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Environmental Superliens and the Problem of Mortgage-Backed Securitization

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I. Introduction

On January 23, 1980, New Jersey, one of the leading state laboratories for environmental regulation,[1] enacted a new provision of its environmental laws. That provision allowed the state environmental agency to obtain a lien against environmentally-contaminated property to recover funds that the state expends, under state environmental law, to remediate any contamination.[2] This lien, however, was not ordinary; it was, rather, a "superlien," which is a lien that enjoys priority as to other liens against the contaminated property *even if such other liens predate the state's lien.*[3] Attracted by the prospect of increasing the likelihood of recovering funds expended on environmental cleanups, a number of states followed New Jersey's lead and enacted superlien statutes during the 1980s; thus, for a time it seemed that a trend was developing.[4]

Not everyone endorsed the superlien mechanism. The enactment of these superlien statutes drew the ire of the mortgage lending community.[5] This

1. *See* Barry G. Rabe, *Environmental Regulation in New Jersey: Innovations and Limitations*, 21 PUBLIUS 83, 83 (1991) (noting that in light of New Jersey's diverse population density, industrial diversity and concentration, and problems of environmental degradation, that state's environmental programs consist of "unusually diverse array of programmatic innovations" making New Jersey "a model for other states and the federal government"); *see also* Jonathan H. Adler, *Wetlands, Waterfowl, and the Menace of Mr. Wilson: Commerce Clause Jurisprudence and the Limits of Federal Wetland Regulation*, 29 ENVTL. L. 1, 45 (1999) ("Allowing the states to operate as green 'laboratories of democracy' can produce both economic and environmental gains." (footnote omitted) (quoting New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting))).

2. N.J. STAT. ANN. § 58:10-23.11f(f) (West Supp. 2000).

3. *See infra* note 79 for additional discussion of the definition of "superlien."

4. Early superlien statutes "seem, for the most part, to have been enacted with little fanfare." Margaret Murphy, *The Impact of "Superfund" and Other Environmental Statutes on Commercial Lending and Investment Activities*, 41 BUS. LAW. 1133, 1158 (1986). *See generally id.* (discussing effect of environmental statutes on commercial financing transactions).

5. *See* JOEL S. MOSKOWITZ, ENVIRONMENTAL LIABILITY AND REAL PROPERTY TRANSACTIONS: LAW AND PRACTICE § 24.8, at 337 (2d ed. 1995) ("Mortgage lenders, particularly the Federal National Mortgage Association . . . [,] were particularly unenthusiastic about such statutes."); William J. Hamel, *Is the Great Superlien Scare Finally Over?*, 21 Env't Rep. (BNA) 853, 853 (Aug. 31, 1990) ("Lenders have . . . taken the offensive in attempting to limit the spread

animus came to a head in 1983 when, mere months after Massachusetts enacted its own superlien statute, the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac),[6] a corporation with ties to the federal government, quietly, but suddenly and deliberately, suspended its purchases of apartment and condominium mortgages in Massachusetts. The FHLMC gave the state one month to amend the superlien statute before it would stop purchasing single-family residence mortgages in the state.[7] Another purchaser of residen-

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of superlien provisions to other states, and the fruits of their labors are beginning to show."); *see also* Norman R. Newman, *How to Counsel the Land Developer on Superfund and Superliens, in* ENVIRONMENTAL LAW IN CORPORATE TRANSACTIONS 43.001, 43.012 (1999) ("These superliens have created a great deal of consternation among lenders, real estate developers and investors, and title insurance companies in those few states that have adopted this enforcement device.").

Other aspects of hazardous waste liability laws have concerned lenders over the years as well. In particular, the subject of direct lender liability for hazardous waste site cleanups has dogged lenders. In *United States v. Fleet Factors Corp.*, the United States Court of Appeals for the Eleventh Circuit held that a creditor can be liable for cleanup costs "without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the [owner's] treatment of hazardous wastes." United States v. Fleet Factors Corp., 901 F.2d 1550, 1557 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991). In response to lenders' concern about decisions such as *Fleet Factors*, in 1992 the EPA issued a regulation that interpreted CERCLA's secured creditor exemption, CERCLA § 101(20)(A), (E), 42 U.S.C. § 9601(20)(A), (E) (1994). *See* National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 57 Fed. Reg. 18,344 (Apr. 29, 1992) (codified at 40 C.F.R. § 300.1100). This rule asserts that lender "participation in the management of a facility" means "actual participation in the management or operation of the facility . . . and does not include the mere capacity or unexercised right or ability to influence facility operations." *Id.* at 18,375. However, the United States Court of Appeals for the District of Columbia Circuit declared the EPA's rule invalid as either a legislative or interpretative rule. *See* Kelley v. EPA, 15 F.3d 1100 (D.C. Cir. 1994) (vacating EPA's lender liability rule because courts are proper designators of such liability under CERCLA), *cert. denied*, 513 U.S. 1110 (1995). Subsequently, the EPA and the Department of Justice adopted the stricken regulation "as a policy statement for the limited purposes of government enforcement actions against lenders." MICHAEL T. MADISON ET AL., THE LAW OF REAL ESTATE FINANCING ¶ 13.10[2], at 13-79 (rev. ed. 1999).

In 1997, as part of the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996, Congress amended CERCLA to incorporate much of the substance of the EPA's invalidated regulation. *See id.* § 13.10[3], at 13-79. In effect, this enactment validated the invalidated regulation. *See id.* at 13-80. In addition, many states have enacted their own lender liability exemptions under their own superfund laws. *See id.* at 13-81 n.338. *See generally* 2 MARK E. BUDNITZ & HELEN DAVIS CHAITMAN, THE LAW OF LENDER LIABILITY ¶ 9.02[6][c]-[e] (2000) (presenting overview of real estate finance legal issues); 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 4.48, 4.49 (3d ed. 1993 & Supp. 2000) (same).

6. As explained below, the Federal Home Loan Mortgage Corporation is a quasi-governmental corporation established, in part, to create and maintain a viable secondary mortgage market. *See infra* notes 48, 50-52, and accompanying text.

7. *See* Laurel E. Lockett, *Environmental Liability Enforcement and the Bankruptcy Act of 1978: A Study of H.R. 2767, the "Superlien" Provision*, 19 REAL PROP. PROB. & TR. J. 859, 863 (1984) (discussing effect of proposed superlien legislation on property values); Mary T. Koelbel, Note, *The Impact of State "Superlien" Statutes on Real Estate Transactions*, 5 VA. J.

tial mortgages with ties to the federal government, the Federal National Mortgage Association (FNMA or Fannie Mae), also pressured Massachusetts in a similar manner.[8]

The action taken by Freddie Mac and Fannie Mae resulted in tangible consequences on the housing market in Massachusetts.[9] Further, the threat of a more extensive withdrawal from the state by Freddie Mac and Fannie Mae raised the specter of additional adverse consequences for the Massachusetts mortgage and housing industries, as well as for homebuyers. This additional threat convinced the Massachusetts legislature to pass an amendment within a month that exempted "real property the greater part of which is devoted to single or multi-family housing" from the scope of its superlien provision.[10]

The actions of the mortgage lending industry curtailed the expansion of the superlien mechanism across the nation. Other states soon followed Massachusetts's lead and exempted residential property from their superlien provisions. Today, only two states – Louisiana and Michigan – have chosen not to exempt residential property from their environmental superlien statutes.[11] Yet, even those two states substantially circumscribe the risks to residential mortgage lenders.[12] Moreover, in the late 1980s the trend toward proliferation of superlien statutes subsided.[13] Only eight states now have superlien statutes.[14]

NAT. RES. L. 297, 299 (1986) (comparing effects of different state superlien statutes on similar real estate transactions). Some commentators describe the Federal National Mortgage Association (another corporation with ties to the federal government) as also having threatened Massachusetts in this respect.

8. *See Direct Governmental Review, Restriction, and Prohibition of Private Sector Transactions and Property Transfers: Panel Discussion*, 18 Envtl. L. Rep. (Envtl. L. Inst.) 10,374, 10,379 (Sept. 1988) (noting quasi-governmental entities pressuring Massachusetts (statement of Michael P. Last)).

9. Newspapers reported that the FHLMC action resulted in about a dozen multi-family residence projects being delayed, and another eleven being abandoned altogether. Lockett, *supra* note 7, at 863; Koelbel, *supra* note 7, at 299.

10. *See* MASS. GEN. LAWS ANN. Ch. 21E, § 3 (amended 1983) (West 2001); *see also* Lockett, *supra* note 7, at 863 (discussing changes and exemptions in Massachusetts' superlien law); Koelbel, *supra* note 7, at 299 (same). Massachusetts amended its statute despite a public statement by its governor "that he would veto any legislation gutting the state Superfund." Lockett, *supra* note 7, at 863. Arkansas, too, enacted restrictions on its superlien statute in response to pressure from the FHLMC and the FNMA. *See* Michael H. Schill, *Lender Liability Under CERCLA and State Superlien Statutes*, C473 A.L.I.-A.B.A. 297, 317-18 & n.38 (1990) [hereinafter Schill, *Lender Liability*] (noting Arkansas restriction of superlien statute). Pressure was also brought to bear in Connecticut. *See* Robert S. Bozarth, *Environmental Liens and Title Insurance*, 23 U. RICH. L. REV. 305, 323 (1989) (discussing additional FHLMC pressure in Connecticut); *infra* notes 134-35 and accompanying text.

11. *See infra* notes 133-34 and accompanying text.

12. *See infra* notes 139-43 and accompanying text.

13. "The trend towards superliens has faltered recently. Arkansas and Tennessee deleted superlien provisions from their cleanup statutes. In 1988, efforts to create environmental superliens in Kansas, New York, and Pennsylvania were defeated." Bozarth, *supra* note 10, at 324.

Some states have repealed their superlien statutes,[15] and only one state has enacted a superlien statute since the end of 1990.[16]

According to the prevailing wisdom, the mortgage lending industry vigorously opposed state superlien statutes because superlien statutes decreased the return lenders could expect from foreclosures on defaulted mortgage loans and, as a result, would substantially increase the price of borrowed funds. In this Article, I argue that this prevailing wisdom is flawed. I demonstrate the insignificance of the immediate economic impact of superlien statutes on residential mortgage borrowers.[17] I then explain that the real cost of superlien statutes to lenders is the nonuniformity that they introduce between states in the laws governing lien priority – and the possibility of future extensions of this nonuniformity into other areas of state law governing lien priority.

The fact that the immediate economic impact of a superlien statute on mortgage pricing remains small suggests that securitization promoters may choose simply to price mortgages from different states without regard to the variations in law across the states. For example, the industry responded to nonuniformity in mortgagor protection laws across state lines in this manner.[18] However, as evidenced by the experience in Massachusetts,[19] residential real estate mortgage securitization promoters disfavored state enactments of superlien statutes.

I argue that the decision by the lending and securitization industries to refuse, in the context of superlien legislation, to price mortgages without regard

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In addition, at least in the early stages, states with superlien statutes other than New Jersey did not "put [their statutes] to much use." Murphy, *supra* note 4, at 1159. Murphy notes that, "[w]hile not articulated, the relative disuse of the superlien statute in any given state could . . . reflect uncertainty as to its effect on investment activity in the state. Clearly, as bankers gain experience with these statutes they become more vocally opposed to them." *Id.*

14. *See infra* note 78 and accompanying text (examining states currently retaining superlien laws).

15. *See* Schill, *Lender Liability*, *supra* note 10, at 316-17 ("In the past year or two, two states that had superlien statutes, Arkansas and Tennessee, have replaced them with non-priority liens.").

16. *See* David P. Farer, *Transaction-Triggered Environmental Laws, Transfer Notice Laws and Super Liens: Latest Developments* § V.A, *in* I ALI-ABA, COURSE OF STUDY MATERIALS: THE IMPACT OF ENVIRONMENTAL LAW ON REAL ESTATE AND OTHER COMMERCIAL TRANSACTIONS 199, at 291-94 (1999) (noting recent trends disfavoring superlien legislation); *infra* note 79 (discussing different definitions of "superliens" and discussing various commentators' views as to states that have superlien statutes).

17. *See infra* Part V.A (finding only insignificant impact of superlien statutes on residential mortgage borrowers).

18. *See infra* note 197 and accompanying text (discussing pricing structures of mortgage lenders in response to state mortgagor protection laws).

19. *See supra* notes 5-10 and accompanying text (examining reaction in Massachusetts to state superlien laws).

to that risk, and instead to demand that residential mortgage liens not be subject to superlien legislation, arises from the nature of the nonuniformity in state laws introduced by superlien statutes.[20] In particular, state superlien statutes create nonuniformity in the law in an area that has been a cornerstone of the securitization movement – the predictability of lien preference ordering. If the mortgage lending industry permits any nonuniformity in the laws governing lien preference ordering, it risks relinquishing control over the future growth and expansion of such dissimilarities. The relatively recent dramatic rise in the practice of securitizing mortgages makes this kind of nonuniformity a serious concern. Nonuniformity of this type may affect significantly the bundling of mortgages from different states and result in substantial costs for mortgage lenders and promoters. Moreover, to the extent that mortgage pools do not transcend state lines, many of the benefits that society draws from securitization – including lower interest rates, nationalization of real estate capital markets, and increased cash flow into real estate capital markets – dissipate.

My analysis and conclusions are important in at least three respects. First, they explain the actions of promoters of residential mortgage securitizations in opposition to state environmental superlien statutes. I conclude that securitization promoters consider state superlien statutes a substantial threat to their business because mortgage lending practices and law in the residential arena are especially uniform across state lines and securitization of residential mortgages relies substantially on that uniformity. Accordingly, I predict that these promoters will act to ensure that states do not broaden existing statutes or enact new statutes whose scope would extend to residential mortgage lending.

Second, while this Article focuses primarily on residential mortgage lending, my analysis and conclusion also apply in the context of commercial mortgage lending. As I discuss below, securitization of commercial mortgage loans often lags behind securitization of their residential counterparts. This lag arises from (i) greater nonuniformity in commercial, as opposed to residential, lending and (ii) the absence of national securitization promoters in the commercial mortgage lending and securitization arena with government ties (such as Fannie Mae and Freddie Mac in the residential arena). Thus, state superlien legislation finds the commercial mortgage securitization setting far more hospitable than the residential setting. However, conditions that allow state superlien legislation to coexist with commercial mortgage loan securitization are changing. Commercial mortgage securitization is increasing rapidly, as is the demand for greater uniformity in commercial mortgage lending in order to facilitate securitization. The commercial side heightens the demand for greater uniformity because commercial loans tend to be much larger than residential loans. As a result, commercial mortgage pools consist of fewer

20. *See infra* text accompanying notes 203-06 (analyzing effects of nonuniformity in state superlien statutes).

loans than do residential mortgage pools; thus, it is more difficult to dilute price differentials on the commercial side. Moreover, superlien statutes probably impose greater pricing differential in the commercial setting than in the residential setting. In light of this, it seems that opposition to superlien statutes that apply to commercial lending should increase in coming years. In particular, pressure on states to repeal such statutes should grow.

Third, the residential mortgage lending industry's antipathy toward, and actions taken to thwart the expansion of, state superlien statutes presents an example of conflict between the economic needs of a particular industry's market and society's goal of heightened environmental protection and quality. This conflict mirrors the general discord between the desire of the lending industry for more nationally uniform real estate laws and the local interest in real estate laws tailored to the particular desires of residents of different regions. This conflict differs, however, from the paradigmatic setting in which recent academic commentary has examined the question of whether environmental standards should be set at the national or local level. Supporters of federal environmental standards justify federal environmental regulation with the argument that states might engage in a "race to the bottom" if authorized to regulate the environment. In other words, commentators argue that because market forces might sway state governments to reduce environmental regulation, federal intervention proves justified to establish a national floor for environmental regulation. By contrast, in the case of state superlien statutes, states that enact such statutes seek a *higher* level of environmental quality, and market forces would frustrate that effort by establishing, in effect, a national *ceiling* for environmental regulation.[21]

In Part II of this Article, I present an overview of the mortgage lending system, including the substantial changes that the growth of securitization has effected on that system in recent decades. In Part III, I discuss the superlien statute. First, I describe how a superlien statute is supposed to function and the statute's intended effect. Next, I discuss the various superlien statutes that have been enacted in different states and highlight important differences among them.

In Part IV, I examine the prospective benefits of superlien statutes and the reasons that many states enacted superlien statutes in the 1980s and early

21. The superlien situation differs from the paradigmatic examination of federal, as opposed to state, control of environmental regulation because, in the former case, the debate is not necessarily one that questions the sovereign in which control should be vested. In other words, market forces have lobbied the states to dissuade them from enacting superlien statutes that apply to residential lending; they resort to lobbying Congress to preempt state efforts in this regard. At the same time, the lending industry has sought, successfully, Congressional help slowing the spread of state real property laws that the lending industry felt adversely affected its business. *See infra* notes 225-30 and accompanying text (discussing lending industry's superlien lobbying efforts in state and federal contexts).

1990s. In particular, I consider the likely effects of the enactment of a state superlien statutes on state environmental quality and state budgeting.

In Part V of this Article, I examine the costs and general effects of superlien statutes on residential mortgage lenders. I describe how superlien statutes generally affect the pre-lending practices of lenders and cause some amount of increase in the price of borrowed funds. With that background, I then consider the extent of that increase in the context of residential mortgage lending. First, in subpart A, I examine the conventional wisdom that superlien statutes, standing alone, substantially increase the cost of residential mortgage funds. I consider arguments made by various commentators to this effect. Ultimately, I find these arguments wanting. I then employ a net present value model for residential mortgage cash flow to predict the actual effect that a superlien statute may have on residential mortgage pricing. The use of this model confirms that superlien statutes likely have a minimal impact on residential mortgage pricing.

In subpart B, I consider the impact of superlien statutes on efforts to securitize residential mortgage loans. I argue that the real problem superlien statutes posed to residential mortgage lenders and securitization promoters consisted of a threat to two aspects of the industry that undergird that industry's function and success: the predictability of mortgage priority laws and the general uniformity of mortgage lending laws. First, residential mortgage lenders generally, and securitization promoters in particular, feared that superlien statutes would prove to be the first chink in the armor of predictability of mortgage priority laws. In other words, the superlien statutes might have been the first step on a slippery slope that ultimately would eviscerate the predictability that undergirds the residential mortgage lending industry. Second, residential mortgage securitization promoters feared that superlien statutes would proliferate, leading to even more variances – and, even more troubling, variances of greater import – in state mortgage laws.

In Part VI, I consider the interplay between superlien statutes and *commercial* mortgage lending. I observe that because of fundamental differences between the residential and commercial mortgage markets – most notably the absence of a federal government player (such as the FHLMC) – the lessons about lender opposition to superlien statutes in the residential mortgage context do not apply readily to the commercial mortgage setting. I acknowledge a recent contribution to the academic literature suggesting that superlien statutes may not be as promising in the commercial lending context. I then consider whether, assuming that superlien statutes are good public policy in the commercial mortgage lending context, such statutes are, and will remain, viable. I observe that because the commercial mortgage securitization industry has lagged far behind its residential counterpart, pressure to impose more uniformity on the practices and law applicable to commercial mortgage lending has been comparatively less. This explains the persistence of state superlien statutes that can apply to displace commercial mortgage security interests. I then note that the growth of commercial mortgage securitizations, along with the concomitant increased pressure for uniformity, likely will increase pressure to restrict the scope of – and perhaps ultimately to repeal – superlien statutes applying to commercial mortgages. Further, because commercial loans tend to be much larger than residential loans, the burden that variations in local law, caused by superlien statutes, impose on securitization promoters may be more pronounced – and, therefore, opposition to superlien statutes may be greater – in the commercial mortgage lending context.

