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Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners

Julia Patterson Forrester*

I. INTRODUCTION

Fannie Mae and Freddie Mac are the giants of the home mortgage industry. Today they own or guarantee about forty percent of outstanding home mortgage debt in the United States.1 In addition, their uniform mortgage instruments document the great majority of home mortgage loans.2

Dale Whitman is a giant in the arena of real estate and property law. The substance and quality as well as the volume of his work make him a giant. Dale's treatises and casebooks are well-regarded and well-known. I teach from his Real Estate Transactions casebook,3 and I consult and cite his treatises regularly.4 His work as reporter for the Restatement (Third) of Property: Mortgages is also renowned and deservedly well-regarded.

Less known is his background in electrical engineering, a background that I happen to share. Also less known is the time he spent in government

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2. See infra note 72 and accompanying text.


service. In 1971, after teaching at the University of North Carolina and UCLA, Dale was a Deputy Director of the Federal Home Loan Bank Board where he worked on promoting minority ownership of savings and loans and loans to minority borrowers. He later served as a senior analyst for the Department of Housing and Urban Development where he drafted the HUD-1 closing statement in substantially the same form it stands today. Subsequently, he taught on the law faculties of Brigham Young University, the University of Washington, and the University of Missouri–Columbia, where he also served as dean for six years. This symposium honors him.

Dale’s work at FHLBB and HUD in the early 1970s occurred during a fascinating time in the development of the secondary market for conventional home mortgage loans\(^5\) by Fannie Mae and Freddie Mac. FHLBB supervised Freddie Mac at the time of its creation in 1970,\(^6\) and HUD has regulated Fannie Mae and Freddie Mac for many years.\(^7\) This time period also saw the birth of the Fannie Mae/Freddie Mac uniform mortgage instruments which are the subject of this Article.

In recent years economists and lawmakers have debated the public costs and benefits of the two housing government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.\(^8\) Some critics of the GSEs have even proposed making the GSEs fully private entities.\(^9\) Some parties involved in the debate have concluded that the costs of the GSEs outweigh their benefits, while others assert the converse.\(^10\) In terms of benefits, both sides consider the GSEs’ contributions to lowering interest rates and encouraging affordable housing.\(^11\) Forgotten, however, is a difficult to quantify but important benefit that the GSEs create for homeowners – the uniform mortgage instruments that evidence the vast majority of home mortgage loans. As this article will demonstrate, the Fannie Mae/Freddie Mac instruments are extraordinarily balanced and fair compared to other documents consumers must sign. The benefit that Fannie Mae/Freddie Mac uniform instruments provide to homeowners is a factor that weighs against privatization of the GSEs.

As an attorney, I usually cringe when I have to sign standard form documents. Apartment leases, rental car agreements, credit card agreements, and many other form contracts that consumers must enter into are contracts of

\(^5\) A conventional mortgage loan is one that is not federally insured.

\(^6\) See infra note 29 and accompanying text.

\(^7\) See infra notes 15 and 153 and accompanying text.

\(^8\) See infra notes 180-85 and accompanying text. In addition, the GSEs have recently received a great deal of criticism based on accounting irregularities and other problems. See infra Part IV.A. Congress has considered revising and increasing federal oversight of the GSEs. See infra note 175 and accompanying text.

\(^9\) See infra Part IV.

\(^10\) See infra notes 183-85 and accompanying text.

\(^11\) See infra note 181 and accompanying text.
adhesion. These contracts are drafted to give a minimum of rights to consumers, and negotiation is not an option.

The story is different, however, for the largest transaction in the lives of most Americans: financing the purchase of a home. When a home purchaser signs loan documents, the legal terms are usually more favorable for the borrower than the terms that sophisticated real estate developers can negotiate in commercial mortgage loans. The reason for the difference is the huge dominance in the home mortgage market of Fannie Mae/Freddie Mac uniform mortgage instruments – standardized loan documents that are extraordinarily fair to consumers.

Part II of this Article discusses Fannie Mae and Freddie Mac, their creation and evolution, their current role in the secondary market, and the development and current use of the Fannie Mae/Freddie Mac standardized forms. Part III looks at these uniform mortgage instruments in detail, and compares them to other residential loan documents and to commercial mortgage loan documents. Part III also considers typical terms of other consumer transactions that are not so balanced and explores how the problems that consumers face in choosing consumer credit make loan documents with fair terms particularly beneficial to consumers. Part IV discusses current criticisms of Fannie Mae and Freddie Mac, proposed regulatory reform, and the debate over privatization of the GSEs. Part IV also explores what role the standardization of mortgage documents by the GSEs should play in the debate. The purpose of the Article is not to weigh in on who should win the privatization debate or on where the balance of the costs and benefits of the GSEs should fall. The Article concludes, however, that the benefits of Fannie Mae/Freddie Mac standardization are a factor that must be considered in the ongoing debate over Fannie Mae and Freddie Mac.

12. These types of contracts have been described as follows:

Standard contracts are typically used by enterprises with strong bargaining power. The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms, either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses. His contractual intention is but a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood only in a vague way, if at all. Thus, standardized contracts are frequently contracts of adhesion . . .


13. The documents are fair and balanced because of legal terms requiring notice before acceleration, giving the homeowner the right to reinstate the loan after acceleration, and providing for the application of insurance and condemnation proceeds to restore the mortgaged property, see infra Part III.B., and because they do not contain onerous terms such as a mandatory arbitration clause, a waiver of right to jury trial, or a broad waiver of notices, see infra Part III.C.
II. FANNIE MAE AND FREDDIE MAC

Fannie Mae and Freddie Mac are government-sponsored enterprises — privately owned corporations operating under federal charters that impose restrictions on their activities and grant benefits that other private corporations do not enjoy. The President appoints five of the eighteen directors of each GSE,14 while the rest are elected by shareholders. Fannie Mae and Freddie Mac are currently regulated by the Office of Federal Housing Enterprise Oversight (OFHEO) and the U.S. Department of Housing and Urban Development (HUD).15 The benefits they receive as GSEs include exemption from state taxes (except for real property taxes),16 exemption from federal securities laws,17 a line of credit from the U.S. Treasury,18 and the ability to issue securities through the Federal Reserve electronic book-entry system.19 Since Fannie Mae and Freddie Mac are not government agencies, their guarantees are not backed by the full faith and credit of the federal government; however, a perception exists that the federal government would honor their obligations in the event of financial trouble.20 This perception provides a substantial benefit because it means that Fannie Mae and Freddie Mac can raise capital at a lower cost than purely private actors in the mortgage market.21

15. HUD has general regulatory authority over Fannie Mae and Freddie Mac except with respect to safety and soundness. See id. § 4541. OFHEO is responsible for the GSEs’ safety and soundness. See id. § 4513(b)(5). In addition, the Department of Treasury must approve their issuance of debt. See id. § 1455(j) (Freddie Mac); id. § 1719(b) (Fannie Mae).
16. Id. § 1433.
17. Id. § 1455(g).
18. See id. §§ 1455(c), 1719(c).
19. See id. §§ 1452(d), 1723a(g). See also Richard Scott Carnell, Handling the Failure of a Government-Sponsored Enterprise, 80 WASH. L. REV. 565, 582 (2005) (discussing explicit government benefits granted to GSEs). In addition, no limits exist on investment in GSE securities by federally chartered depository institutions, and their securities may be purchased by the Federal Reserve Banks and by fiduciaries. Id.
20. See U.S. GENERAL ACCOUNTING OFFICE, HOUSING ENTERPRISES: POTENTIAL IMPACTS OF SEVERAL GOVERNMENT SPONSORSHIP 17 (1996); Carnell, supra note 19, at 583-84. See also Edmund L. Andrews, Fed Chief Urges Cutback in Scale of 2 Big Lenders, N.Y. TIMES, Feb. 18, 2005, at C1 ("Mr. Greenspan, who has long criticized both companies, said they had been able to borrow almost unlimited amounts of money at below-market rates by virtue of the widespread by false impression among investors that the federal government would ride to their rescue if necessary.").
21. Because investors believe that the federal government would bail out the GSEs in the event of serious financial problems, they provide funds at rates lower than they would to similar companies without the implied government guarantee. See
A. Creation and Evolution

Fannie Mae was created in response to the Great Depression under the New Deal leadership of President Franklin D. Roosevelt. Because of widespread foreclosures during the Depression and wide variation in interest rates and availability of mortgages, President Roosevelt’s National Emergency Council recommended the establishment of a program for long-term, federally-insured mortgages and the creation of national mortgage associations to purchase these mortgages. Congress responded by creating the Federal Housing Administration (FHA) to insure home mortgage loans and by authorizing the charter of mortgage associations to purchase the insured mortgages. In 1938 Congress chartered the Federal National Mortgage Association (now called Fannie Mae). Fannie Mae was initially a government agency that issued bonds to raise funds for the purchase of FHA-insured mortgages and, beginning in 1948, Veteran’s Administration (VA)-guaranteed mortgages. In 1968 Congress divided the functions of Fannie Mae between two entities—Fannie Mae, which became a GSE and was allocated the secondary market operations of the former entity, and the Government National Mortgage Association (Ginnie Mae), which remained a division of HUD.

