation of the Mortgage Pool, 11 J. REAL EST. TAX'N 347, 347-58 (1984) (proposed legislation for TIMs is discussed as a way of creating an investment vehicle that would not result in double taxation at the entity level and investor level); see also Trost, Reagan Plan to Increase Private Backing For Mortgages Appears to Have Failed, Wall St. J., Mar. 23, 1984, at 6, col. 2 (the primary opponents to TIMs regulation and other proposals to encourage increased private entity activity in the secondary mortgage market are the FHLMC and FNMA; government linked agencies have 95% of the market and are afraid that new legislation would give too much to private participants).


\(^{150}\) See President's Commission, supra note 40, at 142-44 (suggesting revision to federal and state laws to create an environment for greater pension fund investment in real estate); Mariano, Pension Funds Eyed as Loan Money Source, Washington Post, Mar. 5, 1983, at F1, col. 1 (currently only about 2% to 3% of the estimated $800 billion in pension fund assets is invested in residential mortgages); Pension Fund Investment in Mortgages, LAND USE DIG., May 15, 1984, at 2 (between December 1980 and June 1983 the assets of private pension funds were $526 billion, with $25.1 billion invested in mortgage-backed securities and $6.1 billion in mortgages; public pension funds during this period had an estimated $238 billion in total assets with about 12% invested in mortgage securities); see also Elbash, Social Policy Eyes Pension Fund Assets, REAL EST. REV., Winter 1984, at 90-93 (looking at the need for greater pension fund investment in real estate and noting a California law that pressures government pension plans to earmark 25% of their assets for California mortgages); Monks, Facilitating Pension Fund Investments in Residential Mortgages, 35 LAB. L.J. 387, 387-92 (1984) (adopted from testimony before the labor-management subcommittee of the House Committee on Education and Labor regarding barriers to pension fund investment and proposed legislation).

\(^{151}\) For example, the due-on-sale clause issue causes unnecessary problems with assessing the enforceability of mortgage instruments in certain states and thereby discourages investment. President's Commission, supra note 40, at 150. Similar problems arise in dealing with state securities law. Id. at 146-48. State law affects the secondary mortgage market in a number of ways. States that seek to opt out of the federal preemption that made due-on-sale
D. Why Participate in the Market?

Good reasons exist for both mortgage lenders and investors to participate in the secondary mortgage market. The advantages to primary mortgage lenders of selling loans include: (1) the ability to produce higher yields as interest rates rise by selling existing loans to raise cash for reinvestment in new loans at higher rates; (2) the ability to increase income from loan origination fees by making new loans with the cash generated from the sale of existing loans; and (3) the ability to realize enhanced efficiencies as loan volumes increase because of economies of scale that make record keeping and loan servicing costs diminish on a per loan basis as the size of the entire portfolio expands. For investors in mortgage-related securities the benefits include: (1) the ability to purchase an investment pass-through security that provides a monthly cash flow; (2) if interest rates are rising, the ability to invest the monthly cash flow into higher yield investments for a greater profit; falling interest rates eliminate this benefit; and (3) the ability to hold a liquid investment related to mortgages.

III. IMPLICATIONS FOR CHANGE FOSTERED BY THE SECONDARY MORTGAGE MARKET

The implications of the secondary mortgage market manifest themselves in two broad and interrelated ways. First, the market has changed the manner in which parties interact within the context of a real estate transaction. Second, the market has altered the traditional view of the proper role of state and federal government in administering and developing the law of real property.

Dramatic growth in secondary mortgage market activity has significantly influenced the way in which homebuyers/borrowers, lenders, developers, and investors interact. The increasing access to interregional, national, clauses enforceable may have trouble selling their loans in the market. See 1985 State Legislative Proposals, supra note 43, at 1-2. Several states, in an effort to help borrowers, are considering moratoria on foreclosures; such action would hinder the marketability of their mortgages. Id. at 2. Consumer legislation in some states is requiring "plain language" to be used in mortgage instruments, but this language is not the same as that used in the FHLMC and FNMA uniform forms, and such requirements thus work against national goals of uniformity. Id. Alternative mortgage instruments and state securities law issues have also presented recent problems. Id. at 2, 5. Hazardous waste legislation in some states imposes "superliens" for waste cleanup that would take priority over prior mortgage liens and thus upset the security for underlaying mortgages, making them poor investments. Id. at 2. Massachusetts, one state that did this, was forced to admit its error of judgment and exempted residential property. Id.; see Lipman, Unwitting Owners May Owe for Cleanup of Toxic Wastes, Wall St. J., Aug. 1, 1984, at 23, col. 1 (discussing the hazardous waste "superlien" problem and the decision by FHLMC to pull out of the market in Massachusetts because of the need to purchase first lien mortgages).