In Part VII of this Article, I position the battle over state superlien statutes in the ongoing academic debate over uniformity of law. In particular, I focus on academic debate over the uniformity of real estate law and the debate over the proper allocation of environmental regulatory authority between the federal and state governments. I conclude that the superlien dispute squares nicely with the academic debate over uniform real estate laws. However, the superlien dispute provides a counterpoint to the traditional setting in which environmental academics have analyzed uniformity, since that debate has focused on whether a race-to-the-bottom on the part of states justifies federal imposition of a uniform floor for environmental regulation. By contrast, in the superlien context, states endeavor to enact laws that provide comparatively greater environmental protection, while economic pressures advocate a uniform ceiling. I reason that, even though opposition to superlien statutes applicable to commercial real estate may increase beyond opposition to applying statutes to residential real estate, commercial properties remain more likely than residential properties to become environmentally contaminated. That being the case, applying superlien statutes to commercial real estate ensures greater environmental quality, which is the chief benefit the statutes offer. Accordingly, in Part VIII, I conclude that the economic pressures brought to bear by the expansion of securitization ought not preclude states, as a public policy matter, from maintaining and enacting superlien statutes that apply to commercial real estate properties.

II. Overview of Mortgage Lending

A. Background and the Primary Mortgage Market

Most individuals and families that seek to buy real property do not have sufficient funds to finance such a purchase and thus rely on loans. Further, many who might be able to amass the funds choose for other reasons to finance real estate purchases using borrowed funds. Commercial entities and businesses also often borrow money to finance real estate investments. Persons and entities generally borrow money from professional money-lenders such as banks, savings and loan institutions, and mortgage bankers.[22] In the terminology of the mortgage industry, the lender is called the "originator" of the mortgage.[23]

In general, a borrower must repay the lender the full amount of money that he or she borrowed, plus interest thereon. The interest represents, in effect, the "price" of the borrowed money.[24] Much like any other price, the market determines the interest rate charged. In this primary mortgage market, prospective borrowers demand loans and lenders supply them. The resultant demand and supply curves determine the interest rates that accompany various loan structures.[25] Figure 1 demonstrates this phenomenon, where D represents the demand curve for loans and S represents the lending industry's supply curve. The Figure predicts that there will be q loans entered into at an interest rate of i.

The price of borrowed money includes a premium for the lender.[26] This premium, in turn, includes compensation for assumption of the risk that the borrower might default on the loan.[27] Mortgage lenders mitigate this risk in two principal ways. First, mortgage lenders take back a security interest in the underlying real property as collateral.[28] If the borrower defaults on the loan, the lender may, under local law, foreclose on the collateral to the extent of the shortfall in the loan payments.[29] Because many mortgage loans are nonre-

22. *See* FRANK J. FABOZZI & CHUCK RAMSEY, COLLATERALIZED MORTGAGE OBLIGATIONS: STRUCTURES AND ANALYSIS 10 (3d ed. 1999) ("The three largest originators for all types of residential mortgages are commercial banks, thrifts, and mortgage bankers, originating more than 95% of annual mortgage originations."); Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 396 (1994) (noting governmental programs that promote home equity financing).

23. FABOZZI & RAMSEY, *supra* note 22, at 9.

24. "Interest is the payment made for the use of money." PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 469 (16th ed. 1998). It is "often called the 'price of money.'" *Id.; see id.* ("The cost of borrowing money, measured in dollars per year per dollar borrowed, is the interest rate."); C.F. SIRMANS, REAL ESTATE FINANCE 12 (2d ed. 1989) ("[T]he price of funds in the mortgage market . . . is the interest rate.").

25. *See* SIRMANS, *supra* note 24, at 15, 17 figs. 1-4 (demonstrating effects of supply and demand curves on interest rates and establishing interest rate as equilibrium price of loanable funds).

26. *See* SIRMANS, *supra* note 24, at 7, 15, 17 (describing how "risk premium" contributes to lenders adjustment of interest rates).

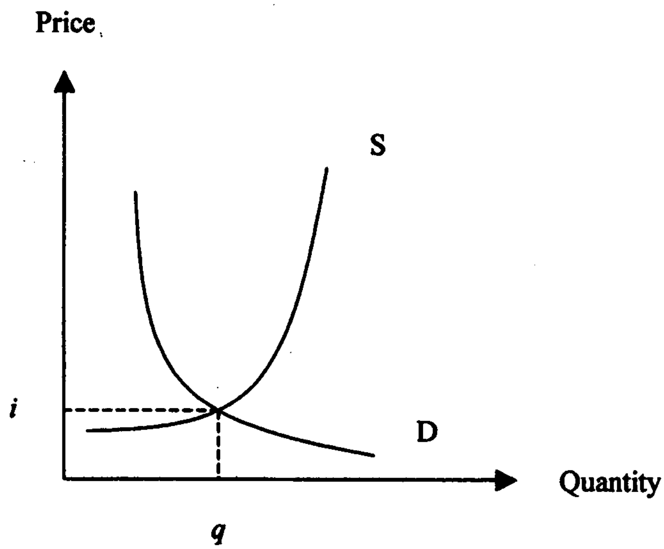
27. *See id.* at 6 (defining default risk). A lender faces, and charges a premium for, risks other than default risk. *See id.* at 5-7 (describing inflation risk, business risk, liquidity risk, and financial risk).

28. *See generally* Ann M. Burkhart, *Lenders and Land*, 64 MO. L. REV. 249 (1999) (discussing history and evolution of mortgage lending).

29. SIRMANS, *supra* note 24, at 71-72 (noting methods used by mortgage lenders to assure payment).

course,[30] foreclosure on the secured property often is the only way that mortgage lenders can recoup any remaining value from a loan on which the borrower defaults.

Figure 1: Supply of, and demand for, mortgage loans



Mortgage lenders also mitigate the risk of default by acting as "self-insurers." Mortgage lenders that service a wide community of borrowers can diversify the risk of default.[31] Further, by compiling and relying upon loss data based on experience with a large number of borrowers, mortgage lenders can predict with at least some accuracy the likelihood of a default based on the characteristics of borrowers.[32] They can use this data to price their mortgages more efficiently and can rely on the law of large numbers to predict that (absent some catastrophic risk) only an expected percentage of borrowers will

30. A loan is a nonrecourse loan if the lender has no right under the underlying note to bring an action personally against the defaulting borrower.

31. *See* SIRMANS, *supra* note 24, at 10 (discussing diversification of mortgage portfolio); *see also* Paul Bennett, *Portfolio Theory and Bank Lending: Avoiding Concentrations of Credit Risk through Strategic Diversification*, 81 J. LENDING & CREDIT RISK MGMT. 64 (1999) (advocating that banks diversify their credit risk by considering impact of reasonable worst case scenarios on their loan portfolios).

32. *See* SIRMANS, *supra* note 24, at 11 (recounting expertise of financial institutions in mortgage lending); *see also* FABOZZI & RAMSEY, *supra* note 22, at 10-11 (discussing lenders' evaluation of borrowers' credit).

default on their loans. The lender thus spreads the risk of default among all borrowers.

Given the social benefits of loans and the lobbying power of lenders, it is not surprising that the law assists mortgage lenders in mitigating default risk. The law achieves this effect by allowing mortgage lenders to register their security interests and thus generally to assure their liens a certain priority of payment in the event of default.

Mortgage filing procedures and lien priorities generally are matters of state statutory law. Because superlien statutes upset the status quo of lien priority statutes, it is of particular importance that lien priority statutes come in three basic varieties: race, notice, and race-notice statutes.[33] Each breed of mortgage filing statute leaves a mortgagee subject to different risks.[34] All these versions of lien priority statutes are similar in that these risks are quite limited in time since no additional risk arises once the lender has recorded its interest.[35] In the long run, absent some intervening factor (such as the action and effect of a superlien statute), a lender who follows proper procedure in filing its security interest is assured of its priority of payment.

This assuredness benefits lenders and, indirectly, borrowers as well. The virtually absolute predictability enables lenders both to avoid an increased likelihood of loss on default and to estimate the likelihood of loss with great accuracy. This, in turn, allows lenders to price mortgages with greater efficiency and generally to minimize the loss premium that they charge, which inures to the benefit of borrowers.

B. Securitizations and the Advent of the Secondary Mortgage Market

Subpart A presented a description of the primary markets for residential and commercial mortgages. Today, secondary markets in these mortgages – that is, markets in mortgages that originated in the primary mortgage

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33. *See* GEORGE LEFCOE, REAL ESTATE TRANSACTIONS 279-80 (2d ed. 1997). Under a race statute, the lender who records its security interest at the appropriate recorder's office first enjoys priority over subsequent filers. *Id.* at 279. Under a notice statute, a lender who lends money to a borrower after another lender takes priority over the prior lender provided that (i) the prior lender has not yet (at the time the second lender lends the money) recorded its interest and (ii) the subsequent lender is unaware of the prior loan. *Id.* Under a race-notice statute, the same holds true, provided that, in addition, (iii) the subsequent lender records its interest before the prior lender does. *Id.*

34. Under a race statute, a lender faces the risk that a subsequent lender will record its interest first. Under a notice statute, a lender faces the risk that a subsequent lender who is unaware of the first loan will lend money before the first lender has recorded its interest. Under a race-notice statute, a lender faces the risk that a subsequent lender who is unaware of the first loan will lend money and record its interest before the first lender has recorded its interest. *See supra* note 33 (describing race, notice, and race-notice statutes).

35. *See supra* note 34 (discussing risks under lien priority statutes).

market[36] – are also well ensconced.[37] The secondary mortgage markets have developed and thrived as a result of the growth of securitization – namely through issuances of mortgage-backed securities.[38] Securitization has effected profound changes on the real estate markets over the course of the last three decades.[39] Real estate securitization rests on the creation and maintenance of a secondary market for mortgage obligations. Under typical conditions, a local lending institution generally originates a loan to a borrower in return for a mortgage obligation, much as it would have years ago. Today, however, the originating lending institution in all likelihood will almost immediately turn around and resell the rights that accompany the mortgage in the secondary market.[40] In most cases, the originator will continue to service the mortgage –

36. *See* SIRMANS, *supra* note 24, at 12 (defining "secondary markets").

37. *See* Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 271-73 (1999) [hereinafter Schill, *The Impact of the Capital Markets*] (describing effects of capital markets on real estate industry).

38. Securitization has expanded beyond its roots in mortgage-backed securities. Today, promoters securitize various cash flows and offer securities backed by various cash-flow-generating assets. *See* Christopher W. Frost, *Asset Securitization and Corporate Risk Allocation*, 72 TUL. L. REV. 101, 104 (1997) (examining recent popularity of asset securitization).

39. Secondary markets for mortgages date back to at least the thirteenth century in England and since the late nineteenth century in this country. *See* Burkhart, *supra* note 28, at 272 (tracing history of secondary markets for mortgages). However, securitization has become a dominant force in domestic real estate markets only over the last three decades. *Id.* at 273-75. The seeds that fueled the vast expansion of real estate securitization were sown during the Depression-era administrations of Presidents Herbert Hoover and Franklin Delano Roosevelt. For a complete description of the evolution of real estate securitizations, see Forrester, *supra* note 22, at 394-96 (describing evolution of securitization); Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL L. REV. 1261, 1265-71 (1991) [hereinafter Schill, *Uniformity or Diversity*] (same).

40. Frank Fabozzi and Chuck Ramsey explain:

> Mortgage originators can either (1) hold the mortgage in their portfolio, (2) sell the mortgage to an investor who (a) holds the mortgage in its portfolio, or (b) places the mortgage in a pool of mortgages that will be used as collateral for the issuance of a security, or (3) use the mortgage themselves as collateral for the issuance of a passthrough security or a [collateralized mortgage obligation].

FABOZZI & RAMSEY, *supra* note 22, at 10. Michael Madison, Jeffrey Dwyer, and Steven Bender elucidate:

> Another way for mortgage originators to avoid the risk of holding loans in portfolio is to sell the loans in the secondary market. Once a loan is sold, of course, the originator no longer has to worry about the impact of future interest rate movements. In exchange for protection against future losses from adverse rate movements, however, the originator also gives up the prospect of profits from favorable yield spreads. Instead, the originator must rely on loan origination fees and, in most cases, on income from servicing the loans for the purchasers.

MADISON ET AL., *supra* note 5, ¶ 4.01[3], at 4-6.

that is, to collect loan payments the obligation as they become due – so that the borrower may not even be aware that the rights to the mortgage obligation into which he or she entered have been sold.[41] In reality, however, the originator serves only as a collector of funds and forwards the monies collected to the purchaser of those rights.

Securitization promoters, or "conduits,"[42] purchase mortgages in the secondary market. They bundle together large numbers of mortgages that they have purchased and create "securities" based upon the underlying mortgages. They then sell those packaged securities to investors.[43]

Promoters pool the mortgages they purchase and use them as collateral to create "mortgage-backed securities."[44] A purchaser of a mortgage-backed security enjoys the proceeds from, and assumes some of the risks of, the mortgages in the underlying pool.[45] The industry refers to a mortgage that is used as part of a collateral pool in the creation of a mortgage-backed security as "securitized."[46]

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41. *See* MADISON ET AL., *supra* note 5, ¶ 4.02[4], at 4-11 (noting recent developments in mortgage practices); Schill, *Uniformity or Diversity*, *supra* note 39, at 1268 n.31 (same).

42. *See* FABOZZI & RAMSEY, *supra* note 22, at 10 ("Two federally sponsored credit agencies and several private companies buy mortgages. Since these agencies and private companies pool these mortgages and sell them to investors, they are called *conduits*." (emphasis in original)).

43. *See id.* at 1-5, 9-10 (discussing sale of packaged securities in secondary markets).

44. There are two basic forms of mortgage-backed securities that securitization promoters create and sell – passthrough securities and collateralized mortgage-backed securities (CMOs). *See id.* at 1-5. A passthrough security affords investors the proceeds from the pool of mortgages that underlies it; each pool underlies only one passthrough security. *Id.* at 2-3. A CMO gives investors some priority of payment of proceeds out of the underlying pool; thus, each pool supports more than one CMO, with some CMOs entitling their holders to payment before the holders of other CMOs. *Id.* at 3-5. The motivation behind creation of CMOs as opposed to passthrough securities is that the former, unlike the latter, distribute prepayment risk variably among the various tranches so as to satisfy the investment needs of various holders. *Id.* at 2-5; Schill, *Uniformity or Diversity*, *supra* note 39, at 1270 (noting that mortgage-backed securities now appeal to diverse investor types); *see also* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 271 (noting that, in wake of Tax Reform Act of 1986, CMOs are structured as Real Estate Mortgage Investment Conduits, or "REMICs").

For a discussion of the history and development of various types of mortgage-backed securities, see Jess Lederman, *The Evolution of Mortgage-Backed Securities*, *in* THE SECONDARY MORTGAGE MARKET: STRATEGIES FOR SURVIVING AND THRIVING IN TODAY'S CHALLENGING MARKETS 121 (Jess Lederman ed., rev. ed. 1992) [hereinafter THE SECONDARY MORTGAGE MARKET].

45. *See* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 271 (examining investor tolerance for risk in mortgage-backed securities).

46. FABOZZI & RAMSEY, *supra* note 22, at 10.

1. Residential Mortgage Lending

Two quasi-governmental corporations – the Federal National Mortgage Association (FNMA or Fannie Mae)[47] and the FHLMC[48] – and one government agency – the Government National Mortgage Association (GNMA or Ginnie Mae)[49] – have played a major role in establishing and maintaining the secondary market for residential mortgages. The federal government established these entities in order to "provide liquidity in the market for residential mortgage loans and to increase the flow of capital to housing."[50] Fannie Mae and Freddie Mac act as conduits for residential mortgage-backed securities.[51] In addition, Fannie Mae, Freddie Mac, and Ginnie Mae all provide payment guarantees for certain residential mortgage-backed securities.[52]

Securitization has substantially affected real estate capital markets. First, the growth of securitization has increased the amount of money in those markets, thus enlarging the funds available for real estate finance.[53] Before the advent of real estate mortgage securitization, many investors shied away from investing in real estate mortgages because of the relative lack of information about those investments and the risks inherent in investing in individual mort-

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47. The federal government created the FNMA in 1938. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1264 (discussing creation of FNMA). In 1968, the government divided responsibility for FNMA's activities between two entities, the FNMA and a newly formed government agency, the Government National Mortgage Association. The latter entity was responsible for the low income housing subsidy programs that FNMA previously administered. Other responsibilities remained vested in FNMA, which the government restructured into a private corporation with ties to the federal government. *See id.* at 1267 (discussing FNMA's ties to federal legislation). The President appoints five members of FNMA's fifteen-member board of directors. *Id.* In 1970, Congress granted FNMA the power to buy and sell conventional, as well as federally insured, mortgage loans. *Id.*

48. The federal government created FHLMC, a private corporation with ties to the government in 1970, and empowered it to buy and sell conventional mortgage loans. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1267 & n.27 (noting creation of FHLMC). The President appoints five of FHLMC's eighteen-member board of directors. *Id.* at 1267 n.26.

49. GNMA was created in 1968 to assume responsibility for low income housing subsidy programs that FNMA previously had administered. *See supra* note 47 (examining FNMA).

50. Schill, *Uniformity or Diversity*, *supra* note 39, at 1268.

51. FABOZZI & RAMSEY, *supra* note 22, at 10. They construct mortgage-backed securities only from "conforming mortgages," which are mortgages that meet "the underwriting standards established by these agencies for inclusion in a pool of mortgages underlying a security that they guarantee." *Id.*; *see* SIRMANS, *supra* note 24, at 15. For a discussion of the evolution of companies that act as conduits for "nonconforming mortgages," see Mark Korell, *The History and Evolution of the Mortgage Conduits*, *in* THE SECONDARY MORTGAGE MARKET, *supra* note 44, at 77.

52. *See* FABOZZI & RAMSEY, *supra* note 22, at 16-17 (discussing three types of agency "pass-throughs" and effects on mortgage guarantee); SIRMANS, *supra* note 24, at 15 (noting that agencies guarantee principal and interest payments even if borrower is delinquent).

53. MADISON ET AL., *supra* note 5, ¶ 4.01[2], at 4-4.

gages. Securitization ameliorates both of these problems. The emergence of a vibrant secondary real estate mortgage market, as well as a market for real estate securitization products, dramatically increased the flow of information relating to securitized products and the real estate mortgages that undergird them.[54] Also, investing in securitization products allows investors to diversify their holdings and to avoid the risk of investing in individual mortgages.

Second, the rise of securitization has led to increased nationalization of the real estate capital markets. Prior to the advent of real estate mortgage securitization, real estate mortgage investing was overwhelmingly local in character. A combination of law and circumstance produced this effect. First, federal law traditionally precluded most banking institutions from engaging in interstate banking.[55] Second, the mortgage loans tended to originate locally. As such, an investor in Chicago was unlikely to be familiar with the conditions of the real estate market in Miami or with the laws governing mortgage lending in Florida, and time constraints often precluded an investor from making an intelligent decision as to whether to invest in a mortgage originating there.

Again, securitization has changed the playing field. First, investors in real estate mortgage securitization products need not worry so much about real estate market conditions in specific areas because the products in which they invest in the commercial mortgage lending and securitization arena are based upon large bundles of mortgages. Second, as discussed above, the amount of information flow relative to real estate mortgage securitization products exceeds in amount and scope the information flow available to mortgage investors before the growth of securitization.[56] Third, the advent of securitization

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54. SIRMANS, *supra* note 24, at 15 (elaborating how broadening of markets has led to easier risk comparisons between mortgage loans and other investments and how computerized information systems have contributed to ease of access to market prices and yields).

55. The McFadden Act, 12 U.S.C. § 36(c) (2000), generally prohibited interstate banking. Some institutions tried to evade this prohibition by constituting themselves as "bank holding companies" that owned banking institutions in more than one state. Bevis Longstreth & Ivan E. Mattei, *Organizational Freedom for Banks: The Case in Support*, 97 COLUM. L. REV. 1895, 1898 (1997). *See generally* Stacey Stritzel, Note, *The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Progress Toward a New Era in Financial Services Regulation*, 46 SYRACUSE L. REV. 161, 169-73 (1995) (discussing restrictions on interstate banking). With the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Congress largely eliminated the McFadden Act's prohibition. Longstreth & Mattei, *supra*, at 1898; David A. Skeel, Jr., *The Law and Finance of Bank and Insurance Insolvency Regulation*, 76 TEX. L. REV. 723, 770 n.172 (1998).

56. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1298 ("[C]entralized sources of information about state mortgage law help minimize transaction costs. Several law firms across the nation specialize in mortgage foreclosures and have experience in all fifty states. In addition, detailed summaries and comparisons of state real estate finance laws are widely available." (footnote omitted)).

gave rise to great pressure on real estate practitioners and legislators to begin to eliminate some of the differences in local real estate practice and law that once might have made investors reticent about investing in real estate mortgages in regions of the country with which they were unfamiliar.[57] This nationalization of the real estate capital markets allowed capital available for real estate investment to flow from richer to poorer areas of the country.[58]

These features – the increase in money invested in real estate capital markets and the nationalization of the real estate capital market – reflect a more general phenomenon wrought largely by the growth of securitization: the integration of real estate capital markets with general capital markets. In general, this integration increased the flow of capital into the real estate markets.[59] In particular, this integration has reduced home mortgage loan interest rates.[60]

2. *Commercial Mortgage Lending*

The development of a secondary market for commercial mortgages lags behind the robust growth of the secondary market for residential mortgages.[61] Four factors conspire against, and have slowed the development of, a secondary market for commercial mortgages. First, Fannie Mae, Freddie Mac, and Ginnie Mae neither generate, nor provide guarantees for, securities backed by

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57. *See* SIRMANS, *supra* note 24, at 15 (detailing changes brought by nationalizing mortgage markets); Schill, *The Impact of the Capital Markets*, *supra* note 37, at 284 ("[W]ith respect to mortgages on single family homes, most lawyers have typically given up trying to get originators to accept provisions that vary from the Fannie Mae or Freddie Mac forms because such provisions would make the loans unsaleable in the secondary mortgage market.").

58. *See* MADISON ET AL., *supra* note 5, ¶ 4.01[1], at 4-3 (discussing nationwide flow of real estate capital); SIRMANS, *supra* note 24, at 15-16 ("Federal credit agencies . . . help create a national market for existing mortgages to . . . shift funds from capital-rich to capital-poor areas."); Burkhart, *supra* note 28, at 280 (examining real estate capital flow); Schill, *Uniformity or Diversity*, *supra* note 39, at 1269 (same).

59. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1271-72 (noting 29% increase in secondary mortgage markets from 1970 to 1984).

60. *See id.* at 1272-73 (noting study estimating reduction as between fifteen and thirty basis points); *see also* A. Michael Froomkin, *Reinventing the Government Corporation*, 1995 U. ILL. L. REV. 543, 600 ("[S]tudies suggest that the existence of Fannie Mae and Freddie Mac in the secondary [mortgage] market ultimately lowers mortgage rates by up to 50 basis points." (footnote omitted)). A basis point equaled 1/100th of an interest rate percentage point. Schill, *Uniformity or Diversity*, *supra* note 39, at 1272 n.51.

61. *See* Georgette C. Poindexter, *Subordinated Rolling Equity: Analyzing Real Estate Loan Default in the Era of Securitization*, 50 EMORY L.J. 519, 523-30 (2001) (discussing collapse of commercial whole loan market and origins of commercial secondary market); Schill, *The Impact of the Capital Markets*, *supra* note 37, at 273-74 ("As the securitization of home mortgage loans exploded in the 1980s, the commercial mortgage debt market was much slower to join the securitization bandwagon.").

commercial mortgages.[62] Indeed, no governmental or quasi-governmental agency or corporation serves to create and maintain a secondary market for commercial mortgages.[63]

Second, the terms of commercial mortgages vary far more greatly than do those of residential mortgages.[64] The terms of residential mortgages are fairly standard on a national basis and generally vary only as to their terms and prices.[65] Commercial mortgages, by contrast, exhibit distinctions that are far more numerous and greater in scope.[66] Moreover, the absence of a national corporation with government ties has influenced the shape of the secondary market in commercial mortgages and on the underlying commercial mortgages themselves. In particular, there is less pressure to bring uniformity to the terms of commercial mortgages between states or even within regions.[67] This lack of pressure to conform terms tends to preserve the broad variations in commercial lending.

Third, "[c]ommercial loans tend to be much larger than residential loans."[68] As a result, a pool of commercial mortgages likely contains far fewer mortgages than a comparably valued pool of residential mortgages. This means that commercial-mortgage pools offer less opportunity for diversification of risk and make securities based upon such pools less attractive to investors.[69]

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62. *See* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 273 ("[N]o secondary mortgage market for commercial mortgage loans was created by the federal government.").

63. *See id.* at 274; *see also* Froomkin, *supra* note 60, at 600. However, the federal government, through the Resolution Trust Corporation, has issued commercial mortgage-backed securities. Although the volume of such issues does not approach the volume of residential securitizations in which Fannie Mae, Freddie Mac, and Ginnie Mae are involved, the impact has promoted a uniform secondary commercial mortgage market structure. *See infra* notes 219-21 and accompanying text.

64. *See* Burkhart, *supra* note 28, at 276 ("[C]ommercial properties and loans are less uniform than residential properties and loans.").

65. *See supra* note 57 (noting rigidity in residential mortgage terms).

66. *See* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 274. Schill states the following:

> Commercial mortgages loans are . . . more idiosyncratic than residential loans. Commercial properties are typically quite different from each other, requiring much more due diligence than pools based upon relatively similar single family loans. Moreover, the loan documentation for commercial properties tends to be much more voluminous and non-uniform as compared to residential properties.

Id.

67. *See id.* ("[W]ithout a secondary mortgage market backed by federal or quasi-federal guarantees, the commercial mortgage-backed securities market required experimentation with different methods of credit enhancement such as letters of credit and overcollateralization.").

68. *Id.* at 273.

69. *See id.* at 273-74.

Fourth, before the economic downturn of the late 1980s and early 1990s, commercial borrowers could readily obtain mortgage loans; they "enjoyed access to a deep capital pool with relaxed underwriting criteria."[70] Until the 1990s, there was simply no strong pressure for the infusion of funds into, and the nationalization of, the commercial real estate market.

Despite these obstacles, a thriving secondary commercial mortgage market has arisen in recent years.[71] Still, commercial mortgage securitizations lag far behind securitizations of residential mortgages.[72]

III. Overview of Environmental Superlien Statutes

A. The Superlien Statute

Federal and state hazardous waste cleanup statutes typically include provisions that give rise to a lien in favor of the jurisdiction's environmental agency as to property that the agency has expended monies to clean. The federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)[73] includes a provision that confers upon the United States Environmental Protection Agency (EPA) a lien against property to the extent that the EPA expends funds in cleaning up the property (a CERCLA lien).[74] The CERCLA lien is a "standard lien"; that is, the priority of the lien

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70. Poindexter, *supra* note 61, at 524.

71. *See, e.g., id.* at 530-32 (noting that issuances of commercial mortgage-backed securities rose from $3 billion in 1990 to $78 billion in 1998); Schill, *The Impact of the Capital Markets*, *supra* note 37, at 274 (noting that volume of commercial mortgage securitizations rose 850% from 1991 to 1997); *id.* at 274-76 (discussing same).

72. *See* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 274 ("As compared to residential mortgages, commercial mortgage-backed securities have a way to go.").

73. Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-9675 (1994 & Supp. III 1997)).

74. CERCLA § 107(*l*), 42 U.S.C. § 9607(*l*) (1994), provides, in pertinent part:

(1) In general

All costs and damages for which a person liable to the United States under [this statute (with an exception not relevant here)] shall constitute a lien in favor of the United States upon all real property and rights to such property which –

(A) belong to such person; and

(B) are subject to or affected by a removal or remedial action.

(2) Duration

The lien imposed by this subsection shall arise at the later of the following:

(A) The time costs are first incurred by the United States with respect to a response action under this act.

(B) The time that the person referred to in paragraph (1) is provided (by certified or registered mail) written notice of potential liability.

Such lien shall continue until the liability for the costs (or a judgment against the person arising out of such liability) is satisfied or becomes unenforceable . . . .

is determined under traditionally applicable rules of lien priority.[75] Thus, a CERCLA lien will be superior to liens held by unsecured creditors and those filed subsequently[76] but will remain inferior to pre-existing liens. Many state laws mimic CERCLA in this respect and also confer standard liens to state environmental agencies under analogous circumstances.[77]

By contrast, Connecticut, Louisiana, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, and Wisconsin provide state environmental agencies with liens of a special, higher priority, called "superliens," for recovering clean-up expenditures.[78] These superliens give state environmental

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(3) Notice and validity
The lien imposed by this subsection shall be subject to the rights of any purchaser, holder of a security interest, or judgment lien creditor whose interest is perfected under applicable State law before notice of the lien has been filed in the appropriate office within the State (or county or other governmental subdivision), as designated by State law, in which the real property subject to the lien is located. Any such purchaser, holder of a security interest, or judgment lien creditor shall be afforded the same protections against the lien imposed by this subsection as are afforded under State law against a judgment lien which arises out of an unsecured obligation and which arises as of the time of the filing of the notice of the lien imposed by this subsection.

This provision was added in 1986 by the Superfund Amendments and Reauthorization Act, Pub. L. No. 99-499, 100 Stat. 1613 (1986).

75. 2 BUDNITZ & CHAITMAN, *supra* note 5, ¶ 9.05, at 9-69. There were unsuccessful efforts to cast the CERCLA lien as a superlien. *See* MADISON ET AL., *supra* note 5, ¶ 13.10, at 13-63; Lockett, *supra* note 7, at 865 (discussing congressional consideration of superlien provision); John Andrew Maher & Kathryn C. Hoefer, Note, *Federal Superlien: An Alternative to Lender Liability Under CERCLA*, 6 ST. JOHN'S J. LEGAL COMMENT. 41, 57 n.92 (1990).

76. The precise nuances of priority will depend upon whether the state has adopted a race, notice, or race-notice recording priority statute. *See* CERCLA § 107(*l*)(3), 42 U.S.C. § 9607(*l*)(3) (1994) ("[The government lien] shall be subject to the rights or any purchaser, holder of security interest, or judgment creditor whose interest is perfected under applicable state law . . . ."); *see also supra* notes 33-35 and accompanying texts (discussing lien priority statutes).

77. *See, e.g.*, ALASKA STAT. § 46.08.075 (2000). A list of nonpriority lien statutes is found in Farer, *supra* note 16, § V.B, at 295-98. *See also* KATHRYN R. HEIDT, ENVIRONMENTAL OBLIGATIONS IN BANKRUPTCY ¶ 7.07 (1993) (examining several states' statutes).

78. CONN. REV. STAT. ANN. § 22a-452a (West Supp. 2001); LA. REV. STAT. ANN. § 30:2281 (West 2000); ME. REV. STAT. ANN. tit. 38, § 1371 (West 2001); MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 2000); MICH. COMP. LAWS ANN. § 324.20138 (West 1999); N.H. REV. STAT. ANN. § 147-B:10-b (Supp. 2001); N.J. STAT. ANN. § 58-10-23.11f(f) (West Supp. 2001); WIS. STAT. ANN. § 292.81(3), (4) (West 1999). These states are identified as having superlien statutes in a study of state hazardous waste cleanup statutes prepared by the Environmental Law Institute. *See* ENVTL. LAW INST., AN ANALYSIS OF STATE SUPERFUND PROGRAMS: 50-STATE STUDY, 1998 UPDATE § III.H, at 38 (1998) [hereinafter ELI SUPERFUND REPORT]. I rely upon the ELI Superfund Report in light of the fact that, in the report's preparation, ELI personnel followed a comprehensive methodology, including interviews with state environmental department staff members and independent verification of responses to interview questions. *See id.* § I, at 2.

Some commentators consider states in addition to the eight listed in the text to have superlien statutes. Kathryn Heidt divides state superlien statutes into two categories: those that give rise to fully retroactive superpriority, and those that give rise to superpriority only as to liens filed after the effective date of the statute. *See* HEIDT, *supra* note 77, ¶¶ 7.05[1], 7.06[1]. Only Connecticut and Maine fall into the latter category. *Id.* ¶¶ 7.06[2], [3]. Heidt places Alabama, Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, Pennsylvania, Wisconsin, and Wyoming in the former category. *Id.* ¶¶ 7.05[1A] to [7] (1993 & Supp. 1999). For purposes of the analysis in this Article, I choose not to consider Alabama, Minnesota, Pennsylvania, and Wyoming among the states that have "true" superlien statutes because these states' statutes do not provide generally for state superliens whenever the state expends money for an environmental cleanup. Alabama's statute applies only to fees the state charges operators of hazardous waste disposal facilities for each ton of hazardous waste they dispose, *see id.* ¶ 7.05[1A] (citing ALA. CODE § 22-30B-9 (1997)); Minnesota's statute applies only to cleanups of landfills, *see id.* ¶ 7.05[2B] (citing MINN. STAT. ANN. § 115B.41(2) (Supp. 1995)); Pennsylvania's statute applies only to funds incurred to abate past mining practices at a site, *see id.* ¶ 7.05[5] (citing 32 PENN. STAT. § 5116(a)(1) (1996)); and, similarly, Wyoming's statute applies only to costs incurred to reclaim mining sites, *see id.* ¶ 7.05[7] (citing WYO. STAT. § 292.82(1) (Supp. 1996)).

David Farer lists the eight states that I have mentioned as having superlien statutes and includes Illinois. *See* Farer, *supra* note 16, § V.A.2, at 302 (citing 65 ILL. COMP. STAT. 5/11-31-1(e), (f) (1999)). The Illinois statute allows municipalities and private parties to obtain a superpriority lien to cover their cleanup expenditures. *See* 65 ILL. COMP. STAT. 5/11-31-1 (1999). That provision has no exemption for residential property. The Illinois superpriority lien is superior to all liens except tax liens. *See id.* 5/11-31-1(a). I do not include it as a superlien statute because it does not create a superpriority lien in favor of the state or a state agency.

Joel Moskowitz considers seven states in his discussion of superliens. As compared to my list of eight states, he omits Michigan and Wisconsin but includes Texas. *See* MOSKOWITZ, *supra* note 5, §§ 7.8-7.14. Under Texas law, a state lien to recover environmental cleanup expenses enjoys priority as to previously-filed liens only if "the person acquiring the mortgage, lien, or other encumbrance on the property had or reasonably should have had actual notice or knowledge that the real property is subject to or affected by a cleanup action or has knowledge that the state has incurred cleanup costs." TEX. HEALTH & SAFETY CODE ANN. § 361.194(g) (1992). Thus, as Moskowitz explains:

> The lien imposed by Texas law follows the normal rule of precedence *unless* the holder of a prior interest had actual or constructive notice of the remedial action that allowed the state's lien at the time of acquisition. In such an event, the state's lien becomes a superlien as to that earlier filer.

MOSKOWITZ, *supra* note 5, § 7.14, at 93 (emphasis in original). He opines that the statutory reference "to a person who 'reasonably should have had actual notice' . . . suggests that some sort of reasonable due diligence is necessary to preserve the priority of a lien or other interest in real property." *Id.* I do not consider Texas as having a superlien statute for purposes of the analysis in this paper because the standard in Texas is to follow "the normal rule of precedence." *Id.*

Norman Newman lists six states as having adopted superlien statutes. Of the eight I list in the text, he omits Louisiana, Maine, Michigan, and Wisconsin, but includes Arkansas and Tennessee. *See* Newman, *supra* note 5, at 43.012, 43.021 app. D. Although Arkansas and Tennessee were among the earliest states to enact superlien statutes, neither state currently maintains a broadly applicable superlien statute. *See* ELI SUPERFUND REPORT, *supra*, § III.H, at 38 ("Arkansas had one of the early superlien authorities, but it is no longer listed in this study agencies liens that are superior to all (or most) other liens regardless of when the competing liens were obtained or perfected.[79]

The underlying motive for these superlien statutes is manifest. Absent such a statute, the traditional rules of lien priority would allow a state to expend funds to clean up a contaminated property, with some or all of the benefit from those expenditures inuring to the senior secured lenders. These lenders would see the value of their security interests increase by virtue of the increase in property value resulting from the cleanup. If a state cannot recover its cleanup expenditures from the contaminating parties, it would be left to pursue any remaining equity in the property and other unencumbered assets of the property owner to recoup its expenses. Because environmental cleanup costs are generally quite large and the property owner is probably insolvent, the

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as having such authority because of constraints placed on the authority by the legislature rendering it largely inapplicable in most instances."); Schill, *Lender Liability*, *supra* note 10, at 316-17 (noting that Arkansas and Tennessee have replaced superlien statutes with non-priority liens).

In addition to the foregoing, at least one municipality – New York City – has enacted legislation that affords its agencies superliens in certain circumstances. The city's superlien statute applies broadly and is not specifically designed to recoup environmental cleanup costs. *See* Marvin N. Bagwell, *The New York City Superlien: What Is It Anyway?*, 13 N.Y. REAL EST. L. REP. 10 (1999) (noting coverage for expenditure "to correct any condition that is dangerous to human life and safety or detrimental to health.").

79. Different commentators offer generally similar definitions of "superliens." *See* 2 BUDNITZ & CHAITMAN, *supra* note 5, ¶ 9.05, at 9-69 (stating that superliens "give priority to claims for environmental cleanup expenses over other claims against a business"); ELI SUPERFUND REPORT, *supra* note 78, § III.H, at 38 ("Superliens differ from ordinary liens in that they claim a higher priority than they would ordinarily obtain under the laws governing security interests .... A superlien changes [ordinary] priority by giving the State's lien for recovery of cleanup costs priority over some or all liens even if they have been recorded earlier."); HEIDT, *supra* note 77, ¶ 7.05[1], at 7-13 ("A superlien law creates a lien that takes priority over all other liens on the property, including existing liens."); 6A WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2d § 149:21, at 149-70 (2000) ("The liens are referred to as 'superliens' because they take priority over all other liens, including previously existing recorded liens." (footnote omitted)); Burkhart, *supra* note 28, at 299 ("[A] mortgage will be subordinated to the environmental 'superlien' even if the mortgage was recorded before the environmental problem existed."); Hamel, *supra* note 5, at 853 ("The term 'superlien' has been used to define a first priority lien: one that take precedence over prior perfected liens."); Newman, *supra* note 5, at 43.011 to 43.012 ("A superlien is . . . a lien that takes priority over all other liens, including those that are prior in time and already perfected."); Koelbel, *supra* note 7, at 298 (stating that under a "superlien," "any expenditures made pursuant to the statute constitute a first priority lien upon the real property of the hazardous waste discharger").

Still, somewhat surprisingly (given what seems to be a fairly straightforward concept), some commentators assert that "there is some room for interpretation as to what constitutes a superlien." DANIEL P. SELMI & KENNETH A. MONASTER, STATE ENVIRONMENTAL LAW § 9.04[2][a], at 9-55 (1995). This contention perhaps is borne out by different commentators' classification of different states as having enacted superlien statutes. *See supra* note 78.

state, under these circumstances, will probably not recover much, if any, of its expenditures.[80]

A superlien statute changes this result. It gives a state the highest priority as to the post-cleanup equity in the property. This prioritization scheme greatly increases the chances that a state will recoup its cleanup expenditures.[81]

Because superlien statutes can give a state's lien priority over other lenders' liens even though the state's lien arose and was perfected later, these statutes are subject to various constitutional challenges.[82] First, one can argue that the state procedures for obtaining and exercising a superlien deprives superior lienholders of property without the due process of law that is required by the Fourteenth Amendment.[83] Indeed, the United States Court of Appeals for the First Circuit held in 1991 that the EPA had violated the Fifth Amendment's Due Process Clause when it obtained a CERCLA lien – of conventional priority – without affording the property owners notice of the lien and allowing for a predeprivation hearing.[84] In fact, as I discuss below, several state superlien statutes do require the state to provide notice of the new lien to preexisting lienholders.[85]

Second, one can argue that use of a superlien statute to supersede a preexisting lienholder's property interest is an unconstitutional state government

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80. *See* ELI SUPERFUND REPORT, *supra* note 78, § III.H, at 38 ("The rationale for the superlien is that if the State had not expended the money, the property would have been worthless; therefore, the State should recoup its expenses before any others benefit.").

81. A more extensive discussion of the likely benefits and costs associated with a superlien statute appears *infra* in Parts IV and V.

Three economists argue that in the context of commercial financing superlien statutes may result, perversely, in states footing more of the bill for environmental cleanups and would be detrimental to public welfare. *See infra* notes 207-13 and accompanying text. Their arguments seem facially inapplicable to the context of superliens as applicable to residential mortgage lending. This is so because the incentives for residential and commercial borrowers are different. In particular, prospective residential borrowers generally do not strongly consider whether or not the borrowed money will be invested profitably.