In 1970 the Emergency Home Finance Act authorized Fannie Mae to purchase conventional mortgages for the first time and also created the Federal Home Loan Mortgage Corporation (Freddie Mac) to purchase conventional mortgages. Freddie Mac was initially under the supervision of the Federal Home Loan Bank Board, and its stock was owned by the twelve Fed-

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22. Regulations Implementing Authority of HUD Over Conduct of Secondary Market Operations of FNMA, 43 Fed. Reg. 36,200 (Sept. 14, 1978). Until the 1930s, the typical home mortgage loan was for only a three- to five-year term. Id. Homeowners were required to refinance their homes frequently, and during the Great Depression when refinancing was not available, many lost their homes to foreclosure. See id.


24. Id. at 36,201. The association was originally named the National Mortgage Association of Washington, but was renamed the Federal National Mortgage Association later the same year. Id.

25. See id.


eral Home Loan Banks. 29 Freddie Mac was expected to purchase mortgages from savings and loan associations, while Fannie Mae was expected to purchase primarily from commercial banks and mortgage banks. 30

In addition to issuing bonds and using the proceeds to purchase loans, in 1971 Freddie Mac began selling pass-through mortgage backed securities (MBS) backed by conventional mortgage loans. 31 With pass-through MBS, "the investor purchases a fractional undivided interest in a pool of mortgage loans, and is entitled to share in the interest income and principal payments generated by the underlying mortgages." 32 In 1983 Freddie Mac issued the first Collateralized Mortgage Obligation (CMO), which created multiple classes of bonds all backed by the same mortgage pool but with each class paid sequentially as principal payments were received from the underlying mortgages. 33 Fannie Mae began securitizing mortgage loans in the 1980s. 34 When the GSEs issue MBS they "guarantee that investors will receive timely principal and interest payments regardless of what happens to the underlying mortgages." 35 Today Fannie Mae and Freddie Mac are almost identical in their charters and functions. They both purchase home loans to hold in their portfolios but securitize even more loans.

Through their purchases and securitization of residential mortgage loans, Fannie Mae and Freddie Mac together provide the largest source of home mortgage financing in the nation. In 2004 nearly thirty-five percent of outstanding home mortgage debt was in the GSEs' MBS, and they held over


33. Leland C. Brendsel, Securitization's Role in Housing Finance, in A PRIMER ON SECURITIZATION 17, 22 (Leon T. Kendall & Michael J. Fishman eds., 1996); Lewis S. Ranieri, The Origins of Securitization, Sources of Its Growth, and Its Future Potential, in A PRIMER ON SECURITIZATION, supra, at 36-37. "The CMO concept is very simple. Rather than look at a mortgage pool as a single group of thirty-year mortgages, the CMO concept approaches it as a series of unique annual cash flows each year for the next thirty years. It recognizes that cash flows are higher in the early years of the pool, and they can be carved up into separate tranches . . . ." Ranieri, supra, at 36.


twenty percent of home mortgage debt in their combined portfolios.\textsuperscript{36} At the end of 2005, they had securitized or were holding in their portfolios forty-four percent of outstanding home mortgage debt.\textsuperscript{37} More recently, they own in portfolio or guarantee through their MBS programs about forty percent of all residential mortgage debt in the nation.\textsuperscript{38}

\textbf{B. Development and Use of Standardized Forms}

Before 1970 little uniformity existed in home mortgage forms. FHA mortgages were standardized to the extent possible considering the differences in the various states’ laws.\textsuperscript{39} In addition, trade associations developed standard forms, and large lenders prepared standard forms for states in which they did business.\textsuperscript{40} However, these forms were developed for the convenience of the lenders rather than to make the loans transferable on the secondary market. Witnesses testifying before Congress in hearings about the enactment of the Emergency Home Finance Act of 1970 uniformly agreed that conventional home mortgage documents needed to be standardized in order to create a secondary market for the loans.\textsuperscript{41}

After President Nixon signed the Emergency Home Finance Act in July of 1970,\textsuperscript{42} Fannie Mae and Freddie Mac agreed that their “first order of business must be the development of a standard mortgage form.”\textsuperscript{43} Fannie Mae created a task force of attorneys as well as representatives of lending institutions to create a draft.\textsuperscript{44} The task force decided that the mortgage form should be divided into “uniform covenants,” containing clauses applicable in

\begin{itemize}
\item \textsuperscript{36} Andreas Lehnert et al., \textit{GSEs, Mortgage Rates, and Secondary Market Activities} \textsuperscript{1} (2006), available at http://www.federalreserve.gov/pubs/feds/2006/200630/index.html (citing \textit{INSIDE MORTGAGE FINANCE}).
\item \textsuperscript{37} See Miller \& Pearce, supra note 1, at 5-6. At the end of 2006 the combined portfolios of Fannie Mae and Freddie Mac totaled $1,428.03 billion and their total combined MBS outstanding were $3,556.10 billion. GSE Business Summary, Inside Mortgage Finance, available at http://www.imfpubs.com/reports/fannie_mae_and_freddie_mac_activity.html.
\item \textsuperscript{38} See Shenn \& Tyson, supra note 1. Fannie Mae and Freddie Mac’s share of the market declined beginning in 2002 as the housing boom began because of private competitors willing to make riskier loans. \textit{Id.}
\item \textsuperscript{39} See Raymond A. Jensen, \textit{Mortgage Standardization: History of Interaction of Economic, Consumerism and Governmental Pressure}, 7 \textit{REAL PROP. PROB. \& TR. J.} 397, 398 (1972).
\item \textsuperscript{40} \textit{Id.}
\item \textsuperscript{42} Pub. L. No. 91-351, 84 Stat. 450.
\item \textsuperscript{43} Jensen, supra note 39, at 399.
\item \textsuperscript{44} \textit{Id.} at 400. Raymond Jensen was a member of the task force. \textit{Id.} at 400 n.7.
\end{itemize}
every state, and “non-uniform covenants” that conformed to local law in each state.45

The task force issued its first draft in November of 1970 and a second draft in February of 1971.46 These drafts contained many pro-lender provisions that were customarily contained in most mortgages. To the extent they limited the lender’s rights or remedies or gave the borrower rights, lenders objected.47 However, the more strenuous objections came from consumer groups.

In response to demands for public hearings from Senator Proxmire and Ralph Nader,49 Fannie Mae and Freddie Mac held a public meeting about the forms on April 5-6, 1971.50 Although not technically a hearing, Congressman Albert Rains chaired the meeting, and forty witnesses testified, including Nader.51 Consumer advocates criticized numerous provisions of the draft forms. Nader testified that Fannie Mae and Freddie Mac had “a golden opportunity to develop perhaps the first fair and balanced standardized form.”52

In response to the public meeting, Fannie Mae and Freddie Mac developed forms that were substantially more consumer-friendly.53 The two GSEs were not able to agree, however, on all of the provisions of the forms. Therefore, when final forms were published in January of 1972, the Fannie Mae and Freddie Mac forms contained some differences.54 The two most substantive differences were a prepayment premium provision in the Freddie Mac form note, but not in the Fannie Mae form,55 and a due on sale clause in the

45. Id. at 400. Uniform covenants included provisions regarding a tax and insurance escrow, the borrower’s obligation to maintain insurance covering the mortgaged property, and application of insurance and condemnation proceeds. See id. at 420-25. Non-uniform covenants included provisions regarding acceleration, foreclosure, and the right of redemption, if any. See id. at 420-26.

46. Id. at 401.
47. Id. at 402.
49. See Jensen, supra note 39, at 402.
51. See id.; Carrozzo, supra note 41, at 798; Jensen, supra note 39, at 402-03.
52. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, supra note 50, at 103.
53. See Jensen, supra note 39, at 410. The new forms addressed some but not all of the objections of the consumer advocates. See id.
54. Id. at 415.
55. See id. The Freddie Mac form required payment of a prepayment premium only in the event that prepayment was the result of refinancing with another lender during the first five years of the loan. Id.
Fannie Mae mortgage, but not in the Fannie Mae mortgage. By 1975,
Fannie Mae and Freddie Mac had reached a compromise and jointly pub-
lished a set of uniform mortgage instruments. The forms have been modi-
fied over the years, but they retain the consumer-friendly provisions negoti-
at in the early 1970s.

Fannie Mae and Freddie Mac require that loans they purchase be docu-
mented on their forms. Therefore, originators who wish to sell their loans
to Fannie Mae or Freddie Mac must use the uniform instruments. Even lend-
ers who do not contemplate selling their loans to the GSEs typically use the
forms, which have become the standard for loans sold on the secondary mar-
ket.