152. See FHLMC, THE SECONDARY MARKET, supra note 1, at 41. See generally Seiders, supra note 47, at 324-25 (discussing other reasons for the secondary mortgage market such as to reduce geographic imbalances in the demand for mortgage credit).

153. See supra note 152.

154. See Explosive Growth in Secondary Mortgage Market Trading, LAND USE DIG., Oct. 15, 1984, at 3 ("Explosive growth in secondary mortgage market trading is the most significant housing finance development of the 1980s . . . . [t]he estimated volume of trading in mortgage
and international capital markets has changed the very nature and structure of traditional housing and real estate market operations.¹⁵⁵ For instance, the flow of funds through the secondary mortgage market to primary mortgage lenders affects housing affordability.¹⁵⁶ Most homebuyers apply for loans at local banks and savings institutions. These institutions, especially in high growth areas like the sunbelt, depend to a great extent on the availability of

pass-through securities used by federal agencies soared from $100 billion to over $500 billion from 1981 to 1983."); Mortgage Securities Spur New Financing Techniques, 3 FREDDIE MAC REP., May 1985, at 1 (securitization—turning residential mortgages into securities—has revo-

lutionized the business of housing finance by making more money available for housing than ever before; at the end of 1984, the volume of outstanding mortgage pass-through securities stood at over $286 billion); Pierce, supra note 102, at 10 (since 1970 Ginnie Mae has issued guarantees on more than $200 billion in securities, and principal balance outstanding on these securities is more than $170 billion; by this means, some 4.4 million homes have been fi-

nanced); Shattering Traditions, supra note 24, at 3-4 (from 1977 to 1983, originations fluctuated, but purchases grew steadily; purchase volume more than tripled in six years, going from approximately $50 billion in 1977 to more than $162 billion in 1983).

¹⁵⁵. For commentary on expanding interregional and national capital markets, see O. JONES & L. GREBLER, supra note 3, at 24-25 (a developed secondary mortgage market would bring more equality of interest rates between regions and local communities by more easily shifting funds from capital-surplus to capital-deficit areas); Brendsel, supra note 72, at 35-37 (mortgage-related securities are discussed in the context of their successful emergence in capital markets; the growth of the secondary mortgage market is seen as “nothing short of phe-

nomenal” and has managed to tap national capital markets at a rate of from $0 in 1970 to more than $200 billion in 1982); Mortgage-Related Securities, supra note 24, at 1 (mortgage-

related securities are seen as serious competition to other investments and are appealing to a wide range of investors); Secondary Market in ARMs Expected to Emerge over Next Decade, 3 FREDDIE MAC REP., Feb. 1985, at 1-2 [hereinafter cited as Secondary Market] (ability to use the interregional and national capital markets to aid in housing finance is illustrated by Cali-

fornia institutions being able to lend out $27 billion more than their total instate capital in-

flow); Strine, supra note 52, at 1024-25 (Utah savings and loan with assets of only $42 million able to lend $58.2 million in 1976); Wantuck, supra note 24, at 32-35 (success of mortgage-

related securities in attracting investment in the national capital markets outlined). Wantuck

asserts that these mortgage-related securities have provided investors with better performance than comparable corporate bonds over much of the last ten years. Id. at 32. She relies in part on statements by Jack Carlson, then-current chief economist of the National Association of Realtors:

Savings once were concentrated in the community . . . but in recent years “we have tended to nationalize our savings.” Insurance, pension funds and the like “have siphoned savings into the large financial centers.” . . . For housing . . . “it

is imperative to go where those funds have gone, to where those pots of money are,” and the secondary market has been a means of doing so.

Id. (citations omitted).