82. Although the statutes are subject to challenge, there is only one reported court decision that addresses constitutional challenges to a state superlien statute. (As discussed below, *Kessler v. Tarrats*, 476 A.2d 326 (N.J. Super. App. Div. 1984), addressed both Takings Clause and Contracts challenges to New Jersey's statute.) This may be a function of the relative desuetude – at least early on – of superlien statutes (other than New Jersey's). *See supra* note 13 (discussing recent superlien trends).

83. U.S. CONST. amend. XIV.

84. Reardon v. United States, 947 F.2d 1509, 1523 (1st Cir. 1991). *See* Cheryl Kessler Clark, *Due Process and the Environmental Lien: The Need for Legislative Reform*, 20 B.C. ENVTL. AFF. L. REV. 203, 229 (1993) ("Without provisions for pre-attachment notice and hearing, the superlien statutes are unconstitutional." (footnote omitted)).

85. *See infra* note 97 and accompanying text (noting state superlien statutes that require state to give actual notice to property owners or lienholders).

taking of property without just compensation.[86] Michael Madison, Jeffrey Dwyer, and Steven Bender argue for a distinction between superlien statutes that afford the state's lien superpriority status only as to liens perfected after the effective date of the statute - such as those in Connecticut and Maine - and those superlien statutes that apply retroactively. They assert that purely prospective applications of superlien statutes would not seem to violate the Constitution, insofar as persons and entities obtaining liens after that date have notice that a subsequent state environmental lien may take priority over their liens.[87] Madison, Dwyer, and Bender further argue that even retroactive applications of superlien statutes do not effect an unconstitutional taking without just compensation, because either (i) the cleaned-up property may well have been valueless before the cleanup so that no compensation was due, or (ii) the cleanup of the property adds to its value, and thus constitutes the due compensation.[88]

Perhaps the most constitutionally challenging superlien statutes are those that allow the state's lien to take priority over liens that cover pieces of property other than the contaminated property that are held by the same owner.[89] However, in *Kessler v. Tarrats*,[90] the only reported court decision analyzing a Takings Clause challenge to a superlien statute, a New Jersey appellate court upheld that state's superlien statute.[91] The court reasoned:

> The illegal dischargers are responsible for the physical damage to the property and any corresponding diminution in market value thereof. What-

86. Compensation for state government takings of property are required by the Fifth Amendment, as applied to the states by the Fourteenth Amendment. U.S. CONST. amends. V, XIV; *see generally* MADISON ET AL., *supra* note 5, ¶ 7.08[2]. In particular, purely prospective applications of superliens statutes (i.e., applications of the pertinent statutes to give the state's lien priority over a lien perfected after the effective date of the statute) would not seem to violate the Constitution, insofar as persons and entities that obtain liens after that date have notice that a subsequent environmental lien obtained by the state may take priority over their liens. *See* MADISON ET AL., *supra* note 5, ¶ 7.08[2][a]. Further, one can argue that applications of superlien statutes to liens covering the property that was the subject of the cleanup do not effect an unconstitutional taking without just compensation, insofar as either (i) the property well may have been valueless before the cleanup so that no compensation was due, or (ii) the actual cleanup of the property adds to the value of the property, and thus constitutes the due compensation. *See id.* ¶ 7.08[2][b][i]. The most constitutionally problematic instance of a superlien statute is where the statute allows for the state's lien to take priority over liens covering pieces of property other than the contaminated property held by the same owner. *See id.* ¶ 7.08[2][b][ii]. However, a New Jersey appellate court upheld that state's superlien statute, which applies in such situations, against such a challenge. *See* Kessler v. Tarrats, 476 A.2d 326, 326 (N.J. Super. App. Div. 1984).

87. *See* MADISON ET AL., *supra* note 5, ¶ 7.08[2][a].

88. *See id.* ¶ 7.08[2][b][i].

89. *See id.* ¶ 7.08[2][b][ii].

90. 476 A.2d 326 (N.J. Super. App. Div. 1984).

91. Kessler v. Tarrats, 476 A.2d 326, 332 (N.J. Super. App. Div. 1984).

ever diminution in value may have occurred to affect plaintiff's security interest was as the result of the acts of polluting the property. Therefore, whatever property, if any, was "taken" was taken by the dischargers of the hazardous substances and not by the State.[92]

Last, one can argue that the application of superlien laws violates the Constitution's Contracts Clause.[93] In *Kessler*, the only reported court decision addressing a Contracts Clause challenge to a state superlien statute, the appellate court rejected this argument against New Jersey's superlien statute on the ground that the adoption and use of the statute was a valid exercise of the state's police power.[94]

B. Variations in State Superlien Statutes

The contours of superlien statutes vary from state to state.[95] Table 1 summarizes important variations in state superlien statutes. First, the procedural path by which a state's environmental lien acquires superpriority status differs among statutes. Generally, all statutes require that the state file its lien.[96] Some statutes further require that the state give actual notice to property owners and, in some instances, to lienholders.[97]

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92. *Id. But cf. In re* Heldor Indus, Inc., 131 B.R. 578, 586 (Bankr. D.N.J. 1991) ("[I]t would violate the Takings Clause of the Fifth Amendment to hold that [New Jersey's Environmental Cleanup Responsibility Act] cleanup costs take priority over security interests in personal property."), *aff'd*, 139 B.R. 290 (D.N.J. 1992), *vacated on other grounds sub nom.* New Jersey Dep't of Envtl. Prot. & Energy v. Heldor Indus., Inc., 989 F.2d 702 (3d Cir. 1993). The *Heldor* bankruptcy court specifically noted that the relationship between the holding of the court in *Kessler* and "the issue of whether liens on real property can be primed under [the Environmental Cleanup Responsibility Act] is beyond the scope of this case." *Id.* at 586 n.7.

93. *See* U.S. CONST. art. I, § 10, cl. 1.

94. *Kessler*, 476 A.2d at 330-31.

95. *See, e.g.*, David G. Butterworth, Comment, *State Superfund Superliens: Who Do They Lean On?*, 1 VILL. ENVTL. L.J. 163, 178-82 (1990) (discussing operation of state superlien statutes); Douglas C. Ballantine, Note, *Recovering Costs for Cleaning Up Hazardous Waste Sites: An Examination of State Superlien Statutes*, 63 IND. L.J. 571, 581-85 (1988) (same); Beth Anne Smith, Comment, *State "Superlien" Statutes: An Attempt to Resolve the Conflict Between the Bankruptcy Code and Environmental Law*, 59 TEMPLE L.Q. 981, 1006-10 (1986) (same).

96. *See* 2 BUDNITZ & CHAITMAN, *supra* note 5, ¶ 9.05, at 9-64 ("All of the superlien statutes require that a notice of lien be appropriately filed."). One might think that, insofar as a superlien statute will likely come into play where the property owner is in bankruptcy, the Bankruptcy Code's "automatic stay" provision, *see* 11 U.S.C. § 362(a), would in many cases interfere with the ability of a state to file its lien and thus obtain a superlien. However, courts have held that the state's action in filing a superlien falls within an exception to the automatic stay. *See* 229 Main St. Ltd. P'ship v. Mass. (*In re* 229 Main St. Ltd. P'ship), 251 B.R. 186 (Bankr. D. Mass. 2000) (holding that Massachusetts superlien did not violate automatic stay); *In re* Microfab, Inc., 105 B.R. 152 (Bankr. D. Mass. 1989) (same).

97. As reflected in Table 1, these states are Connecticut, Maine, and Wisconsin.

Table 1 – Summary of State Superlien Provisions

State and Statute	Connecticut	Louisiana
Are there any prerequisites to the states' lien acquiring superpriority status?	(1) Notice of intent to file a lien must be sent to recorded mortgagees and lienholders;[98] (2) a certificate of lien must be filed;[99] and (3) a copy of the certificate must be mailed to the owner and all persons of record with an interest in the property.[100]	Notice of lien must be filed.[101]
Is the statute wholly retroactive?	No; superlien trumps only those liens recorded after June 3, 1985.[102]	Yes.
Is there a residential property exemption?	Yes; superlien does not apply to "real estate which consists exclusively of residential real estate."[103]	No.
Does the statute extend superpriority beyond the property that has been cleaned up?	No.[104]	No.
Does the statute extend superpriority to the full value of the property?	Yes.	No; superpriority applies only to the post-cleanup value of the property in excess of the property's pre-cleanup value.[105]

98. CONN. GEN. STAT. ANN. § 22a-452a(c)(1) (West Supp. 2001).

99. *Id.* § 22a-452a(b)(1).

100. *Id.* § 22a-452a(b)(2).

101. LA. REV. STAT. ANN. § 30:2281 (West 2000).

102. CONN. GEN. STAT. ANN. § 22a-452a(f) (West Supp. 2001).

103. *Id.* § 22a-452a(f); *see id.* § 22a-452a(g) (allowing state only ordinary lien as to residential property).

104. However, the superlien extends to "real estate which has been included, within the preceding three years, in the property description of such real estate and is contiguous to such real estate." *Id.* § 22a-452a(f).

105. However, the superlien extends to "all real estate of a responsible party that has been included in the property description of the affected real estate within the 3-year period preceding the date of filing of the lien or on or after July 7, 1987, whichever period is shorter." LA. REV. STAT. ANN. § 1371(2)(A) (West 2000).

State and Statute	Maine	Massachusetts
Are there any prerequisites to the states' lien acquiring superpriority status?	(1) Certificate of lien must be mailed to all persons of record who have an interest in the property that the state's lien will trump;[106] and (2) lien must be filed.[107]	"[A] statement of claim" naming persons liable under state law must be "recorded, registered or filed."[108]
Is the statute wholly retroactive?	No; superlien trumps only those liens recorded after July 7, 1987.[109]	Yes.
Is there a residential property exemption?	Yes; superlien does not apply to "a unit of real estate that consists primarily of real estate used or under construction as single or multi-family housing at the time the lien is recorded . . . ."[110]	Yes; superlien does not apply to "real property the great part of which is devoted to single or multi-family housing."[111]
Does the statute extend superpriority beyond the property that has been cleaned up?	No.[112]	No.
Does the statute extend superpriority to the full value of the property?	Yes.	Yes.

106. ME. REV. STAT. ANN. tit. 38, § 1371(3) (West 2001).

107. *Id.* § 1371(4).

108. MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 2000).

109. ME. REV. STAT. ANN. tit. 38, § 1371(2)(A) (West 2001).

110. *Id.* § 1371(5).

111. MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 2000).

112. However, the superlien extends to "all real estate of a responsible party that has been included in the property description of the affected real estate within the 3-year period preceding the date of filing of the lien or on or after July 7, 1987, whichever period is shorter." ME. REV. STAT. ANN. tit. 38, § 1371(2)(A) (West 2001).

State and Statute	Michigan	New Jersey
Are there any prerequisites to the states' lien acquiring superpriority status?	For a superlien equal to cleanup costs to the extent that cleanup increases value of property,[113] lien must be perfected by filing.[114] For amounts beyond that, lien must be perfected by filing,[115] and attorney general may petition to make state's lien a superlien if a regular lien "is insufficient to protect the general interest of the state in recovering response costs."[116]	Notice of lien must be filed.[117]
Is the statute wholly retroactive?	Yes.	Yes.
Is there a residential property exemption?	No.	Yes; superlien does not apply if the property comprises six dwelling units or less and is used exclusively for residential purposes."[118]
Does the statute extend superpriority beyond the property that has been cleaned up?	No.	No.
Does the statute extend superpriority to the full value of the property?	Perhaps; for superlien in excess of the extent to which the cleanup increases the value of the property, the attorney general must file, and a court must approve, a petition.[119]	Yes.

113. *See* MICH. COMP. LAWS ANN. § 324.20138(4) (West 1999) (stating that state can obtain lien to extent that state response activity increased value of property).

114. *Id.* § 324.20138(5).

115. *Id.*

116. *Id.* § 324.20138(2).

117. N.J. STAT. ANN. § 58:10-23.11f(f) (West Supp. 2001).

118. *Id.* § 147-B:10-b(III)(a); *see id.* § 147-B:10-b(III)(c) (stating that liens on residential properties become effective at time and date of filing "without priority on antecedent encumbrances of record").

119. MICH. COMP. LAWS ANN. § 324.20138(2); *see supra* text accompanying notes 100-02 (discussing Michigan requirement that attorney general must petition court for superlien in excess of amount by which cleanup increases value of property).

State and Statute	New Hampshire	Wisconsin
Are there any prerequisites to the states' lien acquiring superpriority status?	To be valid against real property, notice of lien must be filed with property records.[120] To be valid against business revenues and personal property, notice of lien must be filed with secretary of state's financing statement records.[121]	(1) Notice of lien must be given to owner of property;[122] and lien must be filed with the register of deeds in the proper county.[123]
Is the statute wholly retroactive?	Yes.	Yes.
Is there a residential property exemption?	Yes; superlien does not apply to "real property in use as, or being constructed primarily for, residential purposes."[124]	Yes; superlien does not apply if the property is residential property."[125]
Does the statute extend superpriority beyond the property that has been cleaned up?	Yes; superlien extends to "business revenues generated from the facility on which hazardous waste or hazardous materials is located and personal property located at the facility on which hazardous waste or hazardous material is located."[126]	No.
Does the statute extend superpriority to the full value of the property?	Yes.	Yes.

120. N.H. REV. STAT. ANN. § 147-B:10-b(II) (Supp. 2001).

121. *Id.* § 147-B:10-b(III)(b).

122. WIS. STAT. ANN. § 292.81(4) (West 1999).

123. *Id.* § 292.81(3).

124. N.H. REV. STAT. ANN. § 147-B:10-b(III)(a) (Supp. 2001); *see id.* § 147-B:10-b(III)(c) (stating that liens on residential properties become effective at time and date of filing "without priority on antecedent encumbrances of record").

125. WIS. STAT. ANN. § 292.81(4) (West 1999).

126. N.H. REV. STAT. ANN. § 147-B:10-b(III)(b) (Supp. 2001).

Michigan's superlien statute is unique in that it creates two superliens and imposes different prerequisites for each. The first lien, in an amount equal to the lesser of (i) the state's cleanup expenses and (ii) the increased value of the cleaned property,[127] acquires superpriority status as soon as the state files, and thus perfects the lien (the Michigan automatic superlien provision).[128] For lien amounts in excess of the increase in the property's value resulting from the cleanup, the state still must file the lien.[129] In order to achieve superpriority, however, the state attorney general must petition a court and assert that a lien of ordinary priority would be "insufficient to protect the interest of the state in recovering response costs" (the Michigan discretionary superlien provision).[130] A Michigan appellate court has held that the trial court hearing the petition has discretion to grant or deny the attorney general's request.[131]

The state superlien statutes of Connecticut and Maine grant state cleanup liens superpriority status only over competing liens recorded after the effective date of the governing statute.[132] The remaining six states' statutes are wholly retroactive; thus, they grant superpriority status as to all other liens.

Third, of the eight extant state superlien statutes, six explicitly do not apply to "residential" properties.[133] Only those of Louisiana and Michigan contain no such exemption. For example, Connecticut's superlien statute does not apply to "real estate which consists exclusively of residential real estate."[134] This limitation apparently results from the lobbying efforts of residential lenders, the FHLMC, and the FNMC.[135]

Fourth, New Hampshire's statute extends superpriority status as to "business revenues generated from the facility on which hazardous waste or hazard-

127. *See* MICH. COMP. LAWS ANN. § 324.20138(4) (West 1999).

128. *Id.* § 324.20138(5).

129. *Id.*

130. *Id.* § 324.20138(2).

131. *See* Dep't of Natural Res. v. Fenske (*In re* Forty Acres), 566 N.W.2d 652 (Mich. Ct. App. 1997), *appeal denied*, 586 N.W.2d 231 (Mich. 1998) (interpreting statute as "implicitly bestow[ing] discretion upon the trial court regarding the propriety of the superpriority lien").

132. *See* CONN. GEN. STAT. ANN. § 22a-452a(f) (West Supp. 2001) ("Such [superlien] shall take precedence over all transfers and encumbrances on or after [effective date]"); ME. REV. STAT. ANN. tit. 38, § 1371(2)(A) (West 2001) ("Any [superlien] . . . has precedence over all encumbrances on real estate recorded after [effective date].").

133. While these state statutes generally allow states to obtain a lien against a residential property for monies expended to clean up the property, the lien that arises is of normal priority and not a superlien. *See, e.g.*, CONN. GEN. STAT. ANN. § 22a-452a(g) (West Supp. 2001) (stating that lien on residential property shall only have precedence over all encumbrances recorded after that lien); N.H. REV. STAT. ANN. § 147-B:10-b(III)(c) (Supp. 2001) (stating that lien on residential property shall not have priority over antecedent encumbrance).

134. CONN. GEN. STAT. ANN. § 22a-452a(f) (West Supp. 2001).

135. *See* SELMI & MONASTER, *supra* note 79, ¶ 9.04[2][b][ii], at 9-59 (discussing lobbying efforts for non-application of superlien to residential properties).

ous materials is located and personal property located at the facility on which hazardous waste or hazardous material is located."[136] No other state's statute affords superpriority status to anything other than the real property that the state has expended funds to clean up.[137]

Fifth, under both Louisiana's superlien statute and the Michigan automatic superlien provision, the state's superlien enjoys superpriority as to any amounts expended by the state that result in an increase in the value of the property beyond the property's pre-cleanup fair market value.[138] In effect, then, both provisions work to preserve the priority status of previously filed and perfected liens to the extent of the fair market value of the underlying property prior to the state's cleanup. By contrast, all other superlien statutes confer superpriority status on the state's lien over all liens on the entire property.

In this Article, I focus primarily on the impact of superliens on residential lending and securitization of residential mortgages. As such, Parts IV and V of this Article concern only the superlien statutes of Louisiana and Michigan because the remaining six statutes expressly exempt residential properties from their scope. The Louisiana and Michigan statutes each have distinct features. In particular, the Louisiana statute applies only to amounts in excess of the property's pre-cleanup fair market value.[139] The Michigan statute effectively features two superliens.[140] One of Michigan's superliens, the Michigan automatic superlien provision, applies, like Louisiana's provision, upon filing to the extent that the state's cleanup increases the fair market value of the property (subject to a cap equal to the state's actual expenditures).[141] The Michigan statute also allows for a superlien – the Michigan discretionary superlien provision – for amounts in excess of the resulting increase in the property's fair

136. N.H. REV. STAT. ANN. § 147-B:10-b(III)(b) (Supp. 2000).

137. However, Connecticut and Maine have three-year look-back rules that allow the state to obtain a superlien as to all property that was included in a property description with the property at issue within the previous three years. *See* CONN GEN. STAT. § 22a-452a(f) (West Supp. 2001) (stating that lien shall apply to all "real estate which has been included, within the preceding three years, in the property description of such real estate and is contiguous to such real estate"); ME. REV. STAT. ANN. tit. 38, § 1371(2)(A) (West 2001) (stating that superlien includes all real estate that has been included in property description of affected real estate within past three years).

138. *See* LA. REV. STAT. ANN. § 30:2281 (West 2000) (stating that all security interests recorded prior to state's notice of lien shall extend only to fair market value of property prior to remedial action by state); MICH. COMP. LAWS ANN. § 324.20138(2), (5) (West 1999) (applying superlien to increase in value of property beyond property's pre-cleanup market value).

139. LA. REV. STAT. ANN. § 1371; *see* note 111 and accompanying text (noting that in Louisiana superpriority applies only to post-cleanup of property in excess of property's pre-cleanup value).

140. MICH. COMP. LAWS ANN. § 324.20138.

141. *Id.* § 324.201.

market value, but only if the attorney general applies for superpriority and the court approves the application.[142]

In short, then, only one state superlien statute – Michigan's – allows a superlien to apply to the pre-cleanup fair market value of a residential property and applies only if the state attorney general seeks and the court grants such relief.[143] As such, lenders' rights to the pre-cleanup fair market value of a residential property in which they hold security interests remains essentially unfettered by any state's superlien statute.

IV. Benefits of a Superlien Statute

In this Part, I discuss the probable benefits of a superlien law. In particular, I focus on the effects on environmental quality and state budgeting. I conclude that a state superlien law is likely to lead both to improved environmental quality in the jurisdiction and to less taxpayer expense for site cleanups. The extent of these benefits varies according to the state's approach to funding environmental cleanups.