Under the terms of their charters, Fannie Mae and Freddie Mac may
only purchase loans that meet certain requirements, including requirements
limiting loan amount and loan-to-value ratio. Loans that meet the require-
ments for purchase by the GSEs are “conforming” loans, and loans that do
not are “non-conforming.” Loans that are non-conforming because they ex-
ceed the conforming loan limits set by OFHEO, are called “jumbo” loans.

Most jumbo loans are documented using the Fannie Mae/Freddie Mac instru-
ments. Lenders making jumbo loans that cannot be sold to the GSEs,
or who do not contemplate selling to the GSEs, tend to use the Fannie
Mae/Freddie Mac uniform instruments because the instruments are widely
accepted by secondary market purchasers as being the standard. However,
because the loans are not to be purchased by the GSEs, the lenders may make

56. Id. at 416-17.
57. See Practicing Law Institute, Federal National Mortgage Association, Vol. 1
at 203 et seq. (1975). The uniform mortgage instruments contained a due on sale
clause but no prepayment premium. See id. at 205 (prepayment), 211 (due on sale).
58. For current forms, see NELSON & WHITMAN, supra note 3, at App.
59. See infra Part III.B.
60. See FANNIE MAE SINGLE FAMILY 2007 SELLING GUIDE, pt. IV, ch. 1 §
MAE GUIDE]; 1 FREDDIE MAC SINGLE-FAMILY SELLER/SERVICER GUIDE, ch. 6 § 6.7,
available at http://www.freddiemac.com/sell/guide/# (follow “AllRegs” hyperlink)
[hereinafter FREDDIE MAC GUIDE].
61. See Carrozzo, supra note 41, at 802-03.
62. See Wayne Passmore et al., GSEs, Mortgage Rates, and the Long-Run Ef-
63. The conforming loan limit for 2007 is $417,000 for single-family properties,
which is unchanged from 2006. See News Release, Fannie Mae’s 2007 Conforming
Loan Limit Remains at $417,000 Following OFHEO Announcement (Nov. 28, 2006),
News+Releases.
64. Telephone Interview with Kaki Roach, Escrow Officer, LandAmerica
American Title Company, in Dallas, Texas, March 2007.
modifications to the documents that would not be permitted by the GSEs in loans they purchase or securitize. 65

Fannie Mae and Freddie Mac have purchased or securitized subprime loans 66 to a limited extent. 67 Their purchases of subprime loans have been restricted primarily to purchasing loans made to A- borrowers. 68 Therefore, most of the secondary market for subprime loans involves non-GSE securitizations. Nevertheless, a surprising number of subprime loans are made using Fannie Mae/Freddie Mac form documents. 69 Of course, the documents can be modified to be less consumer-friendly when Fannie Mae and Freddie Mac are not the anticipated purchasers of the loans. 70 But even with modifications, many of the standard terms remain in place. 71

The use of Fannie Mae/Freddie Mac uniform mortgage instruments is, therefore, widespread in the prime mortgage market for both conforming and non-conforming loans and even in the subprime market to some extent. By some estimates, more than ninety percent of residential mortgage loans are

65. For example, some lenders offer the option of a prepayment premium in exchange for a lower interest rate. See Ruth Simon, Prepayment Clauses Come With Pitfalls, WALL ST. J., Dec. 12, 2001, at C1.

66. Subprime loans are loans with a higher risk of default based on credit characteristics of the borrower, including delinquencies, foreclosures, bankruptcies, and debt-to-income ratios. Subprime loans have higher interest rates than prime loans. Julia Patterson Forrester, Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders, 74 U. Cin. L. REV. 1303, 1310-11 (2006).


68. See GAO REPORT, supra note 67, at 74; HUD/TREASURY JOINT REPORT, supra note 67, at 46. A-borrowers are the least risky subprime borrowers. HUD/TREASURY JOINT REPORT, supra note 67, at 33.

69. The author discovered this fact by searching real property records online for subprime mortgages. Subprime lenders probably use the uniform instruments for the same reason that lenders use them for jumbo loans – because they are an accepted standard for loans to be securitized.

70. For example, subprime loans are much more likely than prime loans to have prepayment premiums, see infra note 92 and accompanying text, or mandatory arbitration clauses, see infra note 107 and accompanying text.

71. For example, notice requirements before acceleration are likely to remain unchanged. See infra note 94 and accompanying text. The advantage of uniformity may outweigh the cost of consumer-friendly terms to subprime lenders who securitize their loans.
documented on Fannie Mae/Freddie Mac uniform mortgage instruments,\(^72\) although this percentage may have decreased as the size of the subprime mortgage market has increased.

## III. Benefits to Homeowners of Fannie Mae/Freddie Mac Form Documents

Because of their widespread use and their exceptionally fair terms, Fannie Mae/Freddie Mac uniform instruments provide a significant benefit to homeowners. Because the GSEs require the use of their forms for single-family loans that they buy\(^73\) and because they will not accept loans with modifications or additions to the uniform instruments,\(^74\) borrowers actually receive the benefits that consumer advocates negotiated when the uniform instruments were drafted. The benefits to homeowners are the result of both the financial and legal terms of the loans. Because participants in the debate over the GSEs have recognized the benefits of the financial terms,\(^75\) the primary focus of this article will be the legal terms. However, a brief discussion of the financial terms is still merited. This section discusses the terms, both financial and legal, of the Fannie Mae/Freddie Mac uniform instruments, comparing those terms first to other real estate loans, including commercial loans, subprime loans,\(^76\) and sometimes jumbo loans, and then to other types of consumer contracts. It concludes with a discussion of how these fair terms in fact benefit consumers.

Many of the observations made about commercial loan documents and the terms that developers negotiate with their lenders are based on my experience in practice representing lenders and occasionally developers in connection with loans secured by income producing properties. I confirmed my observations by reading recently negotiated loan documents which I obtained from attorneys currently practicing commercial real estate law.

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73. *Fannie Mae Guide*, *supra* note 60, § 102.01; *Freddie Mac Guide*, *supra* note 60, § 6.7.


75. See infra notes 184-85 and accompanying text.

76. Comparisons to subprime loans are in some cases based on characteristics of predatory loans. Although “most subprime loans are not predatory, predatory loans are almost always subprime.” Forrester, *supra* note 66, at 1312. See also *GAO Report*, *supra* note 67, at 4; *HUD/Treasury Joint Report*, *supra* note 67, at 2. Therefore, characteristics of predatory loans are more prevalent in the subprime market than in the prime market.
A. Financial Terms

The financial terms of the loans that the GSEs purchase provide part of the benefit homeowners receive from the GSEs.\textsuperscript{77} The GSEs purchase and securitize a wide variety of loans including 30- and 15-year fixed-rate loans, loans that are amortized over 30 years with a balloon/reset provision after several years,\textsuperscript{78} and adjustable rate loans. Therefore, consumers enjoy the benefit of having choices.\textsuperscript{79}

1. Long Term/Fixed-Rate

The primary benefit in financial terms offered by the GSEs is the availability of the long term fixed-rate loan.\textsuperscript{80} Most loans purchased and securitized by the GSEs are fixed-rate loans.\textsuperscript{81} Fixed-rate loans benefit homeowners because the homeowners do not face the risk of rising interest rates. Payments are constant for the entire term of the loan, so homeowners do not have to rely on their income to increase in order to keep up with mortgage payments. With an adjustable rate loan, however, the monthly payment rises when interest rates rise or when an introductory rate expires, and in some cases the payment may rise beyond the amount the homeowner can afford. In fact, recent increases in interest rates have forced many homeowners with adjustable rate mortgages into default and foreclosure.\textsuperscript{82} In addition, long term, amortized mortgages have equal monthly payments for the entire term of the loan and are paid in full when the last payment is made. Balloon loans on the other hand, must be refinanced in order to avoid a large payment of

\textsuperscript{77} The GSEs and some economists have focused on the availability of long-term fixed rate mortgage loans as a benefit that the GSEs provide. \textit{See infra} notes 184-85 and accompanying text.

\textsuperscript{78} The “balloon” loans purchased by the GSEs do not really balloon since they provide for a reset of the interest rate and a continuation of the term of the loan.

\textsuperscript{79} Home purchasers who desire certainty and plan to live in their home for a long time are likely to choose the 30-year fixed rate mortgage. Those who can afford a higher monthly payment can get a lower interest rate by choosing a 15-year fixed rate mortgage. Those who plan to move soon may choose a balloon loan to get a still lower interest rate. Finally, some homeowners are willing to sacrifice certainty in order to get the lowest possible initial interest rate afforded by the adjustable rate mortgage.

\textsuperscript{80} Comparisons with home mortgages in other countries, commercial mortgage loans, subprime loans, and jumbo loans provide evidence that the long-term fixed-rate loans would not be as available without the GSEs. \textit{See infra} notes 83-88 and accompanying text.

\textsuperscript{81} See Shenn & Tyson, \textit{supra} note 1.

\textsuperscript{82} See Brenden M. Case, \textit{Subprime Crisis Hits Texas Homeowners: Soaring Rates Lead Less-Qualified Borrowers to Default on Loans}, DALLAS MORNING NEWS, July 5, 2007, at 1A.
principal due at the end of the loan. Thus, the safest type of loan for the homeowner is the long term, fixed-rate loan.