The impact of increasing access to international capital markets is discussed in 3 FREDDIE MAC REP., Jan. 1985, at 4 (Prudential Realty Securities III, a subsidiary of the Prudential Insurance Company of America has recently issued in Europe $1.3 billion of fixed-maturity bonds collateralized by commercial mortgages); 3 FREDDIE MAC REP., Mar. 1985, at 4 (Fan-

nie Mae recently issued debentures of 50 billion Japanese yen (approximately $200 million) in the Japanese bond market, and New England Mutual Life Insurance Company is selling $300 million in mortgage-related securities in the Eurobond market); Pierce, supra note 102, at 8 (selected Ginnie Mae securities were listed on the Luxembourg Stock Exchange in January 1984; since the beginning of these foreign listings, hundreds of millions of dollars in housing capital have flowed from Europe to Asia to the United States).

¹⁵⁶. See CONGRESSIONAL BUDGET OFFICE, supra note 38, at 48; O. JONES & L. GREBLER, supra note 3, at 25, 90-91; Lance, supra note 45, at 427 (cost of mortgage credit could be reduced by as much as ⅓ of 1%). See generally Home Economics, supra note 45, at 1, col. 6; Nelson, Special Report 1984, supra note 23, at 24, 30 (potential exists to provide savings of 2% on cost of a home).
interregional, national, or international funds to supply their capital requirements. Purely local concerns of the parties to the transactions must, therefore, give way to the intrusion of national standards of uniformity and investment acceptability. Thus, if homebuyers expect a continuing supply of affordable home-financing, they must also accept the conditions of access to nonlocal capital markets that will make new sources of investment capital available for local real estate development. Because the secondary market can attract and direct these new sources of capital and should thereby reduce

157. See, e.g., Home Economics, supra note 45, at 1, col. 6.
158. See Jensen, supra note 22, at 397-435. Jensen asserts:

That the law follows the path taken by society's economic needs is a truism, albeit everyone recognizes that the speed with which the law follows in the wake of economic developments varies greatly. Of all common law legal categories none has until recently been quite so resistant to change as the law of real property. . . . A segment of real estate law which until now has been peculiarly resistant to innovation has been the law of mortgages.

Id. at 397. He then goes on to discuss the secondary mortgage market and how it has been effective in bringing pressure for change and for more uniform standards. Id. at 397-403.

See also Congressional Budget Office, supra note 38, at 5-20 (volatile interest rates in the 1960s prompted an increased federal concern for housing finance and regulation); O. Jones & L. Grebler, supra note 3, at 45; Miles, Congressional Research Service, Issue Brief, Secondary Mortgage Markets: Major Legislation 1-14 (Sept. 10, 1984) (recent federal proposals to assist the standardization and accessibility of the secondary mortgage market); President's Commission, supra note 40, at 147-54 (discussing various needs for modification of state laws and for more uniform documentation and regulation that will facilitate investment in and development of housing finance markets); Leibold, supra note 55, at 435-40 (discussing uniform standard for mortgages); Murray, supra note 1, at 446-50 (discussing standardization of mortgage documents).

Commentary to the Uniform Simplification of Land Transactions Act states:

The aim of this Article is to provide a simple and unified structure within which the immense variety of financing secured by real estate can go forward with greater certainty and less transaction cost. . . . The Congress finds (1) that disparate State laws relating to the foreclosure of real estate mortgages and deeds of trust have inhibited the free flow of mortgage money to homeowners at reasonable rates in many States and regions of the Nation and have burdened Federal programs involving real estate mortgages made, owned, insured or guaranteed by the United States; . . .

(5) that the availability of a uniform, less expensive, and more expeditious foreclosure procedure is required to ameliorate these conditions, and facilitate the sale and resale in nationwide secondary mortgage markets of secured real estate loans made, owned, insured, or guaranteed by the United States and would remove existing burdens on interstate commerce.

Uniform Land Transactions Act art. 3, introductory comment (Official Text 1978). For articles discussing the Uniform Land Transactions Act, see Bruce, Mortgage Law Reform Under the Uniform Land Transactions Act, 64 Geo. L.J. 1245 (1976); Randolph, The FNMA/FHLMC Uniform Home Improvement Loan Note: The Secondary Market Meets the Consumer Movement, 60 N.C.L. Rev. 365 (1982). See also Hughes, Mortgage Sales by Computer Hit Snags, Wall St. J., May 24, 1985, at 21, col. 2 (reports wide use of computer networks, but also speaks to the issue of high costs); LaGesse, Mortgage Networks Arrange Loans on Computers, Am. Banker, Jan. 23, 1984, at 1 (a new network of computerized information is facilitating lending and secondary mortgage market activities, but its continued development depends on standardized mortgage forms and practices).