A superlien statute generally increases the likelihood that a state will undertake an environmental cleanup. This makes sense, given the fact that such a statute makes it more likely that the state will recover at least some portion of the funds it expends to conduct the cleanup.[144]

In addition, a superlien statute may increase the likelihood that lenders themselves undertake cleanups. This is because, in the absence of a superlien statute, a lender has an incentive to wait until the state cleans up the property and then to apply its superior lien to realize a windfall increase in the value of the property that results from the cleanup, rather than expend its own money to clean up the property. A superlien may reduce this incentive.[145] To the extent that lenders opt to finance their own cleanups, this has the effect of

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142. *Id.*

143. *Id.* §§ 324.20138(2), (5).

144. *See* David H. Topol, *Hazardous Waste and Bankruptcy: Confronting the Unasked Questions*, 13 VA. ENVTL. L.J. 185, 226 (1994) ("The added benefit of superliens [as compared to ordinary liens] is that they apply to property that is already secured and therefore increase the government's ability to collect on environmental claims at the expense of other creditors. The ability to displace secured creditors will enable the government to collect significantly more money.").

145. *See* Bozarth, *supra* note 10, at 322:

> Arguably, a superlien expedites resolution of the environmental and economic problems caused by release of hazardous materials. A superlien discourages a lender, in a conventional lien state, from dragging its feet on cleanup and foreclosure while hoping that the state will shoulder the costs of the remedial work. When the state's response statute grants the state no lien or only a conventional lien, a lender can foreclose the state's lien and realize a recovery on the freshly cleaned property.

Id.

reducing expenditures by the state and, presumably, the effect of increasing the total number of cleanups. To the extent that the state is more likely to undertake cleanups, the frequencies of cleanups will be greater. This, in turn, will increase the overall environmental quality in the state.

Thus, an increase in the ability and likelihood of the state to obtain reimbursement for environmental cleanup expenditures should increase overall environmental quality in the state. However, the extent to which a superlien statute results in more state cleanups varies with the funding mechanism that the state uses to finance environmental cleanups. The vast majority of U.S. jurisdictions (forty-nine states, as well as Puerto Rico) emulate the model of the federal CERCLA statute[146] and provide for a separate state fund dedicated to environmental cleanups (referred to as a "dedicated fund").[147] A dedicated fund finances environmental cleanups conducted by the state, and recoveries from private parties as compensation for cleanup expenses financed by the state are paid into the dedicated fund. Only two United States jurisdictions, Nebraska and the District of Columbia, provide for no such dedicated fund (such states are "general environmental fund states").[148] Environmental cleanups conducted by the state come from funds subject to annual appropriation by the state legislature.[149]

A superlien statute will have a different overall effect in a dedicated fund state than it will in a general environmental fund state. A superlien statute increases the likelihood that a state will recover funds it expends to clean up contaminated properties. This means that states having dedicated funds will find them more easily replenished. Because state decision-makers presumably will be aware of this, the state should be able to, and therefore should be more likely to, undertake more environmental cleanups with a superlien statute than without. It follows that one reasonably can expect environmental quality to be higher in a dedicated fund state that has a superlien statute than in a state without one.

To some degree at least, the same can be said of the effect of a superlien statute in a general environmental fund state. At the same time, however, it seems logical and likely that not all the funds recovered by the state and paid into the general state environmental fund (or the state treasury) will find their way to be used again to finance environmental cleanups. Rather, such funds

146. *See* 26 U.S.C. § 9507 (1994) (establishing fund); CERCLA § 111, 42 U.S.C. § 9611 (1994) (detailing uses of fund).

147. *See* ELI STATE SUPERFUND REPORT, *supra* note 78, § II.E, at 15 (discussing dedicated funds and dedicated fund states). For ease of exposition, I refer to U.S. jurisdictions, such as the District of Columbia and Puerto Rico, as states.

148. *See id.* (stating that Nebraska and District of Columbia have no authorized cleanup fund).

149. *See id.* at 14 (discussing funds set aside by state for environmental cleanups).

might be redirected to fund other environmental (or even non-environmental) priorities or, even more likely, used to justify reducing budget allocations to the state environmental agency. Whether decision-makers deem it appropriate to cut environmental funding or to use the benefits from the superlien statute to fund other initiatives (and thus to justify cutting direct funding of those initiatives), they reasonably can be expected to pass some of the benefits contributed by the superlien statute on to constituents in the form of tax cuts.[150] Thus, the effect of the passage of a superlien statute on a general environmental fund state is likely to comprise (i) increased environmental quality, though less than in a comparable dedicated fund state, and (ii) an increase in the funds generally available to the state government.

It is likely that a dedicated fund would have a greater positive impact on overall environmental quality than would the enactment of a superlien statute. A superlien statute simply increases the incentive for the state to engage in environmental cleanups without guaranteeing that any level of funding in fact will be devoted to that purpose; a dedicated fund envisions funds being allotted in advance to environmental cleanup.[151] Moreover, a superlien statute

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150. It is conceivable, too, that decision-makers might determine that funds devoted to environmental cleanup are a "good investment" for the government, and accordingly increase funding for that purpose. At some point, however, it would seem that decision-makers would want to capture the economic benefits delivered to the government by a superlien statute, and that they would use those benefits to pass along tax cuts to constituents, thus shoring up and even increasing political support.

151. *See* ELI STATE SUPERFUND REPORT, *supra* note 78, § II.E, at 14-15. The Report states the following:

> A State must be able to pay for its activities in cleaning up sites. A readily available source of money is, therefore, an essential element of a State's program to clean up sites. Experience has shown that a fund separated from the operating funds of the environmental agency and continuing from year to year without the need for annual appropriations or other legislative action allows the agency to avoid disruptions to cleanups. A fund allows a State to investigate, plan, design and conduct emergency response and remedial actions at sites where immediate action is required or where [responsible parties] are unavailable, unable, or unwilling to conduct or pay for remedial actions. At least some of these expenditures can be replaced through cost recovery and must be replenished from other sources. A State may also incur certain expenses that it is not authorized to recover form [responsible parties], including some administrative costs.
>
> A [dedicated] fund also allows a State to control the pace of cleanups; if [responsible parties] do not agree to conduct the cleanup, the State will be able to use its own funds to clean up the site without delay. . . . For a State to maintain control over the time sites are cleaned up, a State must have enough money available to pay for cleanup activities when they become necessary. Money should also be available to pay for responses to emergencies and for unexpected expenses, such as for activities at sites where anticipated agreements with [responsible parties] are not reached. . . .
>
> A State [dedicated] fund can also be a significant contributor to a State's cleanup enforcement program. If the State can clean up a site with State funds and promptly

is beneficial only where there is value in the property after cleanup, whereas a dedicated fund has more general applicability.[152]

The foregoing allows some insight into the likely preferences of environmentalists and budget-constraint advocates as to whether a state should have a dedicated fund, a superlien statute, neither, or both. Table 2 presents these preferences for environmentalists. The columns tell whether or not the state enacts a superlien statute, and the rows represent whether the state is a dedicated fund state or not. The number in each box of the grid is the payoff – that is, the relative preference[153] – of environmentalists to each possible combination of row and column.

Table 2 – Environmentalists' Preferences: What Sort of Lien Statute?

		None	Standard Lien	Superlien
Dedicated Fund State?	No	1	2	3
	Yes	4	5	6

Based upon the preferences set forth in Table 2, one can construct the ranking of environmentalists as to the possible governmental legal structures in terms of whether the state should have a superlien statute and whether the state should be a dedicated fund state. That ranking is presented in Table 3.

Table 3 – Environmentalists' Ranking

Ranking	Structure of State Environmental Regime
1	Dedicated Fund, Superlien Statute
2	Dedicated Fund, Standard Lien Statute
3	Dedicated Fund, No Lien Statute
4	No Dedicated Fund, Superlien Statute
5	No Dedicated Fund, Standard Lien Statute
6	No Dedicated Fund, No Lien Statute

> recover its costs, then [responsible parties] may decide that it is in their interests to agree to conduct future cleanups. States that have demonstrated this ability have been able to reach agreements with [responsible parties].

Id.

152. *See id.* (describing how dedicated funds allow for cleanup without waiting for funds or remedial action from landowners).

153. These payoffs, or relative preferences, are just that. They do not purport to be actual measures of utility. As such, they are not additive, nor, for example, should a payoff of "2" be interpreted as twice as desirable as a payoff of "1."

One can construct, along similar lines, a similar preference grid and ranking for budget-constraint advocates. Tables 4 and 5 present such a grid and ranking.

Table 4 – Budget-Constraint Advocates' Preferences: What Sort of Lien Statute?

		None	**Standard Lien**	**Superlien**
Dedicated Fund	No	2	3	4
State?	Yes	1	1	1

Table 5 – Budget-Constraint Advocates' Ranking

Ranking	**Structure of State Environmental Regime**
1	No Dedicated Fund, Superlien Statute
2	No Dedicated Fund, Standard Lien Statute
3	No Dedicated Fund, No Lien Statute
(tie) 4	Dedicated Fund, Superlien Statute
(tie) 4	Dedicated Fund, Standard Lien Statute
(tie) 4	Dedicated Fund, No Superlien Statute

It should be borne in mind that these Tables provide some information about different peoples' likely preferences, in the abstract, as to six different environmental regulatory structures. In reality, decisions as to whether or not a state should have a dedicated fund and whether or not a superlien statute should be enacted are not made in tandem. Indeed, the debate over superlien statutes is more recent and generally made against a backdrop that features the presence or absence of a dedicated fund. Given that, it appears that environmentalists will favor (as they always would) enactment of a superlien statute, whether or not the state has a dedicated fund, and would favor a standard lien to no lien at all. By contrast, budget-constraint advocates will favor enactment of a superlien statute if the state has no dedicated fund. If the state has a dedicated fund, budget-constraint advocates generally should be ambivalent about enactment of a superlien statute.

V. Costs of a Superlien Statute

The discussion in Part IV explained that superlien statutes offer some combination of two benefits: higher environmental quality and lower net government expenditures on environmental cleanups. Accordingly, it predicted that environmentalists and budget-constraint advocates generally would support, or at least not oppose, superlien legislation.

Superlien statutes also impose costs on society. What are these costs, how much are they, and on whom do they fall? In answering these questions, I advance the thesis that these costs are relatively minor in the residential mortgage lending context absent the market pressures of securitization. However, by putting a premium on uniformity of law across state lines, securitization magnifies the costs in states with superlien statutes. I test this hypothesis by examining the costs associated with superlien statutes on mortgage lending in the absence of, and then in the presence of, the effects of securitization.

In Part V.A, I consider the nature and extent of these costs in the absence of securitization's influence. This analysis consists of four parts. In Part V.A.1, I explain that the immediate impact of superlien statutes generally falls on mortgage lenders and borrowers. I describe this impact with a focus on the effects of superlien statutes on residential mortgage pricing (again in the absence of securitization's influence). In Part V.A.2, I consider the conventional wisdom, proffered by commentators, that superlien statutes will have a substantial impact on mortgage pricing. I posit that these arguments, while perhaps relevant in the commercial mortgage lending arena, are not persuasive in the context of residential mortgage lending. In Part V.A.3, I argue more generally (still in the absence of securitization's influence) that superlien statutes should have much less of a pricing impact on residential, as opposed to commercial, mortgage lending. Last, in Part V.A.4, I employ a net present value residential mortgage model to estimate the actual cost that a superlien statute imposes on mortgage lenders and borrowers. The model suggests that these costs will not be significant.

In Part V.B, I consider how the expansion of securitization may augment the costs associated with superlien statutes. I argue that superlien statutes increase the cost of lending substantially once securitization is introduced insofar as superlien statutes create nonuniformity in pertinent law across state lines while securitization markets are impaired by nonuniformity. I also argue that the particular nature of legal nonuniformity and unpredictability that superlien statutes introduce as to the priority of security interests in property is particularly problematic for mortgage lenders and securitization promoters because it directly implicates the fundamental underpinnings of the mortgage lending and securitization industries.

A. Costs of Superlien Statutes to Residential Mortgage Lenders and Borrowers, in the Absence of Securitization

1. Superlien Statutes' Effect on Residential Mortgage Lenders and Borrowers

Even putting the demands and pressures of securitization to the side, there can be little doubt but that a superlien law increases the price of borrowed funds by some amount. As an initial matter, one can note that additional recoveries made by the state through use of a superlien statute – at the expense of secured lenders – are used to fund improvements in environmental quality in dedicated fund states, and a mix of environmental quality improvements and tax cuts in other states. Because lenders pass some portion of these costs on to borrowers,[154] lenders and borrowers both, in effect, subsidize these societal benefits.

A successfully obtained and exercised superlien likely will result in a situation where a secured lender does not recover on foreclosure funds that it otherwise would have recovered.[155] Thus, the threat of a superlien decreases lenders' likely recovery rate and amount on foreclosure. It is logical that this would have an impact on the practices of, and rates charged by, lenders.[156]

First, lenders endeavor to minimize their exposure to the risk that a superlien statute might trump their security interests. They have done this, in connection with prospective loans, by mandating that research, searches, and inspections be undertaken to verify that (i) no superlien is currently pending against the subject property, and that (ii) in the past no activity has taken

154. *Cf.* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 507 (1991) [hereinafter Schill, *Economic Analysis*] ("If mortgagor protection laws generate substantial costs, economic theory suggests that lenders in a competitive market will pass these costs along to borrowers."). The degree to which lenders will be able to pass costs to borrowers depends upon the elasticity of demand for mortgage loans. *Id.* at 507 n.63.

155. That will be so, unless it is the case that, without a superlien, there would have been no cleanup and thus the mortgagee never would have foreclosed because the subject property was valueless. *Cf.* Butterworth, *supra* note 95, at 185 ("[W]ithout a superlien statute, the lender may elect not to foreclose on the property until the government responds to the contamination. The lender may then foreclose, purchase, and dispose of the property in order to recover the value of the collateral that has been restored and enhanced at the taxpayers['] expense.").

156. Environmental superliens also have affected the practices of title insurance companies. "The title insurance industry . . . has responded to the existence of superliens by revising standard contract forms, expanding title searches, and receiving from the EPA periodic lists of properties on which CERCLA liens have been filed." Clark, *supra* note 84, at 229; *see* MOSKOWITZ, *supra* note 5, § 24.8, at 337 ("In 1987, [the American Land Title Association], in cooperation with FNMA, designed a clause for use in transactions involving residential properties that requires the title insurance company to search for environmental liens recorded in federal courts, but still allows the exclusion for state 'superliens.'"). *See* Bozarth, *supra* note 10, at 313-14 (describing ALTA's arrangement with EPA to obtain periodic lists of properties subject to CERCLA liens).

On the subject of insurance coverage explicitly for the risk of superliens, Robert Bozarth explains that "[t]itle insurance superlien coverage in loan policies was available in Connecticut, Massachusetts, and New Hampshire until 1987." *Id.* at 336 (footnote omitted). However, state insurance commissioners determined that the coverage was violative of state restrictions on title insurance companies. *Id.* at 338. By then, moreover, "most title insurers had independently decided the superlien risk was too great and withdrew the superlien coverage from the market. Now the major title insurers not only refuse to extend coverage against superliens but also refuse to reinsure policies containing the coverage." *Id.*

place on (or even near) the property that might require an environmental cleanup of the property in the future, thus exposing the lender to the possible entry of a superlien.[157]

Second, lenders will charge more for borrowed money in order to pass some portion of the risk posed by a superlien statute onto borrowers.[158] This increase in interest rate charge translates into an upward shift in the industry-

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157. *See* Robert McCabe, *Managing Environmental Risk*, 55 MORTGAGE BANKING 87, 87 (1995) ("Environmental due diligence can be viewed as simply one of the costs of doing business in today's market."). Sondra Mulkeen stated the following:

> Connecticut banks are understandably nervous about the effects of [federal and state superfund] laws. As a result, they have decided en masse that the only acceptable environmental risk is no environmental risk. No commercial property gets a mortgage in Connecticut anymore without an "environmental assessment report." This report must be prepared by the buyer at his/her own expense. The bank utilizes this information to decide whether or not this is a "good sale" (i.e.[,] whether or not to lend money). If a clean-up is required, the buyer must then obtain approval from the [state Department of Environmental Protection] before the mortgage is granted. This process consists of a report researched by experts in the field (the aforementioned environmental assessment report), as well as a detailed remediation plan.

Sondra Mulkeen, *Clean-Up: The Cost and the Trade-Offs*, BUS. J.-HARTFORD, Apr. 24, 1989, at 6:. *Cf.* Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131, 136 (1989) (describing how borrowers may agree to allow lenders to maintain, *inter alia*, "monitoring mechanisms" in situations in which lenders fear "debtor misconduct" in order to "decrease the amount of [interest] compensation" demanded by lenders).

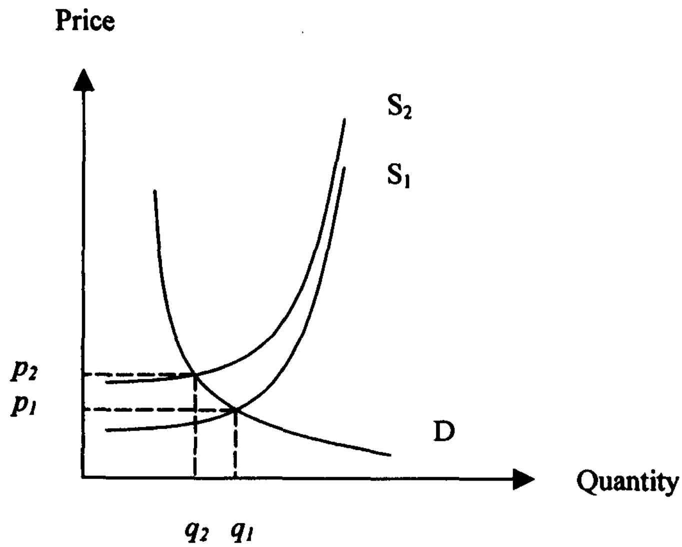
That is not to say that the absence of superlien legislation removes any incentive for lenders to implement such measures. Rather, the mere passage of legislation authorizing liens for state environmental expenses – even if not superliens – likely will induce lenders to undertake such measures. However, because the threat of a standard lien imposes far less risk on lenders than does the threat of a superlien, the incentive to mitigate that risk will be far greater with passage of superlien legislation. *See* Hamel, *supra* note 5, at 854 ("The dangers of superliens and, *to a much lesser degree, non-priority liens*, are such that lenders have adjusted their lending activities to account for the new risks." (emphasis added)); *see also* Burkhart, *supra* note 28, at 298-303 (discussing possible liability and risks of environmental pollution for lenders and borrowers of secured real estate and need for environmental assessment of secured real estate).

Due diligence one day may be supplanted by environmental insurance. Insurers who are long wary of offering insurance against what were perceived to be unpredictable environmental risks, have begun to venture into the field. *See infra* note 163 (describing insurance companies' willingness to offer coverage on environmental risks). Recently, major ratings agencies approved "the use of environmental insurance in lieu of, or in addition to, standard environmental due diligence assessments for commercial mortgage securitizations." Adam Tempkin, *Enviro-Insurance Emerges as Option to Due Diligence*, INVESTMENT DEALERS' DIGEST, June 21, 1999, at 4; *see also* DUFF & PHELPS CREDIT RATING CO., CMBS METHODOLOGY: CRITERIA FOR USING SECURED CREDITOR ENVIRONMENTAL INSURANCE (1999).

158. *See* Fischel, *supra* note 157, at 133-34 (describing how lenders consider likelihood of default and likely recovery on default in setting terms of loans). *See also id.* at 136 ("The greater the amount of anticipated debtor misconduct, the greater the compensation (*i.e.*, the higher interest rate) that a lender will demand.").

wide supply curve for mortgage-backed funds. This effect is represented in Figure 2, in which *D* represents the industry-wide demand curve for borrowed mortgage-backed funds, S_1 represents the industry-wide supply curve before the enactment of a superlien statute, and S_2 corresponds with the industry-wide supply curve after enactment. As the figure reveals, this shift in the supply curve effects (i) an increase in the equilibrium price for mortgage-backed funds, i.e., an increase in the interest rate charged by lenders, from p_1 to p_2,[159] and (ii) a decrease in the amount of funds borrowed from q_1 to q_2, which translates into fewer mortgage loans made.