In Europe, home mortgage loans tend to be variable rate or shorter term fixed-rate loans.83 Denmark and Japan are the only other developed countries where long term fixed-rate mortgages predominate.84 Commercial real estate loans in the United States may be fixed rate, but tend to have shorter terms than home mortgage loans.85 Subprime loans are more likely to be adjustable rate loans86 or to have a balloon payment than prime loans.87 The benefit of the availability of long term fixed-rate financing spills over to some extent to jumbo loans; however, jumbo loans are more likely to be adjustable rate than conforming loans.88 Therefore, borrowers with jumbo loans benefit from having the option of long term fixed-rate financing, although not to the same extent as borrowers with conforming loans.

2. Prepayment

Another beneficial financial term is the fact that conforming home mortgage loans purchased by the GSEs are fully prepayable without prepayment premium.89 As a result, homeowners can freely refinance when interest

84. Id.
86. Case, supra note 82, at 1A.
87. See GAO REPORT, supra note 67, at 19; Forrester, supra note 66, at 1313.
89. Some may argue that lenders charge higher interest rates as a type of insurance against their risk of prepayment. See John M. Harris, Jr. & G. Stacy Sirmans, Discount Points, Effective Yields, and Mortgage Prepayments, J. REAL EST. RES., Winter 1987, at 97. Other studies indicate that inclusion of prepayment premium clauses were not significantly related to rates. Alfred N. Page, The Variation of Mortgage Interest Rates, 37 J. OF BUS. 280, 294 (1964). In fact, some lenders (not planning to sell their loans to Fannie Mae or Freddie Mac) offer borrowers the option of a loan with a lower interest rate if a prepayment premium provision is included as a loan term. See Simon, supra note 65, at 11. Subprime lenders sometimes make the argument that their rates are lower because of the existence of a prepayment premium. However, studies have found that subprime loans with prepayment charges do not carry lower interest rates. See Keith S. Ernst, Center for Responsible Lending, Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages (2005), available at http://www.responsiblelending.org/pdfs/r005-PPP_Interest_Rate-0105.pdf.
rates go down. Thus, homeowners who purchase during periods of high interest rates are not locked into those rates, but homeowners who purchase during periods of low interest rates can lock in a low rate for the entire term of the loan. Commercial real estate loans made at a fixed rate almost always have a prepayment premium or a defeasance provision. Similarly, sub-prime loans are much more likely to have a prepayment premium than prime mortgage loans.

B. Legal Terms

In addition to the financial terms of loans that Fannie Mae and Freddie Mac purchase, their uniform mortgage instruments contain many other terms that are beneficial to homeowners. Most striking are the borrower’s rights upon default. Other terms of the instruments protect borrowers during the term of the loan prior to default.

1. Notice Before Acceleration

The default provisions of the uniform mortgage instruments are among the non-uniform covenants because the rights of a lender to accelerate and foreclose vary among the states. However, the provisions are uniform to the extent possible under the various states’ laws. Each of the instruments provides for a minimum notice period of thirty days prior to acceleration. For example, the Texas version of the uniform mortgage instrument, containing a typical notice provision, states:

The notice shall specify: (a) the default; (b) the action required to cure the default; (c) a date, not less than 30 days from the date the notice is given to Borrower, by which the default must be cured; and (d) that failure to cure the default on or before the date specified in the notice will result in acceleration of the sums secured by this Security Instrument and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration

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90. The disadvantage of refinancing is the closing costs, so a refinance only makes sense if the cost can be recouped through interest rate savings in a relatively short period of time.

91. See Lefcoe, supra note 85, at 202-03. A defeasance clause requires the borrower to find and purchase the lender a substitute investment that will provide the same return to the lender as the prepaid loan would have over its term.

92. Forrester, supra note 66, at 1313.

93. The most obvious variation is that some states permit power of sale foreclosure while others require judicial foreclosure.
and the right to bring a court action to assert the non-existence of a
default or any other defense of Borrower to acceleration and sale.94

A thirty-day notice period for a monetary default would be rare in a commer-
cial loan to a developer. Developers can often negotiate a grace period for a
monetary default and a notice period for a non-monetary default. For exam-
ple, a developer might negotiate a ten-day grace period for monetary defaults
and a thirty-day notice period for non-monetary defaults which take longer to
cure. Thus, developers negotiate to get provisions that may not be as favor-
able as the ones in the uniform instruments.

2. Right to Reinstatement

In addition to notice before acceleration, a uniform covenant of the uni-
form mortgage instrument gives the borrower the right to reinstate (or de-
accelerate) the mortgage up to the date of a court order of foreclosure or up to
five days prior to a power of sale foreclosure. The instrument provides:

If Borrower meets certain conditions, Borrower shall have the right
to have enforcement of this Security Instrument discontinued at
any time prior to the earliest of: (a) five days before sale of the
Property pursuant to any power of sale contained in this Security
Instrument; (b) such other period as Applicable Law might specify
for the termination of Borrower's right to reinstate; or (c) entry of a
judgment enforcing this Security Instrument. Those conditions are
that Borrower: (a) pays Lender all sums which then would be due
under this Security Instrument and the Note as if no acceleration
had occurred; (b) cures any default of any other covenants or
agreements; (c) pays all expenses incurred in enforcing this Secu-
rity Instrument, including, but not limited to, reasonable attorneys'
fees, property inspection and valuation fees, and other fees in-
curred for the purpose of protecting Lender's interest in the Prop-
erty and rights under this Security Instrument; and (d) takes such
action as Lender may reasonably require to assure that Lender's in-
terest in the Property and rights under this Security Instrument, and
Borrower's obligation to pay the sums secured by this Security In-
strument, shall continue unchanged.95

94. FANNIE MAE & FREDDIE MAC, FORM 3044, UNIFORM SECURITY INSTRUMENT:
3044-TexasDeedofTrust.doc. Because this provision is a non-uniform covenant,
some variation exists among the states based on requirements of state law.
95. FANNIE MAE & FREDDIE MAC, FORM 3044, supra note 94, § 19. Fannie Mae
and Freddie Mac permit this right to reinstate to be omitted from the form only in
Thus, even after acceleration, the borrower can stop the foreclosure and reinstate the loan by paying the amounts that would have been due absent acceleration plus the lender's expenses. Without this provision, a borrower would have to pay the entire principal balance of the loan, together with accrued but unpaid interest and the lender's expenses, in order to stop a foreclosure. Homeowners are much more likely to be able to catch up on missed payments before foreclosure than they are to be able to pay off their loan entirely after a default.

A right to reinstate after acceleration is not a provision that a lender would generally accept in a commercial loan. After acceleration, the lender wants the right to proceed to a foreclosure unless the borrower pays the full accelerated balance of the loan.

3. Late Charges

In addition to acceleration and foreclosure, another usual consequence of a borrower's default is the accrual of late charges. Both Fannie Mae and Freddie Mac charge a moderate late fee for payments made more than fifteen days after the due date. Fannie Mae requires a fee of four percent of the late payment, and Freddie Mac permits a fee of five percent of the late payment. This grace period is longer than a commercial borrower would typically receive before accrual of a late charge or default rate interest.

Fannie Mae and Freddie Mac do not permit default rate interest in addition to a late fee as many commercial real estate loans do. Commercial loans often provide for both a late charge and an increased interest rate upon default.

4. Casualty Loss and Condemnation Proceeds

In addition to these rights of the borrower after default, the uniform instruments give borrowers rights during the term of the loan absent a default. In the event of a casualty loss, the borrower has the right to apply insurance proceeds "to restoration or repair of the Property, if the restoration or repair is economically feasible and Lender's security is not lessened." A similar

states with laws more protective of the borrower than the instrument provision. See Nelson & Whitman, supra note 3, at 577.

96. See, e.g., Bell Fed. Sav. & Loan Ass'n of Bellevue v. Laura Lanes, Inc., 435 A.2d 1285, 1287 (Pa. Super. Ct. 1981) ("In a commercial mortgage, an acceleration clause is generally honored; and, once there has been a default and an acceleration, the mortgagee need not accept any less than the full accelerated amount.").

97. See Nelson & Whitman, supra note 3, at 541.

98. Id.


100. Fannie Mae & Freddie Mac, Form 3044, supra note 94, § 5.
provision applies in the case of condemnation or other proceeds except in case of a total taking or loss.\textsuperscript{101} Furthermore, when insurance or condemnation proceeds are paid, the borrower has an obligation to repair or restore the property only if proceeds are released to the borrower rather than applied to reduce the debt.\textsuperscript{102} Developers in commercial loans may typically negotiate a right to repair in the event of casualty loss with additional conditions such as the loan not being in default and the project itself still being economically feasible. However, the starting point in most lender documents would give the lender discretion to use insurance proceeds to rebuild or to pay down the loan.\textsuperscript{103} Furthermore, commercial loans are less likely to provide a right to restore the property in the event of condemnation.