159. See Congressional Budget Office, supra note 38, at 48; O. Jones & L. Grebler, supra note 3, at 25, 90-91; Lance, supra note 45, at 427 (the cost of mortgage credit could be reduced by as much as 1/2 of 1%); see also Home Economics, supra note 45, at 1, col. 6; Nelson, Special Report 1984, supra note 23, at 30 (there is potential to provide a savings of
financing costs for homebuyers,\textsuperscript{160} homebuyers have an interest in maintaining a strong secondary market.

An active secondary mortgage market also benefits local mortgage lenders by providing them with the opportunity to originate and service many more loans than would be possible if they merely held all of their loans in portfolio until maturity.\textsuperscript{161} The market increases the local mortgage lenders' liquidity and thereby enhances long-term profitability by giving them greater access to the capital markets and better protection against interest rate changes. The market also provides indirectly a source of substantial income through loan origination and servicing fees.\textsuperscript{162}

Both the reduction in home financing costs and the increased ability to provide loans to a given local market constitute positive economic benefits for real estate development. These positive economic benefits for the homebuyer/borrower and lender, however, are not without their costs. A local mortgage lender that aggressively taps nonlocal markets for primary mortgage funds may shift from using and managing local funds for local investments to mass retailing of loans, local and otherwise, for sale in the secondary mortgage market.\textsuperscript{163} In this manner the local mortgage lender

\textsuperscript{2\% on the cost of a home). See generally President's Commission, supra note 40, at xv, 9-13 (housing that is affordable is a national priority).


\textsuperscript{160. See supra note 156.}

\textsuperscript{161. See Lance, supra note 45, at 427-28 (as an example, reference is given to the early success of United Savings and Loan of Utah that in 1976 had only $42 million in assets yet originated $58.2 million in new mortgages while servicing an additional $119 million worth of debt); Shealy, supra note 45, at 35 (involvement in secondary mortgage market increases liquidity and profitability); see also Secondary Market, supra note 155, at 1 (California lenders focused on origination services and were able, by use of the secondary mortgage market, to originate $27 billion more in loans than they had in local capital assets between the years 1977-1980).

\textsuperscript{162. See Bankers Forum, supra note 45, at 9-10 (originating and selling mortgages in secondary market provides liquidity and profitability for lenders concerned with volatile interest rates and risks of holding long-term mortgages); Shattering Traditions, supra note 24, at 2-11 (secondary mortgage market allows for greater liquidity, profitability, and for hedging investments against inflation); Shealy, supra note 45, at 35-41 (involvement in secondary mortgage market increases liquidity and sources of profitability); see also O. Jones & L. Grebler, supra note 3, at 23-24; Cahnman, Kamradt & Otto, supra note 45, at 10-16 (discussing economic consequences of a well-functioning secondary market).

\textsuperscript{163. See generally Bankers Forum, supra note 45, at 9-10 ("The executive vice-president of a $7-million-in-assets bank in Wisconsin says that his bank doesn't write anything it can't turn around and sell."); Nelson, Special Report 1983, supra note 23, at 12 (referring to the extensive secondary mortgage market activities of lenders, the article quotes the complaints of speakers at a conference sponsored by BNA's Housing and Development Reporter: "The mortgage business is dead; every mortgage lender is now in the securities business."); Shealy, supra note 45, at 35-41.
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may redefine its self-image and restructure its operations to facilitate the directing of local and individual needs into prepackaged arrangements that are acceptable for resale rather than tailoring services to meet local and individual needs. As a result, the borrower and lender relationship changes and becomes less personal.

Investor requirements of the secondary mortgage market also affect the projects of real estate developers. Consequently, developers should seek to modify their projects to ensure that project construction standards and legal documentation will be acceptable to the major secondary market entities. If the developer ensures that the secondary market will accept the primary mortgage loans secured by the developed property, then more primary mortgage lenders will be willing to extend mortgage financing to the project based on the greater liquidity of such mortgages. Even if the developer plans to offer its own purchase money mortgage financing to individual property buyers, it should consider the requirements of the secondary mortgage market investor. If the underlying purchase money mortgages satisfy investor expectations by resembling other standard mortgages, then the developer retains the potential to issue builder bonds. In this manner access to the capital markets can be used to finance continued real estate development.