Figure 2: Demand curve and supply curves for mortgage loans before (1), and after (2), enactment of a superlien statute.



2. *Evaluation of the Conventional Wisdom: Superlien Statutes Directly and Substantially Affect Residential Mortgage Pricing*

The foregoing information makes it clear that one reasonably might expect a superlien statute to result in an increase in the price of mortgage-backed funds. The question remains: how great will that increase be? Commentators

159. *See* Harry F. Klodowski, Jr., *Redevelopment Under State Superfund Laws*, RISK MGMT., Feb. 1, 1995, at 29 ("[T]he existence of a priority lien is often a compelling reason for them to refuse to make the loan, or at least to charge a higher rate of interest to compensate for the increased risk.").

generally assume that the increase will be large and have offered varying justifications for that conclusion. Retaining the focus on *residential* mortgage lending, I now turn to an examination of these justifications. I conclude that none are persuasive.

At first blush, one might comprehend the threat that superlien statutes pose to lenders simply as the possibility that lenders' prior liens might be superseded by subsequently filed superliens. The concept of a subsequent lien taking precedence over a prior lien is hardly novel, however: Many state laws provide that liens for recovery of real estate taxes take precedence over other liens, even where the holders of the prior liens have filed and perfected those liens before the tax lien arises.[160] Thus, it seems unlikely that the mere fact that a superlien is a retroactive lien is *alone* the cause of lenders' great enmity toward superlien statutes. The problem for lenders with retroactive *environmental* liens, as opposed to retroactive *tax* liens, is that the latter are far more predictable, both in terms of occurrence and magnitude. As Grant Nelson and Dale Whitman explain:

> Granting automatic senior status to real estate tax liens usually poses no significant problem for the mortgage[s] because they frequently "escrow" for such liabilities and, in any event, can predict with relative certainty the extent of their . . . future tax burden. On the other hand, . . . finding and predicting environmental problems represents a much less manageable task for the mortgagee . . . .[161]

Robert Bozarth echoes: "[R]eal estate taxes also enjoy a superpriority, but prospective purchasers and lenders can discover current and delinquent tax liabilities in the title examination. In addition, the total tax delinquency rarely exceeds a fraction of the value of a commercial or industrial property."[162]

However, as time passes and experience with environmental cleanups grows, it becomes easier to quantify the likelihood and magnitude of environmental risks.[163] Thus, the retroactivity of superlien statutes may not present

160. *See, e.g.*, CAL. REV. & TAX CODE § 2192.1 (West 1998) ("Every tax declared in this chapter to be a lien on real property, and every public improvement assessment declared by law to be a lien on real property, have priority over all other liens on the property, regardless of the time of their creation."). *See also* Newman, *supra* note 5, at 43.012 ("The most obvious and common known lien having a superpriority is the lien for real estate taxes."); *supra* note 79 (providing definitions for "superlien" that clearly encompass liens for real estate taxes that enjoy first priority status).

161. 1 NELSON & WHITMAN, *supra* note 5, § 4.50, at 291 (footnotes omitted). On this basis, Nelson and Whitman conclude that "the current lack of priority status for the CERCLA lien probably represents sound policy" and that by implication state superlien laws do not. *Id.*

162. Bozarth, *supra* note 10, at 323.

163. Thus, while insurers long shied away from offering coverage for environmental risks, they now are able profitably to underwrite such coverage. *See supra* note 157 (discussing how insurance companies have begun to offer coverage for environmental risks); *see also* Jonathan

as sizeable a pricing problem for lenders as one at first might think. Moreover, while Bozarth's comment on the relative size of tax delinquencies helps explain why superlien statutes might cause large price increases in the commercial mortgage context, it suggests that price increases in the residential context would be comparatively minimal.

A more likely cause for an increase in residential mortgage pricing is a superlien statute that allows state liens to trump other liens that were perfected before the effective date of the statute, i.e., liens where the lenders were not on notice of the possible applicability of a superlien statute and thus had no opportunity to charge a premium for that additional risk. Notably, the superlien statutes in Connecticut and Maine avoid this problem because they vest superpriority in state liens only as to liens that were perfected after the respective statute's effective date.[164] Residential lenders in these states nonetheless sought, successfully, residential property exemptions. Moreover, the fact that a state superlien statute may apply to liens that were perfected before the statute's effective date should not impact the pricing of residential mortgages issued today, i.e., after the statute has gone into effect.

Mark Budnitz and Helen Chaitman disagree that retroactivity is the lender's central problem with superlien statutes. While conceding that "[t]here is nothing a lender can do to prevent the imposition of a retroactive lien on contaminated property,"[165] they assert:

> In practice, the imposition of such a lien may be of no consequence to the lender. The lender may not even wish to enforce its security interest on contaminated property, given the risk of the lender's liability as an owner for the cleanup. Moreover, once the property is cleaned up, the possibility of unfound waste will leave the property undervalued.[166]

Rather, Budnitz and Chaitman argue that the "greatest concern" for lenders arising out of superlien statutes is "the lien on business revenues that might otherwise be used to satisfy the business's debt to its lender."[167] This argument persuasively suggests that superlien statutes may cause commercial mortgage lenders to increase substantially the cost of borrowed funds to insure against this increased risk. At the same time, this argument implies by omission that residential lenders will not experience a similar motivation.

R. Nash, Note, *Environmental Law: An Economic Approach to the Availability of Hazardous Waste Insurance*, 1991 ANN. SURV. AM. L. 455.

164. *See supra* text accompanying note 103 (listing statutory provisions of Connecticut and Maine).

165. 2 BUDNITZ & CHAITMAN, *supra* note 5, ¶ 9.05, at 9-63.

166. *Id.*

167. *Id.*

B. Comparison of the Costs Associated with Superlien Statutes in the Residential and Commercial Mortgage Lending Arenas

The foregoing discussion established that commentators' proffered reasons for heightened mortgage pricing resulting from superlien statutes, while applicable to commercial mortgage lending, are not persuasive in the context of residential mortgage lending. An examination of the risks faced by residential, as opposed to commercial, mortgage lenders confirms this dichotomy.

As an initial matter, the argument that enactment of a superlien statute substantially reduces mortgage lenders' expected recovery on mortgage default in the case of residential property seems dubious. The chance of a residential site being environmentally contaminated – or even subject to a risk of such contamination – is smaller than the comparable risk for commercial property. Activities carried on at a site that is used for residential purposes are exceedingly unlikely to result in environmental contamination. Thus, contamination of residential properties is far more likely to result from activities conducted at adjacent or nearby properties. It tends to be the case, however – whether for reasons of zoning[168] and planned development or simply because of consumer preference – that residences are likely to be located near other residences. This further reduces the risk of a residential property becoming environmentally contaminated.

Second, lenders can act to minimize their risk even if some residential properties in which they hold a security interest become contaminated. In spite of the foregoing, risks of contamination at residential properties remain. A residential property may have become contaminated because of activities conducted at the site before its current residential use. That risk, however, is one that a prospective lender should be able to avoid (or at least knowingly undertake) with the help of due diligence. Due diligence should also mitigate the risk that a residential site that is not currently contaminated might become contaminated because of activities at a nearby site.

Third, even if a residential site is contaminated (or becomes contaminated), it does not necessarily mean that the owner of the property will be pursued to recover response or remedial costs at the site. Indeed, it is the policy of the EPA not to pursue innocent landowners.[169] If state authorities

168. *See* William D. McElyea, *Playing the Numbers Game: Local Government Authority to Apply Use Quotas in Neighborhood Commercial Districts*, 14 ECOLOGY L.Q. 325, 349 (1987) (discussing how zoning preserves "character of single-family residential neighborhoods").

169. *See* EPA: Guidance on Federal Superfund Liens, OSWER No. 9832.12, § 2 (Sept. 22, 1987), *available at* http://es.epa.gov/oeca/osre/870922.html ("Regional offices should not file notice [of a CERCLA lien] where it appears that the defendant satisfies the elements of the innocent landowner defense . . . ."); EPA: Superfund Today – Focus on Property Issues, OSWER No. 9378.0-09 AFS, at 5 (Sept. 2000), *available at* http://www.epa.gov/superfund/tools/today/sitefaq2.pdf [hereinafter Superfund Today] ("EPA will not take actions against a

follow this logical policy, then they presumably would not invoke a superlien statute to deprive an innocent landowner of any of the value of his or her property. Thus, the practical risk to a residential lender is comparatively small.

Fourth, even if a lender cannot avoid all risk that the state may clean up a residential site in which it holds a security interest and may rely on a superlien statute to trump the lender's interest, the lender may be no worse off in the long run, and indeed even may be better off. To the extent a property is contaminated or is likely to become contaminated, the lender may face recovery below the value of its security interest even in the absence of a superlien statute. This is because, as I discuss above, a superlien statute makes environmental cleanups more likely to occur.[170] That being the case, if a cleanup of a property would not occur in the absence of a superlien statute, then the property is likely to remain contaminated and therefore worth substantially less – perhaps below (possibly even far below) the value of the lender's security interest. In addition, because more common and frequent environmental cleanups tend to enhance overall environmental quality – and therefore property values in general[171] – lenders may in the long run prefer to have a superlien statute in effect.[172]

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residential home owner, unless the owner polluted the site or made existing pollution problems worse (a release or threat of release of hazardous substances) and forced a cleanup action by EPA at the site."); EPA: Policy Towards Owners of Residential Property at Superfund Sites, OSWER No. 9834.6, § I.C (July 3, 1991), *available at* http://es.epa.gov/oeca/osre/910703.html ("In the past, the Agency has not required owners of residential property located on a Superfund site to perform response actions or pay response actions or pay response costs except where the residential homeowners' activities lead to a release or threat of a release of hazardous substances, resulting in the taking of a response action at the site . . . . The purpose of this policy is to continue the Agency's past practice and to provide guidance for Agency enforcement staff.").

170. *See supra* notes 144-45 and accompanying text (noting that superlien statute increases likelihood of environmental cleanup).

171. *See* Superfund Today, *supra* note 169, at 3 ("Property values can be affected by a number of environmental factors: perceived health risks; impacts on safe drinking water; air pollution; odor; construction activity; and noise."); Thomas M. Carroll, *The Economic Impact of a Transient Hazard on Property Values: The 1988 PEPCON Explosion in Henderson, Nevada*, 13 J. REAL EST. FIN. & ECON. 143 (1996) (stating that property values are sensitive to mean distance of property from hazard); *cf.* Christopher G. Leggett & Nancy E. Bockstaal, *Evidence of the Effects of Water Quality on Residential Land Values*, 39 J. ENVTL. ECON. & MGMT. 121 (2000) (using land value as proxy to measure marginal willingness to pay to live alongside cleaner water); Jeffrey E. Zabel & Katherine A. Kiel, *Estimating the Demand for Air Quality in Four U.S. Cities*, 76 LAND ECON. 174 (2000) (using housing prices as proxy to measure marginal willingness to pay for cleaner air).

172. *But see* Thomas M. McMahon, *Lender's Perspectives on Hazardous Waste and Similar Liabilities*, 18 Envtl. L. Rep. (Envtl. L. Inst.) 10,368, 10,369 (Sept. 1988). McMahon states the following:

> Some lenders may view the possibility of a government cleanup as a potential windfall, because they assume that the government will clean up the site to their benefit. There is a distinction, however, between a cleanup sufficient to protect

C. Economic Analysis of the Costs Associated with Superlien Statutes That Apply to Residential Properties

More precise methods of estimating the likely economic effect of a superlien statute on residential mortgage pricing reinforce the conclusion that the costs associated with superlien statutes are, at least in the absence of securitization, insignificant. I employ a net present value model of a mortgage to examine and estimate the precise economic effect of a superlien statute on residential mortgage pricing.[173] Let:

$V =$ the initial principal balance of the loan;
$T_m =$ the term of the loan;
$T =$ the year in which the loan is prepaid;
$i =$ the annual interest rate of the mortgage;
$\pi =$ the annual inflation rate;
$L_t =$ the principal balance of the loan in any year t;
$C_0 =$ the net cost to the lender of originating the loan;
$C_t =$ the annual cost to the lender of servicing the loan;[174]
$r =$ the lender's cost of funds;
$M =$ the annual lump sum payment by the borrower to the lender;[175]
$d_t =$ the probability that the borrower will default in any year t;
$R_t =$ the revenue received by the lender from the foreclosure sale and deficiency judgment;[176]
$h =$ the time between the borrower's last payment and the date the lender receives R_t;

> against an imminent hazard, and a full cleanup, in which the waste material is removed and the remedy is permanent. If the government sees that a lender may get a windfall benefit, it is likely to preserve its own resources and seek an interim solution. It will do just enough to protect the public health and other sensitive environmental concerns and then let the chips fall where they may.

Id.

173. This use of a net present value model to estimate the economic impact of a superlien statute on residential mortgage pricing is based upon the use by Michael Schill of a similar model to estimate the economic impact of mortgagor protection laws. *See* Schill, *Economic Analysis, supra* note 154, at 501-07 (constructing model to estimate economic impact of mortgagor protection laws).

174. I assume that C_t increases each year by the inflation rate π, $C_t = C_1(1 + \pi)t$. *See* Schill, *Economic Analysis, supra* note 154, at 501 n.49 (assuming that lender's annual cost of servicing loan increases each year by inflation rate).

175. $M = iV/(1\text{-}1/((1+i)T_m))$. Thus, the model assumes annual mortgage loan payments, rather than the monthly payments most mortgages require. The results between the two approaches do not vary greatly. *See* Schill, *Economic Analysis, supra* note 154, at 502 n.50 (using annual mortgage loan payments in model).

176. $R_t = \theta L_t$

F_t = the cost to the lender of foreclosing the mortgage and bringing a deficiency judgment action;[177] and

θ = the proportion of the loan balance recovered by the lender by virtue of the foreclosure sale and deficiency judgment.

The net present value of a mortgage equals the sum of the following component cash flows to the lender:

(1) $-V-C_0$,

constituting the payment by the lender of the loan principal and origination cost;

(2) $$\sum_{t=1}^{T} \frac{(M-C_t)(1-\sum_{s=1}^{t} d_s)}{(1+r)^t},$$

constituting the discounted value of the regularly scheduled payments received by the lender for the years that the borrower remains in good standing;

(3) $$(1-\sum_{t=1}^{T-1} d_t)\left(\frac{L_T}{(1+r)^T}\right),$$

constituting the discounted value of all loan prepayments received by the lender; and

(4) $$\sum_{t=1}^{T-1} \frac{d_t\left(\frac{R_t}{(1+r)^h}-F_t\right)}{(1+r)^t},$$

constituting the discounted value of all net revenue received by the lender from the foreclosure sale and deficiency judgment.

Thus, the net present value equals:

$$-V-C_0+\sum_{t=1}^{T} \frac{(M-C_t)(1-\sum_{s=1}^{t} d_s)}{(1+r)^t}+(1-\sum_{t=1}^{T-1} d_t)\left(\frac{L_T}{(1+r)^T}\right)+\sum_{t=1}^{T-1} \frac{d_t\left(\frac{R_t}{(1+r)^h}-F_t\right)}{(1+r)^t}.$$

177. I assume that F_t increases each year by the inflation rate π, $F_t = F_1(1+\pi)t$. *See* Schill, *Economic Analysis*, *supra* note 154, at 502 n.52 (assuming that cost to lender of foreclosing mortgage and bringing deficiency judgment action will increase each year by inflation rate).

I assume that most of the variables in the model remain constant throughout the net present value simulation. In particular, I assume, in keeping with current mortgage and economic data, that:

$V = \$80{,}000$;[178]	$T_m = 30$ years;
$T = $ year 9;[179]	$C_T = \$161$;[180]
$d_1 = 0.04\%$;[181]	$d_2 = 0.12\%$;
$d_3 = 0.28\%$;	$d_4 = 0.52\%$;
$d_5 = 0.83\%$;	$d_6 = 0.90\%$;
$d_7 = 0.75\%$;	$d_8 = 0.66\%$;
$h = 3$ months;[182]	$r = 6\%$; and
$\pi = 5\%$.	

178. This assumes a $100,000 purchase price and a loan-to-value ratio of 80%. *See* Terms on Conventional Home Mortgages – 2000, *available at* http://www.fhfb.gov/mirs/mirstbl9.htm (last visited Mar. 23, 2002) (indicating that 43% of mortgages nationwide have loan-to-value ratio of between 70.1% and 80.0%); Schill, *Economic Analysis*, *supra* note 154, at 503 n.54 (using same value for V under similar assumption).

179. Schill explains that "[r]elatively few loans are held to maturity because borrowers prepay them to move elsewhere, obtain a lower interest rate, or default." Schill, *Economic Analysis*, *supra* note 154, at 503 n.56. In presenting a net present value mortgage model, Schill notes that "[e]stimates of an average mortgage life range from seven to twelve years," and uses a mortgage life of nine years in a net present value calculation similar to the one I present here. *Id.* at 503 n.56; *see also* Brent W. Ambrose & Charles A. Capone, *The Hazard Rates of First and Second Default*, 20 J. REAL EST. FIN. & ECON. 275, 284 (2000) ("Each month from origination increases the probability of prepayment . . . by 38 percent . . . . Simulations show a marked decline in the hazard[ ] of prepayment . . . after month[ ] 48 . . . ."); Tyler T. Yang et al., *An Analysis of the* Ex Ante *Properties of Mortgage Prepayment and Default*, 26 REAL EST. ECON. 651, 659 fig.1 (1998) (presenting empirical data on mortgage prepayment rates).

180. Here, I use the number used by Schill in 1990, augmented by an annual 6% inflation rate to account for the intervening decade. Schill, *Economic Analysis*, *supra* note 154, at 503. This amount represents the initial year. *See supra* note 174.

181. Values for default probabilities are based upon empirical data presented in Yang et al., *supra* note 179, at 660 fig. 2. *See also* Ambrose & Capone, *supra* note 179, at 284 ("Each month from origination increases the probability of . . . default by . . . 5.6% . . . . Simulations show a marked decline in the hazard[ ] of . . . first default after month[ ] . . . 60 . . . ."). As Schill did, I use default rates in excess of actual empirical default rates "[i]n order to present a 'worst possible case' scenario." Schill, *Economic Analysis*, *supra* note 154, at 503 n.55. I note that the default probabilities that I use are significantly lower than the probabilities Schill used for years one through five, and higher for years five through eight – in other words, my assumptions predict that default, if it occurs, is more likely to occur later in the term of the mortgage. *Id.* at 503. Also, the total probability of default in years one through eight is lower under my assumptions than it is under Schill's. *Id.* A possible explanation for this discrepancy is that Schill performed his computation in 1991 during an economic downturn. By contrast, the data on which I rely come from the 1990s, the majority of which constituted good economic times during which one might expect the probability of default to be lower.

182. *See* Schill, *Economic Analysis*, *supra* note 154, at 505 & n.61 (setting value of *h* at three months).

This model does not identify variables the presence or absence of which a superlien statute is likely to affect, such as the cost of mortgage origination, C_0; the cost of pursuing a foreclosure action, F_1; the proportion of the outstanding loan balance that the lender can expect to recover on foreclosure, θ; or the interest rate, i, the value of which depends upon the values of the other variables. The value of C_0 is likely to be somewhat higher in a jurisdiction that has enacted a superlien statute insofar as lenders are more likely to undertake additional due diligence in response to the statute. Still, C_0 is unlikely to be substantially higher both because lenders are likely to pass some of the cost of the additional due diligence to borrowers[183] and because federal and state environmental liability schemes generally prompt lenders to undertake due diligence even in the absence of a superlien statute.[184] One also would expect F_1 to be somewhat higher in a state with a superlien statute. However, the true cost of a superlien statute is not that foreclosure of properties becomes more expensive; rather, a lender is less likely to recover as much after a successful foreclosure than the lender would if no superlien statute were in effect. Thus, while a superlien statute may lead to a slight increase in F_1, it is more likely to cause a substantial decrease in θ.

Assuming that mortgage markets are competitive, the net present value of the mortgage will be zero.[185] Thus, by substituting in the values for the variables listed above and by varying C_0, F_1, and θ, one can solve for i. In particular, one can determine the effect of different values of C_0, F_1, and θ on i. Table 6 presents the values of i that result from different input values. Table 6 also includes the corresponding values of M, the annual debt service, in order to convey a more complete sense of the likely economic impact of changes to the independent variables.