5. Lender’s Consent

Other provisions of the uniform instruments require the lender to act reasonably. For example, the borrower may choose an insurance carrier “subject to Lender’s right to disapprove Borrower’s choice, which right shall not be exercised unreasonably.”\textsuperscript{104} In addition, the borrower is obligated to occupy the mortgaged property for at least a year “unless Lender otherwise agrees in writing, which consent shall not be unreasonably withheld, or unless extenuating circumstances exist which are beyond the Borrower’s control.”\textsuperscript{105}

C. Terms Not Included

Perhaps more important than the terms included in the uniform mortgage instrument are the terms not included. Many onerous or unfair provisions that often appear in other mortgage documents are not in the Fannie Mae/Freddie Mac uniform instruments.

First, the instruments do not contain a mandatory arbitration clause or a waiver of the right to trial by jury. Fannie Mae guidelines specifically mention arbitration clauses as a modification that is not acceptable in its loans.\textsuperscript{106} Subprime and/or predatory loans are much more likely to have mandatory

\textsuperscript{101} Id. \textsect 11.

\textsuperscript{102} Id. \textsect 7.

\textsuperscript{103} In some cases, commercial borrowers are not able to negotiate for the right to rebuild, and the lender retains the option to require that insurance proceeds be applied to the debt. See, e.g., Loving v. Ponderosa Sys., Inc., 479 N.E.2d 531 (Ind. 1985) (discussing mortgage provision giving the lender the right to apply insurance proceeds to debt).

\textsuperscript{104} FANNIE MAE & FREDDIE MAC, FORM 3044, supra note 94, \textsect 5.

\textsuperscript{105} Id. \textsect 6.

\textsuperscript{106} FANNIE MAE GUIDE, supra note 60, \textsect 102.01.
arbitration clauses, and commercial loan documents may require arbitration or have a waiver of jury trial.

The instruments do not contain a broad waiver of notices to the borrower. Although the promissory note forms do contain a waiver of presentment, this is hardly troublesome considering the detailed notice required to be sent to the borrower prior to acceleration. Many commercial notes contain much more comprehensive waivers of notices by the lender to the borrower.

The Fannie Mae/Freddie Mac instruments do not contain a broad reservation of rights clause permitting the lender to deal with successor owners of the property without affecting the liability of the borrower. The uniform mortgage instrument does provide that the borrower is not released by an extension or by modification of amortization agreed to with a successor owner of the property. The borrower is, therefore, entitled to raise any other suretyship defense that would arise from the lender’s dealings with a successor owner. Most commercial mortgages would contain a much broader reservation of rights clause that would permit the lender to change the interest rate, release security, or release an obligor without affecting the liability of the borrower.

The instruments do not contain a broad indemnity of the lender by the borrower. Many commercial mortgages require the borrower to indemnify the lender from various losses that the lender may incur relating to the property, including losses relating to environmental problems and losses resulting from the lender’s own negligence.

The instruments are not perfect from a consumer’s point of view. For example, they provide that notices to the borrower are effective when mailed, but the notices to the lender are only effective upon receipt. However, compared to the types of documents that a subprime borrower might have to sign and even compared to the documents that a powerful commercial developer could negotiate, the Fannie Mae/Freddie Mac uniform instruments are extraordinarily fair.

The comparison to commercial loan documents illustrates that Fannie Mae/Freddie Mac uniform instruments are as favorable, and usually more favorable, to consumers than documents that are negotiated. The comparison to subprime loan documents illustrates the types of unfavorable terms that

108. “Presentment” is “a demand made by or on behalf of a person entitled to enforce an instrument to ... pay the instrument.” U.C.C. § 3-501 (2004).
109. See supra note 94 and accompanying text.
110. FANNIE MAE & FREDDIE MAC, FORM 3044, supra note 94, § 12.
111. See NELSON & WHITMAN, supra note 4, § 5.19.
112. See FANNIE MAE & FREDDIE MAC, FORM 3044, supra note 94, § 15.
borrowers might see in loans but for the influence of the GSEs. Another useful comparison is to the terms of the typical agreement that a consumer might sign in other types of transactions.

D. Other Consumer Agreements

Most agreements that consumers enter into are contracts of adhesion. Sellers of goods or services, the stronger parties in the transactions, use standardized contracts containing terms to their benefit; and consumers, the weaker parties, are “frequently not in a position to shop around for better terms.”113 The seller participates in many transactions of the type involved, and presents the form contract on a “take-it-or-leave-it” basis, except perhaps with a few terms, such as price, that can be negotiated.114 Compared to the seller, the consumer “enters into few transactions of the type represented by the form.”115 The consumer is “unlikely to have read the standard terms before signing the document and is unlikely to have understood them if he has read them.”116

As with other consumer transactions, home mortgage lenders do not negotiate the terms of their loans and offer their loan document forms on a take-it-or-leave-it basis.117 Borrowers are unlikely to have read their loan documents before signing them, and even if they have read them, are unlikely to understand their terms.118 Consumer advocates, however, negotiated the terms of the Fannie Mae/Freddie Mac uniform instruments when they were first developed.119 As a result, the instruments are very different from other agreements that consumers enter into such as credit card agreements, residential leases, car rental agreements, shrink-wrap agreements, and click-wrap agreements.

A comparison of the uniform mortgage instruments to other consumer transactions in the credit and real estate arenas illustrates the types of onerous provisions that borrowers might face if they were forced to sign documents

113. Kessler, supra note 12, at 632. According to Professor Kessler, the reason consumers are not able to shop for better terms is “either because the author of the standard contract has a monopoly (natural or artificial) or because all competitors use the same clauses.” Id. The monopoly theory of contracts of adhesion has been mostly discredited, and “transactions costs plus agency costs, relative to the modest stakes in most consumer transactions, are sufficient explanations for why sellers prefer a form contract to individual negotiations.” Lucian A. Bebchuk & Richard A. Posner, One-Sided Contracts in Competitive Consumer Markets, 104 Mich. L. Rev. 827, 828-29 (2006).
114. See Rakoff, supra note 12, at 1177.
115. Id.
116. Id. at 1179.
117. See infra subpart E.
118. See infra notes 130-31 and accompanying text.
119. See supra notes 49-53 and accompanying text.
created by a purely private mortgage lending industry or by lenders’ trade associations. Credit card agreements, another type of consumer credit,\textsuperscript{120} typically contain onerous terms, particularly those terms applicable to the borrower’s default. On default, the consumer may be charged a substantial late fee as well as substantially higher interest rates. In addition, many credit card agreements provide for the “universal default.”\textsuperscript{121} If the borrower defaults in payment of another debt to another lender, the borrower is in default and must pay the default rate of interest.\textsuperscript{122}

Residential leases are another example of agreements that can be particularly onerous. Residential lease forms are often drafted by landlords’ trade associations.\textsuperscript{123} Most residential leases impose few duties on landlords;\textsuperscript{124} to the extent that landlords do have duties, they are imposed by courts or legislatures.\textsuperscript{125} Furthermore, most residential leases either ignore or

\textsuperscript{120} The method of contracting is different from the typical home mortgage loan transaction. The consumer typically receives an offer for a credit card that contains the terms that a consumer is most likely to consider in making a decision to apply for the card—such as interest rate and payment terms. See Ronald J. Mann, “Contracting” for Credit, 104 Mich. L. Rev. 899, 906 (2006). The consumer then completes an application, and upon acceptance is sent the credit card with additional terms in fine print. \textit{Id.} at 907. By activating the card, the consumer accepts the terms of the agreement. At this point the consumer is unlikely to read the fine print terms, and even if read, the consumer is unlikely to understand many of the complex terms. \textit{Id.} at 907-08. Furthermore, the agreement may be amended frequently with inserts in the consumer’s monthly statement. The consumer “accepts” the change by continuing to use the credit card. \textit{Id.} at 908-09.

\textsuperscript{121} See \textit{id.} at 923-24.

\textsuperscript{122} \textit{Id.}


\textsuperscript{124} For example, most of the leases impose no duty on the landlord to supply utilities, maintain common areas, or even to deliver physical possession of the property to the tenant at the commencement of the lease. See Curtis J. Berger, Hard Leases Make Bad Law, 74 Colum. L. Rev. 793, 822-24 (1974). In reaching his conclusions, Professor Berger reviewed lease forms from 16 cities all around the country, including the Texas Apartment Association form lease. See \textit{id.} at 821 n.122. A perusal of the current Texas Apartment Association form lease confirms that Professor Berger’s analysis is still valid. See Texas Apartment Association Sample Apartment Lease Contract, \textit{supra} note 123.

\textsuperscript{125} For example, most states imply a warranty of habitability in residential leases, see STOEBUCK & WHITMAN, \textit{supra} note 4, §§ 6.38, 6.39 (the former section discussing common law warranties of habitability and the latter discussing statutory
limit tenant’s remedies, but set forth the landlord’s remedies in great detail.  

Generally, the only limits on the landlord’s remedies are imposed by law.  