Through the secondary mortgage market, the homebuyer/borrower, lender, developer, and investor interact. Even though the secondary market investor does not directly participate in the underlying transaction, the importance of the secondary market process to the continued financing of real estate development makes the investor an indirect participant. The indirect participation of unrelated investors has significantly changed the point of reference for interaction in real estate transactions. Increasingly, direct parties must refer to the objectives and business standards of unknown investors as benchmarks for the conduct of what superficially appears to be a local real estate transaction.

In addition to changing the manner in which parties to a real estate transaction interact, the secondary mortgage market has affected the perceived roles of state and federal government in administering and developing real property law. The financing of real estate development increasingly appears to require access to interregional, national, and international capital markets.

164. See Sanders, Condominium Legal Requirements of the Secondary Mortgage Market, 1981 Fla. B.J. 733, 733-35 (discussing guidelines for proper drafting of condominium documents so that resulting mortgages on projects will be acceptable in secondary mortgage market).

165. For further discussion, see supra notes 46-153 and accompanying text. This section discusses mortgage-backed bonds and their use by builders. When these bonds are backed by the builder's purchase money mortgage they are sometimes referred to as builder bonds. Note that the secondary mortgage market would seem to be able to serve the additional purpose of reducing developers' tendencies to use onerous legal documentation. Thus, in an indirect sense marketability considerations also provide some degree of consumer protection.

166. See President's Commission, supra note 40, at 137 ("greater participation in mortgage investment by private financial institutions with diversified asset portfolios is essential for the broad based and resilient system of housing finance needed to meet the demands for mort-
appropriate law is thus diminishing. The nonlocal capital markets require a degree of uniformity in both documentation and underlying real property law so that investors can easily access alternative investments without detailed investigation of particular lenders and particular state law.167 Likewise, the ability of secondary mortgage market entities to issue securities based on mortgages requires a substantial degree of national uniformity in order to make the underlying pooling arrangements manageable.168

With the success and variety of the various mortgage-related securities currently available, pressure to facilitate the further development of the secondary mortgage market has increased.169 The success of the market in bringing new sources of capital to real estate development has bestowed upon the market a reputation as the "goose that lays the golden eggs." Indeed, real estate transactions appear to be capable of attracting a substantial portion of the billions of dollars available for capital investment if the appropriate legal changes are made to facilitate a competitive market for the origination, issuance, and resale of mortgage-related securities.

The success of the secondary mortgage market has demonstrated that real estate transactions are matters of national, not purely state and local, concern. The success and viability of a national housing policy and of a national policy to revive our financially troubled lending institutions depends, at least in part, on a healthy secondary mortgage market that by its very nature is national in scope.170 Consequently, for 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.

The secondary mortgage market thus is serving as a catalyst for change by elevating certain issues of real property law from purely state law concerns to federal concerns. In this respect federal legislation has recently addressed
the issues of mortgage due-on-sale clause enforceability, urus interest limitations, and the ability of mortgage lenders to offer new and innovative mortgages as alternatives to the fixed-rate, thirty-year mortgage. This recent activity follows previous federal intrusion on real estate transaction and finance law issues under such legislation as the Interstate Land Sale Full Disclosure Act (ILSFDA), anti-redlining legislation, truth-in-lending requirements, and securities law requirements. The implication seems clear: the secondary mortgage market is transforming real estate transactions into matters of national concern and, through the vehicle of federal law, should bring greater uniformity to real property law and practice.

171. See Nelson & Whitman, supra note 42, at 243-312. This article provides an excellent overview of the due-on-sale problem and the legislative response to it. Details of the Garn-St. Germain Depository Institution Act of 1982 (Pub. L. No. 97-320, 96 Stat. 1469 (1982)) are discussed, including the types of lenders and loans covered by the Act's preemption and the operation of a "window period" for the preemption in the various states. Id. at 260-309. The Act leaves some room for individual states qualifying for a "window period" of exemption to extend the exemption from federal preemption, but in no case can a state absolutely prohibit enforcement of the due-on-sale clause. Id. at 296. See also Barad & Layden, supra note 42, at 138-50 (discussing implication of federal preemption of due-on-sale clause); Berryhill, supra note 36, at 35-116 (discussing the requirements of the due-on-sale clause); Blocher, supra note 36, at 49-99 (discussing due-on-sale clauses in relationship to secondary mortgage market); Herron, supra note 42, at 529-43 (discussing extent of preemption); McGuire, supra note 36, at 487-532 (discussing due-on-sale clauses as restraints on alienation); Murry, supra note 42, at 229-42 (discussing legality of due-on-sale clauses in adjustable rate mortgages); Rudolph, Schmelzer & Weiner, supra note 42, at 1311-27 (discussing federal preemption of due-on-sale clauses).