183. *See supra* notes 154, 158, and accompanying text (noting that lenders likely would charge higher interest rates to compensate for incurring higher risks).

184. *See supra* note 157 (noting that lenders will likely undertake environmental due diligence due to passage of state statutes authorizing liens for environmental expenses).

185. *See* Schill, *Economic Analysis*, *supra* note 154, at 503 n.53 (analyzing costs of mortgagor protection laws by creating model of expected returns to lenders, which assumes competitive markets and zero net present value of loan).

Table 6 – Net Present Value Simulation Results

Cost of Origination (C_0)	Cost of Foreclosure (F_1)	Break-Even Interest Rate (i)	Annual Debt Service (M)
Proportion of Loan Balance Recovered (θ) = 0.98			
$800	$275	6.46%	$6,101
$800	$600	6.46%	$6,101
$800	$3,000	6.48%	$6.113
$1,200	$275	6.53%	$6,145
$1,200	$600	6.54%	$6,152
$1,200	$3,000	6.55%	$6,158
$1,600	$275	6.61%	$6,196
$1,600	$600	6.61%	$6,196
$1,600	$3,000	6.63%	$6,209
Proportion of Loan Balance Recovered (θ) = 0.88			
$800	$275	6.50%	$6,126
$800	$600	6.50%	$6,126
$800	$3,000	6.52%	$6,139
$1,200	$275	6.58%	$6,177
$1,200	$600	6.58%	$6,177
$1,200	$3,000	6.60%	$6,190
$1,600	$275	6.65%	$6,222
$1,600	$600	6.66%	$6,228
$1,600	$3,000	6.67%	$6,235
Proportion of Loan Balance Recovered (θ) = 0.78			
$800	$275	6.54%	$6,152
$800	$600	6.54%	$6,152
$800	$3,000	6.56%	$6,164
$1,200	$275	6.62%	$6,203
$1,200	$600	6.62%	$6,203
$1,200	$3,000	6.64%	$6,215
$1,600	$275	6.70%	$6,254
$1,600	$600	6.70%	$6,254
$1,600	$3,000	6.72%	$6,267

I chose as the base case the situation where, in line with current residential mortgage data, $C_0 = \$800$,[186] $F_1 = \$275$,[187] and $\theta = 98\%$.[188] This base situation produces an interest rate (i) equal to 6.46%. If θ is 88% (as one might result under a superlien statute),[189] then i will increase only by four basis points. Even reducing θ to 78% – which seems overly pessimistic for residential mortgages, if not for all mortgages – will increase the interest rate by only twelve basis points with a corresponding increase of less than five dollars in monthly debt service.[190]

The data reflect that increases – indeed, even substantial increases – in F_1 have only a minimal impact on i and M. Increases in C_0 have a greater impact. Under the particularly unlikely case where θ shrinks to 78% while C_0 and F_1 increase to \$1,600 and \$3,000, respectively, the model predicts that i will increase 26 basis points. While this increase is not insubstantial, it is unlikely to occur and still represents less than a \$15 increase in monthly debt service payments. Thus, as expected, the net present value simulation predicts

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186. Federal Housing Finance Board ("FHFB") mortgage data for 1999 indicate that initial fees and charges constitute, on average, 0.74% of the mortgage value. *See* Fed. Hous. Fin. Bd.., Table 1: Terms on Conventional Single-Family Mortgages, Annual National Averages, All Homes, *available at* http://www.fhfb.gov/mirs/mirs_t1.xls (last visited Mar. 23, 2002) (compiling annual average data on home mortgages). On a mortgage of \$80,000, initial charges and fees would average \$592. Because the average loan exceeds this value, *see id.*, and because presumably some portion of initial charges and fees is fixed and does not vary with the size of the mortgage, I employ a slightly higher number.

The number I use for initial costs and fees is less than the number Michael Schill used – \$1,250 – in presenting a net present value mortgage cash flow model a decade ago. *See* Schill, *Economic Analysis*, *supra* note 154, at 504 (using \$1,250 as cost of initial fees throughout analysis). The FHFB explains the reasons for this change as follows:

> Generally, initial fees as a percent of the loan balance have been declining since the middle 1980's, when such fees were more than 2.5 percent of the loan balance. The downward trend in initial fees reflects both the easing of mortgage market conditions and the increased popularity of no-point, purchase-money mortgages.

Fed. Hous. Fin. Bd., Mortgage Interest Rate Survey, Conventional Mortgage Loans, *available at* http://www.fhfb.gov/MIRS_loans.htm.

187. *See* Schill, *Economic Analysis*, *supra* note 154, at 505 (using model in which $F_1 =$ \$275, based on figures from Texas).

188. *See id.* (using model in which $\theta = 0.98$ is consistent with empirical evidence available at time).

189. Specifically, one might expect θ to be 88% if a superlien statute were in effect and *regularly invoked*. In fact, as discussed above, *see supra* note 13 and Part VI.B, superlien statutes have not been and are not likely to be invoked frequently, even if they might be applicable in theory.

190. *See* Schill, *Economic Analysis*, *supra* note 154, at 505 (calculating increase in breakeven interest rate by decreasing θ and keeping i and F_1 constant). Schill uses a net present value model to gauge the impact of decreases in θ in the context of state mortgagor protection laws. *Id.* He concludes, based upon data culled from the late 1980s, that similar decreases in θ will not have a substantial impact on i. *Id.* at 506.

that the impact of a superlien statute on residential mortgage pricing is not significant.[191]

D. Costs of Superlien Statutes on the Residential Mortgage Securitization Markets

Part V.A established that, at least in the absence of securitization, the costs associated with superlien statutes are comparatively small. Part IV identified some benefits associated with superlien statutes, such as greater environmental quality at less cost to the government. Part IV did not quantify those benefits; nonetheless, it is reasonable to conclude that, given the small size of the accompanying costs and *assuming that securitization does not magnify those costs substantially,* one should not rule out superlien statutes as beneficial as matters of public policy and efficiency.[192] This Section examines whether this assumption is a valid one.

As discussed above, securitization offers many benefits: It increases the flow of capital into real estate markets, leads to greater flow of capital from region to region, and ultimately results in lower interest rates.[193] Securitization can function only if its promoters successfully can "bundle together" groups of mortgages in "mortgage pools" that serve as underlying collateral for the securities that the promoters issue. In turn, this bundling can take place only if the terms of the mortgages that are bundled together and the laws that govern them are substantially similar.

That some states feature a superlien statute creates nonuniformity in the law governing mortgage loan priority across state lines. Three options are open to securitization promoters in addressing this nonuniformity: they can (1) continue to bundle mortgages from different states (regardless of whether states have superlien statutes), and either (a) calculate the price of mortgages depending upon whether the state of origin features a superlien statute, or

191. In addition to using a net present value model, Schill relies upon a multiple regression analysis to argue that state mortgagor protection laws do not inordinately affect the prices of residential mortgages in states that have such laws. *See id.* at 507-14 (concluding that effect of mortgagor protection laws on interest rates is statistically insignificant due to small magnitude of actual costs associated with such loans). I do not employ a multiple regression analysis because, as I discuss above, six of the states that have superlien statutes exempt residential property from their scope, while the remaining two state statutes are highly unlikely to put at risk a lender's equity in a property. *See supra* notes 139-43 and accompanying text (describing variations in state superlien statutes). In effect, then, no state has in place a superlien statute that would put a lender's equity in residential property at risk as much as a superlien statute possibly could. As a result, no state can act as a reference on which to test the economic impact of such a statute using a multiple regression analysis.

192. *See* Schill, *Economic Analysis, supra* note 154, at 501 (arguing that costs generated by mortgagor protection laws are not as great as lawyers and economists have argued, based on model of expected returns to lenders).

193. *See supra* Part V.B (discussing benefits of securitization).

(b) price mortgages without regard to whether their state of origin features a superlien statute; or (2) decline to include mortgages originating in states with superlien statutes in mortgage pools. Each of these options has drawbacks.

First, securitization promoters have the capability, at relatively low expense, to include the costs associated with superlien statutes in the formula to determine the price of mortgages in mortgage pools.[194] This inclusion would allow conduits to discount the price of mortgages originating in states that feature superlien statutes to reflect the increased risk associated with such statutes.

Two drawbacks exist for this approach. First, even if pricing mortgages differentially because of variations in law is not expensive, myriad variations in numerous laws in multiple states at some point will generate more substantial transaction costs. Moreover, residential mortgage securitization promoters are predominantly corporations with ties to and subject to the regulatory oversight of the federal government.[195] Such corporations may decide that they risk inviting congressional oversight and regulation if they price mortgages differently according to the state of origin.[196] Indeed, "[f]ederally related secondary mortgage agencies such as FNMA, GNMA and FHLMC do not price mortgage market loans differentially to reflect the expected costs attributable to state mortgage laws."[197]

A second approach in which conduits continue to assemble mortgage pools with mortgages from states whose laws increase lender risk, is for the conduits simply to ignore the heightened risk in pricing mortgages from those states. This approach avoids the transaction costs inherent in differential pricing, as well as the political difficulties FNMA, FHLMC, and GNMA might encounter were they to engage in differential pricing.[198] At the same time, this approach has drawbacks of its own. These problems arise because this approach imposes no economic burden on states that enact laws creating higher lender risk. As a result, states without such laws subsidize the benefits that residents of the states with these laws enjoy. In other words, this approach

194. *Cf.* Schill, *Uniformity or Diversity*, *supra* note 39, at 1293 (stating that, "[g]iven the elaborate pricing models already used to evaluate real estate investments, . . . an adjustment factor for state laws is unlikely to add significantly to transaction costs" (footnotes omitted)).

195. *See supra* notes 47-49 and accompanying text (describing creation and responsibilities of FNMA, FHLMC, and GNMA).

196. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1293 n.159 (advancing this theory as possible justification for failure by FNMA, GNMA, and FHLMC to price mortgage loans differentially to reflect expected increased costs associated with variations in state mortgage laws).

197. *Id.* at 1292. Schill suggests as an additional reason for this approach that the expense of pricing the cost variations may exceed the benefits, given the modest variations in cost to which these state law differences give rise the cost of pricing the cost variations may exceed the benefits. *Id.* at 1292 n.159.

198. *See supra* text accompanying notes 195-97 (explaining that political difficulties of differential pricing include congressional oversight and regulation).

allows states with protective laws to internalize the benefits of such laws while externalizing some of the costs. Equally pricing mortgages from all states acts both as an artificial incentive for states to enact costly, protective laws such as superlien statutes and as a disincentive against enactment of uniform laws that securitization prefers.[199] As such, this approach introduces inefficiency both into the securitization markets and into state decision-making processes. Thus, this option will be viable only when the amount of the increased cost, and the number of loans featuring that increased cost, are small.[200]

Additionally, whether or not securitization promoters adopt an approach that prices mortgages differentially according to their state of origin, a great disincentive remains against including in mortgage pools too many mortgages that are subject to comparatively heightened risk. Credit rating agencies examine the mortgage pools underlying mortgage-backed securities in rating the securities; the ratings that the credit agencies give to a security determine the market price of the security. The greater the number of higher-risk mortgages in an underlying mortgage pool, the lower the ratings the security will receive and, accordingly, the higher the effective interest that the promoter will have to promise investors to compensate them for accepting the lower rating and higher risk.[201] At some point, then, the cost of including many

199. *Cf.* Schill, *Uniformity or Diversity*, *supra* note 39, at 1293 n.160 ("Differential pricing of mortgage loans to reflect the cost of state laws might indirectly promote uniform real estate finance law. Once the externality created by the secondary mortgage market is internalized, states with exceptionally protective laws might decide that the costs of the laws outweigh their benefits.").

200. *Cf.* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 287 (noting that "[t]he size of an individual residential loan or set of loans from a state with costly borrower protection laws is likely to be insignificant when considered in the context of the entire pool of mortgages backing a particular issue of securities"). Commercial mortgage loans are less likely to be insignificant in size. *Id.*; *see infra* note 223 and accompanying text (stating that size of commercial loans becomes significant because of small number of mortgages in commercial mortgage pool).

201. *See generally* Mitchell Fenton, *Commercial Real Estate Financing*, 418 PLI/Real Estate 1119, 1122 (1997) (noting that loans that fail to meet requirements of rating agencies have lower ratings and thus lower prices). Fenton believes the following:

> In general the standards for securitization are driven by the requirements of the rating agencies. The rating agencies review the loan pools and assign ratings to them based upon their income-producing potential. The failure of a loan to meet the rating agencies' requirements will result in the loan having exceptions. The more exceptions that a loan has to these requirements, whether in the area of due diligence or documentation, the more likely that there will be a negative impact on the pricing.

Id. The risk that too many mortgages in a mortgage pool might hail from a state that increases the risk associated with those mortgages is a subset of "concentration risk" – the risk of "high concentrations of payments by a relatively small number of obligors." Steven L. Schwarcz, *Structured Finance: The New Way to Securitize Assets*, 11 CARDOZO L. REV. 607, 610 (1990). *See also* Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution,* mortgage loans from states with laws that create greater risks for lenders may become prohibitive.[202]

In fact, superlien statutes introduce nonuniformity in state laws that would impair substantially promoters' ability to include in mortgage pools residential mortgage loans originating from those states that feature such statutes.[203] Superlien statutes threaten the cornerstone of residential mortgage lending: predictability of lien priority.

Predictability of lien priority is of paramount importance in real estate lending. A superlien statute substantially damages that predictability. As a New Jersey Superior Court judge concisely explained:

> Seen, not from the clinical viewpoint of an environmentalist but from the coldly practical position of those whose interests involve the status of land titles in New Jersey, this statute, while highly commendable in its intent[,] is, with respect to land titles, a hibernating time bomb. Our whole system of recordation of land titles depends upon the ability of one who seeks to acquire an interest in real property to ascertain beyond peradventure the true state of the title. The entire industry of title insurance depends on this. The willingness of lending institutions to finance the acquisition of real estate depends on it. The financial safety of myriad numbers of owners of real property depends on it. It is probably an understatement that the financial health of a great portion of our economy depends on the simple fact that anyone wishing to invest in real estate, or finance such investment, is able to go to the proper recording officer and be assured of the posture of the title, saving only forgery .... Into this arena of crystal clarity, the [superlien] act introduces doubt.[204]

Current Issues and New Frontiers, 69 TEX. L. REV. 1369, 1379 n.41 (1991) (defining "concentration risk" as "the degree to which the pool of mortgages ... is geographically concentrated").

202. *Cf.* Burkhart, *supra* note 28, at 281 (explaining effects of foreclosure laws on value of mortgage securities).

> The differences [in the law of foreclosure] among the states are so pronounced that they can have a significant impact on the value of mortgage securities. For this reason, prospectuses for mortgage securities offerings usually include a description of the mortgage laws for the states in which the pooled mortgages originated. The relevant state laws also significantly affect credit rating agencies' evaluations of mortgage securities. Presumably, mortgage securities with lower ratings will be less attractive to investors and may impede the flow of mortgage capital to those states with more pro-borrower foreclosure laws.

Id. (footnotes omitted).

203. *See* Schill, *Lender Liability*, *supra* note 10, at 317 ("Idiosyncratic state laws, such as state superlien acts, increase the risk to lenders of purchasing or originating loans in certain states and may generate large transaction costs in the secondary mortgage market.").

204. Simon v. Oldmans Township, 497 A.2d 204, 209 (N.J. Super. Ct. Ch. Div. 1985) (footnote omitted).

A superlien statute thus upsets the otherwise predictable priority that residential mortgage liens enjoy. Moreover, a superlien statute represents a real threat to residential mortgage lenders and to securitization promoters that it may be only the first of many exceptions to that predictability. To the extent that securitization promoters view superlien statutes in such a light, the statutes present a threat and added cost beyond the actual economic cost that the statutes currently pose.

If securitization promoters determine that they cannot include mortgages from states with laws that create a substantially greater risk to mortgage lenders, such as superlien statutes, then the promoters may decide simply to refuse to purchase mortgages that originate in those jurisdictions. Indeed, that option is exactly what FNMA and FHLMC chose in Massachusetts in the mid-1980s.[205]

Such a decision will impact the cost of residential mortgages in the states in which securitization no longer takes place (or takes place with substantially less frequency). Recall that one would expect the enactment of a superlien statute to result in higher interest rates and in fewer mortgages in a state, even in the absence of the securitization market. If, indeed, the enactment of a superlien statute does affect the availability of securitization in a state, then those effects will be even more pronounced. This result is because the resulting upward shift in the state mortgage lending industry supply curve (as Figure 2 reflects) will be greater than previously described, as the supply curve will shift upward both because of (1) the effect of the superlien statute alone on the traditional mortgage lender-borrower scenario, and because of (2) the resulting effect on the availability of securitization. In effect, some or all of the downward shift in the supply curve that is reflected in Figure 2 no longer will inure to residents of the state. In other words, assuming that the superlien statute renders securitization wholly unavailable, the shift in the supply curve will not be only from S_1 to S_2 as Figure 2 reflects, but from S_0 to S_2 as Figure 3 reflects. Thus, the interest rate lenders charge will increase not from p_1 to p_2, but from p_0 to p_2, which may amount to as much as an additional 30 basis point increase due to the unavailability of securitization in a state.[206] Also, the number of mortgages will decrease not from q_1 to q_2, but from q_0 to q_2. These changes are the real and substantial costs that a superlien statute applicable to residential properties can impose on a state. These costs become substantial only because the securitization market effectively magnifies their impact.

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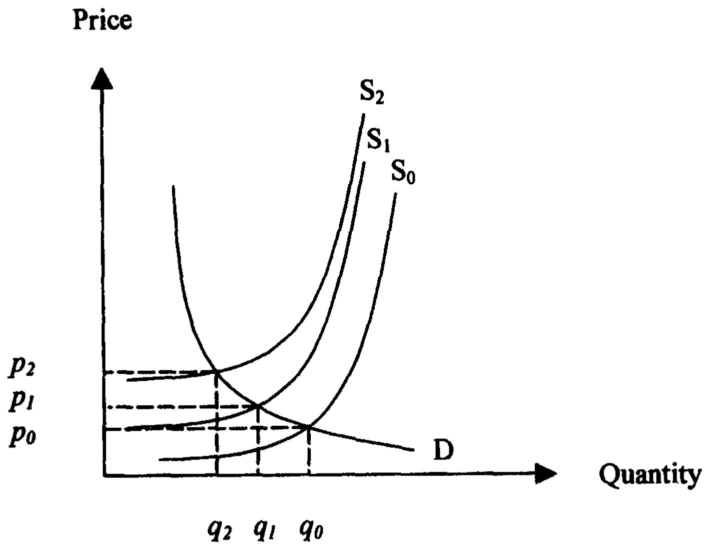
205. *See supra* text accompanying notes 5-10 (describing how FNMA and FHLMC in Massachusetts stopped buying residential multi-family housing mortgages and threatened to stop buying single-family housing mortgages until Massachusetts amended its newly-passed superlien statutes to exempt residential property mortgages).

206. *See supra* note 60 and accompanying text (noting that integration of real estate capital markets with general capital markets reduced home mortgage loan interest rates by fifteen to thirty basis points).

Figure 3: Demand curve and supply curves for mortgage loans. S_1 is the supply curve before enactment of a superlien statute without securitizations available, S_0 is the supply curve before enactment of a superlien statute with securitizations available, and S_2 is the supply curve after enactment of a superlien statute (which, inter alia, eliminates the availability of securitizations).



VI. Commercial Mortgage Lending and Superliens

While in this Article I have generally focused on the effects of superlien statutes on *residential* mortgage lending, a few words about the impact of such statutes on *commercial* mortgage lending are in order.