If lenders used residential mortgage forms they drafted themselves or forms drafted by lenders’ trade associations, the forms would probably be one-sided, with terms benefiting lenders to the extent permitted by law. Because the Fannie Mae/Freddie Mac uniform instruments were negotiated by consumer advocates, however, their terms are fair to consumers.

E. Why Fair Mortgage Documents are Particularly Beneficial to Homeowners

The fair terms of the Fannie Mae/Freddie Mac uniform instruments are of particular benefit to consumers because of the problems that consumers face in choosing consumer credit. These problems include consumers’ inability to negotiate legal terms of mortgage loan documents; their limited access to information about the legal terms of the documents as well as difficulty in understanding the terms; the existence of information overload if too much information about loan terms is available; and consumers’ inability to make good decisions about loan terms because of their tendency to underestimate the likelihood of default.

First, consumers cannot negotiated the legal terms of their mortgage loan documents. Lenders will not, and because of the economics of home mortgage lending cannot, negotiate document terms with individual home buyers (except perhaps with very large loans). Consumers must either accept the offered terms or go to another lender. Consumers are, therefore, in a “take it or leave it” situation. Negotiation is simply not an option. Even if consumers could negotiate the terms of their mortgage documents, most do not have the knowledge or expertise necessary to negotiate legal terms. Hiring an attorney to review and negotiate loan documents would greatly increase the cost of the closing.

When home mortgage lenders use the GSEs’ uniform mortgage instruments, however, negotiation is not necessary. The legal terms of the documents are already more favorable than most real estate developers can negotiate for their commercial loans. Therefore, consumers avoid costly attorneys’ fees that would ordinarily be necessary to get the balanced documents that lenders use.

implied warranties), and most states impose a duty on a landlord to deliver physical possession of the premises at the commencement of the lease, see id. § 6.21.

126. See Berger, supra note 124, at 828-30.

127. For example, many states limit the right of a landlord to evict by self-help. See STOEBUCK & WHITMAN, supra note 4, § 6.80. However, limitations on landlord’s remedies may not be sufficient. See Mary B. Spector, Tenants’ Rights, Procedural Wrongs: The Summary Eviction and the Need for Reform, 46 WAYNE L. REV. 135, 137 (2000).
Second, consumers do not have the information they need or the ability to make an informed choice of a lender based on loan documents. Consumers typically receive information about the interest rate and term of the loan before they make a loan application. In fact, consumers often "shop" for the best interest rate offered by various lenders.\textsuperscript{128} In addition, the Real Estate Settlement Procedures Act requires lenders to provide a written "good faith estimate" of closing costs within three business days after receiving a loan application.\textsuperscript{129} However, loan documents are usually not prepared until shortly before closing. Thus, consumers are unlikely to see loan documents until it is too late to choose a different lender.\textsuperscript{130} Even when consumers are given the opportunity to review loan documents before closing, they are unlikely to understand their terms enough to make an informed choice among lenders.\textsuperscript{131} Only sophisticated borrowers would be able to make an informed decision based on the legal terms of loan documents.

Because most lenders use the Fannie Mae/Freddie Mac uniform mortgage instruments, however, consumers do not need to shop for their loan based on the legal terms of the documents. The documents are usually identical to those used by other lenders, and in fact are more favorable to the borrower than consumers would probably expect.

Third, when consumers can choose among providers of mortgage credit, they are only able to consider a limited number of variables. If people were strictly rational, they would consider all relevant factors when making decisions and would have unlimited computational capabilities to balance all of the factors in the decision-making process.\textsuperscript{132} If this were the case, consumers would always benefit from increased product information disclosure. On the contrary, because people are not "perfectly rational,"\textsuperscript{133} the availability of

\begin{itemize}
\item \textsuperscript{129} 12 U.S.C. § 2604(c), (d) (2006).
\item \textsuperscript{130} When the consumer sees loan documents for the first time, often at closing, the consumer may not even read the documents because of the volume of documents to be signed at closing.
\item \textsuperscript{131} See generally Rakoff, supra note 12, at 1179 (discussing this problem in the context of contracts of adhesion). Consumers who try to consider too many attributes in choosing a loan may also face information overload. See infra notes 134-36 and accompanying text.
\item \textsuperscript{133} See Paredes, supra note 132, at 435; Simon, supra note 132, at 2. People are "boundedly rational" rather than "perfectly rational;" thus, their cognitive capabilities are scarce and must be allocated. See Paredes, supra note 132, at 435; Simon, supra note 132, at 2.
\end{itemize}
too much information gives rise to "information overload." Some commentators believe that because of information overload, a consumer may not be able to make a good choice if the number of relevant attributes that the consumer considers exceeds three. Other commentators conclude that when too many attributes are available, consumers select the ones they believe are the most important. In choosing a home mortgage loan a typical borrower would focus only on the most important and available attributes, probably those relating to interest rate, loan term, monthly payments, and possibly closing costs. Other attributes are not available, non-negotiable, or too confusing. Thus, a consumer is likely to accept onerous legal terms while focusing only on the most important financial terms of the transaction. Therefore, lenders would not "compete" on legal terms of documents, and would have no incentive to offer particularly fair terms.

Because so many residential mortgage lenders use the uniform instruments, whether the loans are to be sold to the GSEs or not, the number of attributes that a consumer must choose from is greatly reduced. With fewer attributes to choose from, the consumer is less likely to experience information overload. In addition, because the only choice of loan documents is a good choice, consumers only need to focus on financial terms. Although lenders use the documents, not as a means to induce potential customers to

135. See Mann, supra note 120, at 910.
136. See id. at 911; Grether, supra note 134, at 299-300; Russell Korobkin, Bounded Rationality, Standard Form Contracts, and Unconscionability, 70 U. CHI. L. REV. 1203, 1203 (2003); Nicholas H. Lurie, Decision Making in Information-Rich Environments: The Role of Information Structure, 30 J. CONSUMER RES. 473, 482 (2004). Consumers "are boundedly rational decisionmakers who will normally price only a limited number of product attributes as part of their purchase decision." Korobkin, supra, at 1203.
137. In the context of credit cards:
[T]he rational approach for the typical cardholder will be to select a product based on a small number or price and service attributes that are of obvious relevance, recognizing that the remaining terms of the agreement are non-negotiable. . . . [E]mpirical research suggests a typical consumer selects a card based on the brand, annual fee, grace period, affinity or rewards benefits, and the stated interest rate if the consumer expects to pay interest in the immediate future.
Mann, supra note 120, at 911.
138. "When contract terms are not among [the attributes considered as part of the purchasing decision], drafting parties will have a market incentive to include terms in their standard forms that favor themselves, whether or not such terms are efficient." Korobkin, supra note 136, at 1203.
choose their product, but to facilitate the sale of their loans on the secondary market, borrowers nevertheless benefit.

Finally, because consumers tend to underestimate the likelihood of their default on a loan, the foreclosure of their home, or the occurrence of a casualty loss, they are likely to underestimate the importance of legal terms relating to default, foreclosure, and casualty loss. Empirical studies show that people tend to underestimate the occurrence of certain low-probability, high-loss events. Default on a home mortgage loan, loss of a home to foreclosure, and loss of a home by fire, flood, or other casualty are low-probability events that involve a major loss.

In judging the probability of the occurrence of an event, people use short-cuts, called "heuristics," which make the judgment process simpler but lead to serious errors. One heuristic that may be involved in a person's underestimation of the risk of foreclosure or casualty loss is the "availability" heuristic, which causes people to judge an event as probable only if it is easy to imagine. Because default, foreclosure, and casualty loss occur infre-


141. The current delinquency rate for home mortgage loans was 4.84% in the first quarter of 2007, and the percentage of loans in foreclosure was 1.28%. See Press Release, Mortgage Bankers Association, Delinquencies Decrease in Latest MBA National Delinquency Survey (June 14, 2007), available at http://www.mortgagebankers.org/NewsandMedia/PressCenter/55132.htm. These percentages represent an increase from last year. Id.


143. See Carmen Keller et al., The Role of the Affect and Availability Heuristics in Risk Communication, 26 Risk Analysis 631, 632 (2006); Paul Slovic, Baruch Fischhoff & Sarah Lichtenstein, Facts Versus Fears: Understanding Perceived Risk, in Judgment Under Uncertainty: Heuristics and Biases, supra note 142, at 463,
quently and are unlikely to receive a great deal of publicity, homeowners tend to underestimate their likelihood.\textsuperscript{144} Another relevant heuristic is called “anchoring,” which causes people to make judgments by reference to a starting point and have a bias towards that starting point.\textsuperscript{145} Because anchoring may cause people to overestimate the likelihood of success and underestimate the possibility of failure, homeowners will tend to underestimate the risk of default on their home mortgage loan, foreclosure of their home, or casualty loss.\textsuperscript{146}

Another factor relevant to the underestimation of risks is “unrealistic optimism,” people’s tendency to believe that negative events will affect others but not themselves.\textsuperscript{147} This optimism would tend to cause homeowners to estimate their own risk of default, foreclosure, or casualty loss as lower than a third party’s risk. Furthermore, the more control people believe they have in avoiding a risk, the more optimistic they are about their susceptibility to harm from that risk.\textsuperscript{148} Since homeowners feel they have control over making their

\textsuperscript{145} Robyn A. LeBoeuf & Eldar Shafir, \textit{The Long and Short of It: Physical Anchoring Effects}, 19 J. BEHAVIORAL DECISION MAKING 393, 404 (2006); Tversky & Kahneman, supra note 142, at 14. Even when new information becomes available, people resist changing their evaluation of the probability of an event. Noll & Krier, supra note 140, at 754.