172. See Ewing & Vickers, supra note 41, at 171-98. The most far-reaching preemption by the federal government in this area occurred as a part of the Depository Institutions Deregulation and Monetary Control Act of 1980. 12 U.S.C. § 3503(a) (1982), which effectively eliminated state interest caps on first loans to residences. Id. The federal legislation was set up to allow states to opt out of the preemption by acting before April 1, 1983. Id. at 176. At least ten states did so. Id. For background perspective on the usury issue, see Crafton, supra note 41, at 135-45, and Nosari & Lewis, supra note 41, at 30-38.

173. See Sclar, supra note 39, at 273-79.


175. See Bettauer, Federal and State Anti-Redlining Laws: Must National Banks Comply With Both?, 97 BANKING L.J. 329, 329-45 (1980) (this legislation was designed to make loans available to all neighborhoods and prevent lenders from avoiding neighborhoods merely because they are low income or racially integrated). For an example of federal anti-redlining legislation, see The Interstate Mortgage Disclosure Act of 1975, 12 U.S.C. §§ 2801-2811 (1982).


177. See Malloy, Lender Liability for Negligent Real Estate Appraisals, 1984 U, ILL. L. REV. 53, 87-89, 95-96 (the securities laws apply to real estate transactions if a real estate contract is classified as an investment contract). See generally Real Estate—FTC Starting to Crack Down on Ads for Home Financing, Wall St. J., June 1, 1983, at 33, col. 1 (the Federal Trade Commission has been reviewing home financing ads in an effort at consumer protection); Young, supra note 176, at 44-63 (discussing the impact of Federal Trade Commission activities and environmental law regulations); Note, Prime-Rate Fraud Under RICO, 72 GEO. L.J. 1885, 1885-1905 (1984) (discussing use of the Racketeer Influenced and Corrupt Organization Act (RICO) to allege fraud in the setting of "prime rate," which is a base for mortgage interest rates to be quoted).
IV. Conclusion

From its inception, the secondary mortgage market has been greatly influenced by federal legislation and the active participation of government-related entities. These entities, the GNMA, FNMA, and FHLMC, still comprise the major source of secondary mortgage market activity. With the increased acceptance among investors of mortgage-related securities such as Ginnie Maes, MBSs, PCs, CMOs, and MBBs, however, participation in the market by private entities has become increasingly profitable and manageable. New efforts are also underway to expand the market beyond the traditional realm of residential mortgages to include commercial mortgages, mobile home mortgages, and industrial mortgages. Revisions to the tax code, pension fund regulations, and securities laws designed to enhance investment opportunities in mortgage-related securities are also under consideration.

The development of this secondary mortgage market has put a process in motion for creating structural change in the conduct of real estate transactions. The success of mortgage-related securities in the capital markets has opened the door to new sources of funds for real estate development, to more affordable housing, and to increased financial strength for financially troubled lending institutions. At the same time the success of the market has fostered a change in the interaction of the homebuyer/borrower, lender, developer, and investor by changing the point of reference from the parties' local concerns to a concern for the objectives and business standards of unrelated market investors. The very success of the secondary mortgage market has also demonstrated that for growth to be maintained the federal government must play a greater role in administering and developing national standards of uniformity that will enhance the market position and acceptability of mortgage-related securities.

The secondary mortgage market must, therefore, be viewed as a catalyst for significant change in the conduct of real estate transactions. Failure to recognize this development, to understand the market, and to go beyond the pure mechanics of the market's operation will leave one ill-equipped to deal with the emerging complexities of the law of real estate transactions and finance.

178. See Seiders, supra note 47, at 319-20.
179. See Mortgage-Related Securities, supra note 24, at 1 (“The three quasi-public secondary mortgage market agencies—FNMA, GNMA, and FHLMC—accounted for 95% of the mortgage-backed securities volume transacted by the end of 1983.”); Shattering Traditions, supra note 24, at 2, 4 (in 1983 the FHLMC, FNMA, and GNMA accounted for over 61% of the secondary mortgage market); Wantuck, supra note 24, at 32-35.