\textsuperscript{146} See Thomas H. Jackson, \textit{The Fresh-Start Policy in Bankruptcy Law}, 98 \textsc{Harv. L. Rev.} 1393, 1411-12 (1985); Schill, supra note 128, at 528.


\textsuperscript{148} Adam S. Goodie, \textit{The Effects of Control on Betting: Paradoxical Betting on Items of High Confidence With Low Value}, 29 J. EXPERIMENTAL PYSCHOL. 598, 599 (2003); Weinstein, \textit{Why It Won’t Happen}, supra note 147, at 452; Dan Zakay, \textit{The...
mortgage payments, they underestimate their likelihood of defaulting in payment.

Because homeowners are likely to underestimate their risk of default on a mortgage loan and their risk of a casualty loss, they are unlikely to be particularly concerned with loan document provisions relating to these events. Consumers are likely to underestimate the importance of such provisions in loan documents. However, the uniform mortgage instruments are particularly fair in their treatment of a defaulting homeowner and in the case of casualty loss. Therefore, consumers are better protected against the consequences of these events than they realize they need to be.

Thus, the Fannie Mae/Freddie Mac uniform mortgage instruments are particularly beneficial to consumers because mortgage loan documents are typically not negotiable, because consumers do not have adequate information or the ability to choose between lenders based on the legal terms of their loan documents, because consumers either would experience information overload when faced with choosing based on legal terms or would ignore those terms altogether, and because consumers are unlikely to be concerned with important document provisions relating to default and casualty loss.

IV. RECENT CRITICISM OF THE HOUSING GSEs AND THE PRIVATIZATION DEBATE

A. Criticism

In recent years, Fannie Mae and Freddie Mac have been the subject of much criticism. In the late 1980s, housing advocates believed that underwriting guidelines used by Fannie Mae and Freddie Mac favored white suburban homebuyers. In response to this and other issues, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 to give the housing GSEs incentives to purchase loans to low and moderate-income families and in low and moderate-income neighborhoods. The Act required HUD to set affordable housing goals for loans purchased by Fannie Mae and Freddie Mac, and prohibited them from discriminating on the

1102


149. See supra subpart B.


152. Id. § 1331(a) (codified at 12 U.S.C. § 4561(a)). HUD set goals for loans secured by homes of low- and moderate-income homeowners/renters at fifty percent and loans located in underserved areas at thirty-one percent. See AMBROSE & THIBODEAU, supra note 150, at vii.
basis of prohibited factors.\textsuperscript{153} Despite the Act, the GSEs continue to receive criticism for not doing enough in the area of affordable housing,\textsuperscript{154} and disagreement exists as to their success on this front.\textsuperscript{155} 

In the late 1990s, both GSEs were accused of being involved in the predatory lending problem by purchasing and securitizing subprime loans that could be characterized as predatory. Both Fannie Mae and Freddie Mac responded immediately with initiatives to avoid purchasing or securitizing predatory loans.\textsuperscript{156} More recently, both GSEs have offered to help victims of


\textsuperscript{155} A recent study sponsored by HUD considered the impact of the affordable housing goals required by the FHEFSSA on low- and moderate-income families. AMBROSE & THIBODEAU, \textit{supra} note 150, at vii. The study found that the goals helped make homeownership more attainable for these families. \textit{id.} at ix. In response to FHEFSSA, Fannie Mae and Freddie Mac adopted more flexible underwriting standards and introduced automated underwriting systems which reduced underwriting costs. As a result, lenders that sell loans to Fannie Mae and Freddie Mac began using more flexible underwriting standards that permitted more borrowers to qualify for the loans. \textit{id.} at vii-ix. In addition, purchases by Fannie Mae and Freddie Mac of loans to lower income borrowers and in target neighborhoods increased liquidity and allowed additional lending activity to these borrowers and in these neighborhoods. \textit{id.} at ix. The study suggests that the affordable housing goals have thus helped make homeownership more attainable to low- and moderate-income families.

\textsuperscript{156} See \textit{Press Release, Fannie Mae, Fannie Mae Chairman Announces New Loan Guidelines to Combat Predatory Lending Practices} (Apr. 11, 2000), \textit{available at} http://www.csrwire.com/PressRelease.php?id=35 (citing Lender Letter LL03-00, Eligibility of Mortgages to Borrowers with Blemished Credit Histories); \textit{Press Release, Freddie Mac, Freddie Mac Announces Steps to Protect Borrowers from Predatory Lending Practices} (Mar. 24, 2000), \textit{available at} http://www.freddiemac.com/news/archives2000/predatory.htm. Fannie Mae will not purchase or securitize loans with points and fees in excess of five percent, loans identified as "high-cost" mortgages under HOEPA, loans with prepaid single premium credit insurance, or loans with prepayment premiums unless the borrower has received a benefit. \textit{See Fannie Mae Press Release, supra.} Fannie Mae requires its lenders to determine the borrower's ability to repay, to avoid steering borrowers to higher-cost loans if they qualify for a lower-cost loan, to report a borrower's entire payment history to credit repositories (to improve the borrower's credit history), and to maintain escrow deposit accounts. \textit{See id.} Freddie Mac will not purchase HOEPA loans, loans with single premium credit insurance, loans with prepayment penalties that continue for more than three years, or loans with mandatory arbitration clauses. \textit{See Freddie Mac Combats Predatory Lending,} http://www.freddiemac.com/singlefamily/anti-predatory.html (last visited Nov. 9, 2007). Freddie Mac requires its lenders to report a borrower's entire payment history to credit repositories and refuses to purchase loans from lenders that engage in predatory lending practices. \textit{See id.}
subprime or predatory lending schemes by promising funds for loans these homeowners may obtain to refinance out of their existing loans.\textsuperscript{157}

In recent years, the GSEs have been criticized because of accounting problems and misleading financial disclosures.\textsuperscript{158} Both Fannie Mae and Freddie Mac have been involved in accounting scandals resulting in reporting errors in the billions of dollars,\textsuperscript{159} with Fannie Mae overstating profits by $6.3 billion\textsuperscript{160} and Freddie Mac misstating earnings by almost $5 billion.\textsuperscript{161} Both GSEs used “cookie jar” accounting — a term for reserving money in good years to be used later in bad years in order to smooth out earnings.\textsuperscript{162} By smoothing out earnings, Fannie Mae and Freddie Mac overstated their earnings and understated their risks,\textsuperscript{163} thus misleading the market and resulting in artificially high market prices.\textsuperscript{164} In 2003, top Freddie Mac officials, including CEO Leland Brendsel, resigned; and Freddie Mac agreed to pay $125 million in fines.\textsuperscript{165} Later Fannie Mae’s top officials, including CEO Franklin Raines, were forced to resign, and Fannie Mae agreed to penalties of $400 million.\textsuperscript{166} As recently as spring of 2007, OFHEO criticized the GSEs for delays in implementing risk controls.\textsuperscript{167}

The GSEs have also been criticized based on concerns about their financial stability and the feared effects of their failure on the national economy.\textsuperscript{168}


\textsuperscript{158} See Andrews, supra note 20, at C1; Stephen Labaton, Limits Urged in Mortgage Portfolios, N.Y. TIMES, Apr. 7, 2005, at C1; Shenn & Tyson, supra note 1.

\textsuperscript{159} See Jonathan Glater, Fannie Mae Corrects Mistakes In Results, N.Y. TIMES, Oct. 30, 2003, at C1; OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT, REPORT OF THE SPECIAL EXAMINATION OF FANNIE MAE (2006).


\textsuperscript{161} See James Tyson, Freddie Mac’s Progress is Criticized by Regulator, WASH. POST, Nov. 16, 2006, at D03.


\textsuperscript{164} See Lee, supra note 162, at C1.

\textsuperscript{165} See Thomas A. Fogarty, Regulators Fine Former Freddie Mac CEO $5.8 Million, USA TODAY, Dec. 18, 2003.

\textsuperscript{166} See Lee, supra note 162, at C1; Hilzenrath, supra note 160, at D01.


\textsuperscript{168} See WALLISON, supra note 21, at 2-10; David Reiss, The Federal Government’s Implied Guarantee of Fannie Mae and Freddie Mac’s Obligations: Uncle Sam Will Pick Up the Tab, 42 GA. L. REV. (forthcoming 2008), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=david_reiss;
The risk to taxpayers and the economy is a result of the government’s implied guaranty of the GSEs’ obligations and the size of the GSEs. Although the government denies any responsibility for their obligations, the market has behaved as if a guaranty exists. In the past, Congress has come to the assistance of Fannie Mae and has bailed out another government-sponsored enterprise, the Farm Credit System. Critics claim that a rescue of the GSEs would dwarf the savings and loan bailout of the 1980s and 1990s and that financial problems for the GSEs would create a risk to the national economy.

In response to accounting problems, concerns about the financial stability of the GSEs, and concerns about the risks they pose to the national economy, Congress has considered changing the regulatory structure governing the housing GSEs and limiting the size of their retained portfolios of loans. Bills have been introduced in recent sessions that would strengthen regulatory control over the GSEs and limit their size, but none has yet passed.

B. The Privatization Debate

Recent criticism of Fannie Mae and Freddie Mac has renewed debate over whether they should be converted to wholly private entities. The privatization debate is not new. As far back as the 1950’s, private market participants in the mortgage market have complained that they cannot compete against the GSEs. The Federal Housing Enterprises Financial Safety and

Anthony B. Sanders, Government Sponsored Agencies: Do the Benefits Outweigh the Costs?, 25 J. REAL EST. FIN. & ECON. 122 (2002); Andrews, supra note 20, at C1; Labaton, supra note 158, at C1.

169. The GSEs’ charters explicitly deny any government guarantee of their obligations. See 12 U.S.C. § 1719(b), (d)-(e) (2006) (Fannie Mae); id. § 1455(h) (Freddie Mac).

170. See supra notes 20-21 and accompanying text.

171. See Reiss, supra note 168, at 48.

172. In 1987, “Congress and the administration developed and implemented a $4 billion bailout plan.” WALLISON, supra note 21, at 3.

173. See id.

174. See id. at 6-10.


177. In discussing the FNMA Charter Act of 1954, supplementary information provided in the implementation of regulations by HUD stated:

As the volume of FNMA’s operations increased, traditional mortgage lenders complained that FNMA’s participation in the mortgage-lending field depressed mortgage interest rates to unreasonably low levels and competed unfairly with private enterprise. In the early 1950’s various organizations of traditional mortgage lenders advocated winding up FNMA
Soundness Act of 1992 required the Comptroller General, the Secretary of Housing and Urban Development, the Secretary of the Treasury, and the Director of the Congressional Budget Office to conduct a study of privatization,178 resulting in studies published in 1996.179 Despite these studies, Congress has not acted to privatize the GSEs.

Economists, lawmakers, and other interested parties on both sides of the issue discuss whether the housing GSEs are efficient in passing the government subsidies they receive on to consumers.180 They measure the costs of the government subsidies as well as the benefits that the GSEs create. On the benefit side, they often focus on only two benefits—the GSEs’ success both in lowering mortgage interest rates for conforming loans and in reaching their

or replacing it with a secondary market facility which would ultimately become privately financed and operated. These traditional mortgage lenders pointed out that they could not afford to deal in the low-interest-rate, longterm mortgages purchased by FNMA. These lenders stated that FNMA was able to purchase such mortgages only because “it raised its investible funds under the protection of the Treasury at rates below the rates private investors paid for their funds.”

Id.


affordable housing goals. They sometimes include benefits such as integrating mortgage and capital markets and stabilizing mortgage markets. The benefit of lowering interest rates is ostensibly easy to quantify and thus a major focus of economists involved in the debate. Those opposed to the GSE structure find that the costs of the government subsidies exceed the benefits of lower interest rates and that the GSEs provide an inefficient method for passing the government subsidies through to the public.

The GSEs and their proponents raise other benefits they believe should be included in the balance and reach a contrary result. For example, proponents have considered the availability of financial terms such as long-term fixed-rate loans and free prepayment as benefits that must be considered in the balance. A recent Freddie Mac report discusses the benefits of these financial terms, of the GSEs' contributions to increasing macroeconomic stability by reducing fluctuations in the housing market, and of the GSEs' promotion of other important social goals related to increasing the rate of homeownership.

The benefits of the legal terms of the Fannie Mae/Freddie Mac uniform mortgage instruments should also be considered in the balance of the costs and benefits of the GSEs. If Fannie Mae and Freddie Mac were privatized, they would not receive the same type of public, congressional, and administrative scrutiny that they are now under. As a result, it is highly unlikely that they would promulgate, or require for loans they purchase, mortgage loan documents as fair and balanced as the current Fannie Mae/Freddie Mac uniform mortgage instruments. Or they (and other secondary market purchasers) might require the use of forms drafted by a trade association. Their loan documents would more likely mirror the ones used for most subprime or predatory loans or contain the types of terms seen in other consumer transactions.

181. See Passmore, Effect, supra note 180, at 2.
182. See FANNIE MAE RESPONSE, supra note 180, at 12.
183. See 1996 CBO REPORT, supra note 179; 2001 CBO REPORT, supra note 180.
185. MILLER & PEARCE, supra note 1, at 17-21. The report focuses in particular on the benefits to children from growing up in owner-occupied homes. Id. at 21 (citing Robert J. Sampson & Jeffrey Morenoff, Durable Inequality: Spatial Dynamics, Social Processes, and the Persistence of Poverty in Chicago Neighborhoods, in POVERTY TRAPS (Samuel Bowles et al. eds. 2006)).
186. Professor Reiss compares standardization in the subprime market by the GSEs, which he concludes has a beneficial impact, with standardization by the three major rating agencies, which he concludes is against the public interest. See David Reiss, Subprime Standardization: How Rating Agencies Allow Predatory Lending to
Alternative means could provide fair standardized home mortgage loan documents. Congress could promulgate required mortgage terms or could delegate to HUD or another agency the task of promulgating home mortgage forms. Individual states also could promulgate and require the use of particular forms for mortgages in their states. However, this type of legislation has not been adopted for mortgages or other types of consumer credit. Thus, proponents of privatization should not rely on Congress or state legislatures to promulgate fair home mortgage forms.

Although difficult to quantify, the uniform instruments provide real and substantial benefits to homeowners, especially in light of the inability of consumers to negotiate loan documents and their inability to properly assess the benefits that fair and balanced legal terms provide. The difficulty of quantifying the benefit is increased by the fact that the benefit spills over to homeowners whose loans are not purchased by the housing GSEs and even to homeowners whose loans are not eligible for purchase by the GSEs.

Some may argue that lenders increase their interest rates to account for the additional costs that fair terms provided to consumers impose on them. Professor Michael Schill in a study of the economic consequences of the mortgagor protection laws, such as statutory rights of redemption and anti-deficiency statutes, determined that additional consumer protection given by law in some states did not cause a substantial increase in the cost of credit. Similarly, mortgagor protections in loan documents may not increase the cost of credit. Assuming the terms of the uniform instruments do not cause an increase in interest rates for the loans they document, they provide tangible benefits that homeowners enjoy and that should be considered in the debate.

If lenders do charge higher interest rates because of the terms of the documents they use, those higher interest rates distort measures of the benefits that the housing GSEs provide in lowering interest rates. One of the benefits that the economists consider is the GSEs’ success in lowering mortgage interest rates for conforming loans. Therefore, if the use of fair loan documents causes an increase in the interest rates charged, then the interest rate differential between GSE and non-GSE loans would appear smaller.


187. Professor Korobkin calls for legislatures to mandate non-salient terms of consumer contracts because “the market check on seller overreaching is absent.” Korobkin, supra note 136, at 1207.

188. Such legislation is not currently necessary in the conforming loan market because of the GSEs and their uniform mortgage documents. It would be beneficial in the subprime mortgage market, but has not been forthcoming.

189. See supra notes 61-72 and accompanying text.

190. This argument has been made with respect to freely prepayable loans. See supra note 89 for a discussion of this debate.

191. See Schill, supra note 128, at 537-38.

192. See supra note 181 and accompanying text.
Thus, consideration of the benefits of the legal terms of the documents in balancing the costs and benefits of the GSEs becomes all the more important.

V. CONCLUSION

Fannie Mae and Freddie Mac uniform instruments have become the standard for use by residential lenders, including many who do not intend their loans to be sold to the GSEs. The instruments are fair to consumers as shown by a comparison with terms of commercial mortgage loan documents, subprime mortgage loan documents, and other types of consumer documents. Consumers benefit from the uniform instruments because home mortgage loan documents are not negotiable, because consumers usually do not have the information needed or the ability to shop for a loan based on legal terms, because consumers experience information overload or consider a limited number of variables in choosing among mortgage lenders, and because consumers are likely to underestimate the importance of certain legal terms of their mortgage documents.

Parties involved in the debate over privatization of Fannie Mae and Freddie Mac and in balancing their costs and benefits must consider all of the relevant factors including benefits the GSEs provide that are difficult to quantify. One such benefit that has thus far been ignored is the benefit of the fair and balanced legal terms of the Fannie Mae/Freddie Mac uniform instruments. It is a benefit that must be considered in the ongoing debate.