First, Klaas van 't Veld, Gordon Rausser, and Leo Simon argue that, in the context of commercial lending, superlien statutes actually may reduce monies states recover for environmental cleanups and, as such, constitute poor public policy.[207] These economists explain that two factors encourage a company's decision to issue secured debt (as opposed to unsecured debt). First, financing a project through secured debt allows a firm to shift risk (in the event the project fails and bankruptcy results) to "non-adjusting" creditors,

207. *See* Klaas van 't Veld et al., Fitting the Glass Slipper: Optimal Capital Structure in the Face of Liability (Oct. 2000) (unpublished manuscript, on file with University of Michigan Department of Economics). Their arguments do not readily translate to the context of residential mortgage lending. *See supra* text accompanying note 80 (noting that state will not likely recover much since environmental cleanup costs are large and property owners are often insolvent).

the size of whose claims will not vary if bankruptcy results (such as the state for recoupment of environmental cleanup expenses).[208] Second, a firm may offer to secure a debt as an incentive for a creditor to lend money (in particular, for enough money to satisfy the needs of the firm).[209]

Van 't Veld, Rausser, and Simon assert that enactment of a superlien statute decreases the attractiveness of the first reason that firms offer secured debt because as it increases the priority of some non-adjusting claims and thus reduces the ability of firms to minimize non-adjusting claims.[210] They argue that this effect may shrink the range of projects that firms will undertake to below the socially-optimal level.[211] They further assert that, if the projects that the firms no longer undertake are ones that would have proven to be especially successful, then less money may be available to pay creditors, including the state; thus, the state may find, perversely, that it is "paying *more* cleanups out of public funds."[212] Van 't Veld, Rausser, and Simon recommend, as an alternative to a superlien statute that grants the state's lien superpriority status over all of a firm's assets, a statute that gives superpriority to the state only for secured liens that arise in connection with the particular project that gave rise to the environmental contamination.[213]

Assuming that superlien statutes constitute good public policy in the commercial lending setting (or at least that they can do so if crafted correctly), the question of whether these statutes are economically compatible with commercial lending and securitization practices remains. In this regard, the fact that commercial mortgage lending and securitizations have coexisted with superlien statutes in eight states[214] is important. By contrast, six of the eight states that feature superlien statutes have some form of residential property

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208. *See* van 't Veld et al., *supra* note 207, at 1. The authors list the following as examples of non-adjusting claims:

> (1) liability claims on the firm, which are generally determined by the courts without taking into account possible subordination of the claims in bankruptcy; (2) claims for environmental damages, tax claims, and other government claims, which are generally fixed by law; and (3) claims by various creditors that are simply too small to make adjustments worthwhile, given the transaction costs involved.

Id.

209. van 't Veld et al., *supra* note 207, at 1-2.

210. *See id.* at 25-28.

211. *See id.* at 28. However, the authors emphasize that this result need not obtain; whether it will depends upon the particular circumstances. *Id.*

212. *Id.* (emphasis in original); *see also* McMahon, *supra* note 172, at 10,369 ("[L]ender liability schemes tend to devalue the property, the asset. As a result, loans become scarcer and smaller. In the end, there is less money available in that business for – among other things – the cleanup.").

213. *See* van 't Veld et al., *supra* note 207, at 28-30.

214. *See supra* Table 1.

exemption, and the remaining two substantially circumscribe the scope of the statutes as to residential property.[215] From this common feature, one can infer that opposition to superliens in the commercial lending context has been either (1) far less great, (2) far less successful, or most likely, (3) some combination of both. Several reasons exist for this conclusion.

First, the structure and actors in the residential and commercial secondary mortgage markets differ substantially. Unlike the presences of Fannie Mae, Freddie Mac, and Ginnie Mae in the secondary residential mortgage market, no national – let alone quasi-governmental – entity exists that plays a corresponding role in the secondary market for commercial mortgages.[216] The Massachusetts experience clearly demonstrates the power behind having such an institution object to particular legislation that that institution views – correctly or incorrectly – as a threat to its function.[217] Nor are these institutions' governmental ties irrelevant in this regard. State legislators are likely to think twice before running afoul of an agency or of a corporation with ties to the federal government, for fear that the agency or corporation might prevail on Congress to preempt the state legislatures' prerogative in the field entirely.[218] In the commercial setting, by contrast, state legislators are free from such concerns. Thus, the pressure for uniformity is far less.

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215. *See supra* notes 139-43 and accompanying text.

216. *See supra* text accompanying notes 62-63 (noting that Fannie Mae, Freddie Mac, and Ginnie Mae have no analogy in commercial mortgage context). *Cf.* Marilyn R. Seymann, *Banking's Role in Emerging Secondary Markets*, 47 CONSUMER FIN. L.Q. REP. 253, 255 (1993) ("In the post-FIRREA credit crunch, Congress is now investigating the merits of a commercial mortgage market. Realtors and developers are lobbying heavily for the creation of a Fannie Mae-like agency to anchor the new market, a quasi-independent corporation that could borrow from the Federal Reserve and act as the market maker for bank-created assets.").

217. *See supra* text accompanying notes 5-10 (describing how Freddie Mac suspended its buying of multi-family residential mortgages after Massachusetts adopted superlien statute, in effect forcing Massachusetts legislature to amend statute to exempt residential mortgages).

218. Although federal government corporations (FGCs) in which the government owns stock may not expend funds to lobby Congress or make campaign contributions, that prohibition does not apply to FGCs, such as Fannie Mae and Freddie Mac, in which the government owns no stock. Froomkin, *supra* note 60, at 598. This exception gives the latter variety of FGC "a potential source of leverage over Congress." *Id.* Michael Froomkin provides the following episode involving Fannie Mae as an example of this leverage:

> [W]hen the Reagan administration indicated that it was considering making Fannie Mae fully independent, Fannie Mae established a political action committee to oppose the Reagan administration initiatives. It also took out more than $100,000 worth of newspaper advertisements to "raise housing as an issue in this election year." Fannie Mae's chairman reportedly told congressmen that if they severed Fannie Mae's links to the government, he would make sure that they had to "run for reelection on a platform that you just made it more expensive to buy a home."

Id. (citations omitted).

Second, the existence of greater variations among residential mortgages as compared to commercial mortgages also decreases the pressure for uniformity. In particular, as I argue above, the general existing uniformity among residential mortgages both within states and across state lines greatly heightens the impact of superlien statutes on the ability of promoters to securitize residential loans originating in states with such statutes.[219] Compared to residential mortgages, commercial mortgages historically have featured, and continue to feature, much more diversity. Any two commercial mortgages may have significant differences. Those differences, moreover, generally do not arise because of variations in commercial mortgage practices or due to laws across state lines; rather, the particular circumstances of the transaction, mortgagor, and mortgagee will determine the terms of a commercial mortgage.

These circumstances may change, however. First, even in the absence of a national corporation that promotes commercial mortgage securitizations, the growth of a secondary market in commercial mortgages has begun to increase pressure on commercial lenders to make the terms of commercial mortgages more uniform.[220] Increased pressure on commercial lenders in turn increases the pressure on legislatures to minimize variations in state laws that affect commercial lenders' rights, such as superlien statutes. Moreover, in the early 1990s, the federal government began to issue commercial mortgage-backed securities through the Resolution Trust Corporation (RTC).[221] Although the number of commercial mortgages included in RTC's securitizations is comparatively low,[222] still "[t]he methods RTC created to securitize these mortgages have provided a more uniform national structure for the secondary market to securitize commercial mortgages."[223]

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219. *See supra* text accompanying notes 205-06 (noting that securitization promoters may decide to refuse to purchase mortgages from states with superlien statutes, rather than accepting additional risk).

220. *See* Schill, *The Impact of the Capital Markets*, *supra* note 37, at 284 ("[R]igidity over [mortgage] terms is . . . beginning to find its way into commercial mortgages. More often the requirements of the rating agencies are dictating the form and content of commercial mortgages.").

221. *See* Burkhart, *supra* note 28, at 276 (noting that RTC, in order to dispose of large number of mortgages from failed thrift institutions, issued mortgage-backed securities, which further accelerated commercial mortgage securities market); Poindexter, *supra* note 61, at 528-29 (noting that "RTC created market acceptability of commercial real estate securitization," which allows for potentially more efficient debt servicing); Peter F. Culver, *The Dawning of Securitization*, 8 PROB. & PROP., 34, 37 (1994) (noting that timely disposal of mortgages from savings loan crisis required RTC to combine commercial mortgage loans into large pools and to issue interest in cashflow from mortgages to investors).

222. *See* Burkhart, *supra* note 28, at 276 (stating that "commercial mortgage-backed securities were issued for less than five and one-half percent of total outstanding commercial mortgage debt in 1994").

223. *Id.* (footnote omitted). *Accord* Seymann, *supra* note 216, at 255 ("[T]he RTC's liquidation efforts have set the foundation for a stronger, more widespread secondary market

Second, although the number of residential loans subject to state superlien laws is likely to be small in the context of mortgage pools,[224] the insignificance of a singe mortgage is not as likely with commercial mortgages. This difference results from the fact that "the number of loans in a commercial mortgage-backed security pool is much smaller and [so] any one loan is likely to have a far greater impact."[225] As a result, loans from states with statutes that veer from the norm - such as superlien statutes - may pose a larger barrier to securitization in the commercial setting than they do in the residential setting. Thus, as Michael Schill concludes, the forces that challenge the continued existence of variable state laws affecting commercial lenders' rights "are probably stronger today than at any time in our past."[226]

In light of this conclusion, one might expect the pressure for national uniformity to grow as the commercial mortgage securitization continues to expand. This pressure, as it builds, should overtake the pressure for uniformity in the context of residential mortgage lending because the structure of commercial mortgage lending allows superlien statutes applicable to commercial property to greater frustrate securitization of loans than their residential counterparts. In particular, the comparatively large size of commercial mortgage loans makes loans with differentiations that much more difficult to isolate in a diversified mortgage pool that generally does not feature such differentiations.

VII. Superliens and the Debate over Uniformity of Laws

In this Article, I argue that the national securitization markets and their demand for greater uniformity in the laws governing lien preferences magnifies and makes substantial the costs of superlien statutes. As such, the pressure to eliminate and to restrict state superlien laws is analogous to the general pressure to eliminate state variations in the laws governing real estate nationwide.[227] These efforts have taken the forms of federal legislative proposals

for commercial real estate debt."); Culver, *supra* note 221, at 37 (suggesting that consortium of National Association of Realtors, Mortgage Bankers Association of America, and National Realty Committee has also spurred development of more uniform structure).

224. *See supra* note 200 and accompanying text (noting that ignoring heightened risk in loans from states with superlien statutes is plausible only if number of such loans is insignificant, which is the case).

225. Schill, *The Impact of the Capital Markets*, *supra* note 37, at 287. Another factor that increases the likely magnitude of commercial loans subject to superlien statutes is that the number of states with superlien statutes applicable to commercial real estate is four times larger than the number with statutes applicable to residential real estate. *See supra* text accompanying note 133 (noting that superlien statutes in six out of eight states exempt residential property).

226. Schill, *The Impact of the Capital Markets*, *supra* note 37, at 288.

227. *See generally* Schill, *The Impact of the Capital Markets*, *supra* note 37 (describing and predicting effects of growth of real estate capital markets); Schill, *Uniformity or Diversity*, *supra* note 39 (examining "normative case for replacing diverse state real estate finance laws with a uniform national law"); Symposium, *Whatever Happened to the Uniform Land Transac-*

and enactments to preempt state law[228] and of attempts to induce state legislatures to enact uniform laws.[229] Commentators observe that economic forces drive these efforts,[230] which have had mixed success.[231] In short, the argument for uniform laws "is one of competitive advantage for available capital."[232] Lenders and securitization conduits have called to curtail state laws that afford their residents rights not available to residents of other states in order to reduce the transaction costs and protect the viability of a national market.

The similarity that the debate over state superlien laws bears to the deliberation over nationalizing real estate laws stands in stark contrast to the dissimilarity between the superlien debate and a current discussion in the environmental academic literature over the proper allocation of environmental regulatory authority between the federal government and the states.[233] This

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tions Act, 20 NOVA L. REV. 1017 (1996) [hereinafter ULTA Symposium] (examining, in depth, Uniform Land Transactions Act to illuminate why no state ever adopted it).

228. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1280-86 (describing federal courts' rejection of state mortgage foreclosure laws when federal government is mortgagee).

229. *See* Patrick A. Randolph, Jr., *The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act*, 20 NOVA L. REV. 1017 (1996) (noting that Congress might preempt state legislation if states with judicial sale foreclosure practices do not adopt Uniform Land Security Interest Act); ULTA Symposium, *supra* note 227 (addressing fate of Uniform Land Transactions Act).

230. *See* Burkhart, *supra* note 28, at 281-84 (noting that federal government has "demonstrated its willingness to preempt state mortgage lending laws," and that this willingness may arise from the failure of "past attempts to achieve voluntary national uniformity by the states"); Randolph, *supra* note 229, at 1111-12 (noting that specialized state real estate laws have spawned social conditions that make laws resistant to change, which is why "development in this area is slower than in the areas regulated by the UCC"); Schill, *The Impact of the Capital Markets*, *supra* note 37, at 285 (noting that "the track record among states in voluntarily adopting the uniform laws promulgated by the National Commissioners on Uniform Laws has been dismal," but that federal government has successfully imposed uniform laws on states in certain instances). On efforts to have the states enact uniform laws, see generally Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569 (1998).

231. *See* Randolph, *supra* note 229, at 1111 (noting that greatest argument for uniformity is economic efficiency – nonuniformity in state laws creates unpredictability in performance of real estate investments, resulting in disincentive for lenders to invest); Schill, *The Impact of the Capital Markets*, *supra* note 37, at 285 (noting that higher costs of interstate real estate transactions create incentive for eliminating differences in states' laws).

232. Randolph, *supra* note 229, at 1111.

233. *Compare* John P. Dwyer, *The Practice of Federalism Under the Clean Air Act*, 54 MD. L. REV. 1183, 1219-24 (1995) (explaining "dramatic growth of state environmental regulation over the last twenty-five years"); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210 (1992) (arguing that federal regulation is not appropriate response to state "race to bottom" over environmental standards); *and* Richard L. Revesz, *The Race to the Bottom and Federal Environmental Regulation: A Response to Critics*, 82 MINN. L. REV. 535 (1997) [hereinafter Revesz, *A Response*] (advocating rebuttable presumption in

debate has centered largely on the validity of one of the primary justifications that supporters of federal environmental regulation offer – that the states, left to their own devices, will embark on a race-to-the-bottom that will result in suboptimal protection of the environment. The superlien debate differs from the paradigm of race-to-the-bottom supporters in that, in the context of the superlien, the states that enact such statutes provide *greater* environmental protection than other states.

Table 7 presents the taxonomy of support for uniform environmental regulation in the context of the ongoing academic debate and in the context of superlien statutes. The table sets forth the following in each context: (1) which group tends to support enactment of uniform law, (2) the state action of which supporters of uniform law complain, (3) the supporters' suggested response, and (4) the justification underlying that response.

Table 7 – Taxonomy of Opposition to State Environmental Regulations

	Standard Debate over Uniformity of Environmental Regulation	**Debate over Superliens**
Identity of Supporters of Uniform Law:	Environmentalists	Lenders and Securitization Conduits
State Action:	Enacting Laws that Provide Too Little Protection for the Environment	Enacting Superlien Statutes that Provide Greater Environmental Protection
Suggested Response:	Uniform Federal Floor for Environmental Regulation	Uniform Ceiling for Environmental Regulation
Justification:	Prevent a "Race-to-the-Bottom"	Protection of National Market for Securitizations

favor of state regulation of environment), *with* Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and Is It "To the Bottom"?*, 48 HASTINGS L.J. 271 (1997) (arguing for federal minimum environmental standards and federal inducements to state cooperation in environmental standard-setting); Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570 (1996) (arguing for multi-tier environmental regulatory structure); *and* Joshua D. Sarnoff, *The Continuing Imperative (But Only from a National Perspective) for Federal Environmental Regulation*, 7 DUKE ENVTL. L. & POL'Y F. 225 (1997) (arguing for federal environmental regulation). *See generally* Daniel C. Esty, *Toward Optimal Environmental Governance*, 74 N.Y.U. L. REV. 1495 (1999) (suggesting changes in current environmental policy efforts that would lead toward optimal multi-tiered environmental governance).

Before I analyze the merits of the argument for uniformity in the context of superlien statues, I note that the taxonomy that Table 7 demonstrates is somewhat problematic for race-to-the-bottom adherents. In particular, the superlien statute debates provide an example where some states have not engaged in such a race, but instead have tried to provide greater environmental protection than their neighbors. Moreover, the pressure for uniformity is not for a uniform floor for environmental protection, but rather for an effective uniform ceiling to cap the states' effort in this regard. At the same time, race-to-the-bottom adherents could point also to the debate over state superliens and could argue that the success of lenders and securitization conduits in halting the proliferation of superlien statutes is indicative of the same forces that generally drive the race-to-the-bottom.

Turning to the merits of the argument for a uniform law that restricts state superlien statutes, Richard Revesz posits three reasons in favor of a general presumption of decentralization of environmental regulation.[234] First, the question of whether a community wishes to invest in increased environmental protection is one of resource allocation. As Revesz explains, "we can generally purchase additional environmental protection at some price, paid in the currency of jobs, wages, shareholders' profits, tax revenues, and economic growth."[235] Given the large size and diversity of the United States,[236] different regions reasonably would have different aggregate preferences as to how much environmental protection to purchase.[237] Different regions also may rank other interests higher and therefore think that it is appropriate to devote more resources to those causes. Indeed, this logic is borne out by empirical evidence and supported by political theory.[238]

Revesz's second reason that favors a presumption of decentralization is that the benefits that certain measures of environmental protection offer in fact vary throughout the country.[239] As Revesz explains: "For example, a stringent ambient standard may benefit many people in densely populated areas but only a few elsewhere. Similarly, a particular level of exposure to a contaminant may be more detrimental if it is combined with exposure to other contaminants with which it has synergistic effects."[240]

234. *See* Revesz, *A Response*, *supra* note 233, at 536-37 (providing justifications for rebuttable presumption of decentralization).

235. *Id.* at 536.

236. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1300-01 (noting meaningful differences among states and among states' economies).

237. *See* Revesz, *A Response*, *supra* note 233, at 536 (noting that regulators should not disregard different preferences of citizens of different regions of country).

238. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1301-04 (showing documented connections between state culture and state law).

239. Revesz, *A Response*, *supra* note 233, at 536.

240. *Id.* at 536-37.

Third, the costs of meeting a given environmental standard also vary throughout the country.[241] Revesz elucidates as follows:

> For example, a source may have a large detrimental impact on ambient air quality if it is directly upwind from a mountain or other topographical barrier. Similarly, a water polluter will have a far larger impact on water quality standards if it disposes its effluents in relatively small bodies of water. Climate might also play a role: certain emission or effluent standards may be easier (and cheaper) to meet in warmer weather.[242]

Of these factors, the last – the cost of compliance – seems less likely to vary in the case of cleanups of hazardous waste sites than with other forms of pollution. However, the particular topography and chemical makeup of a contaminated site surely can affect the cost of cleanup and accordingly can affect the likelihood that a superlien statute might apply.

The second factor – the benefits of more frequent environmental cleanups – indeed can vary across regions. For example, greater numbers of environmentally-contaminated sites are more likely to concern a more densely populated state. By contrast, a sparsely populated state may be more content to allow contaminated sites in uninhabited areas to remain untreated.[243]

The first factor – variations in priorities and preferences across state and regional lines – resonates especially loudly in the context of superlien legislation. Residents in one region might value environmental quality quite highly and be willing to pay, among other things, higher rates of interest to attain a higher level of it. Also residents in another region – in particular, in a region with comparatively lower average incomes or in a region that highly values home ownership – might be willing to sacrifice some marginal amount of environmental quality in exchange for lower home mortgage interest rates. Indeed, Michael Schill bases his conclusion that scholars have not convincingly established the case for uniform real estate laws as a policy matter in large measure on the existence of regional variations in preferences.[244]

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241. *Id.* at 537.

242. *Id.*

243. *Cf.* James T. Hamilton & W. Kip Viscusi, *The Benefits and Costs of Regulatory Reforms for Superfund*, 16 STAN. ENVTL. L.J. 159 (1997) (arguing in favor of determining appropriate Superfund remediation strategies based upon cost-benefit analysis of sites that would focus on health risk continued contamination would pose to current residents); James T. Hamilton & W. Kip Viscusi, *Human Health Risk Assessments for Superfund*, 21 ECOLOGY L.Q. 573 (1994) (critiquing EPA's policy of requiring cleanup of Superfund sites based on all possible future uses of sites rather than eliminating future risks by imposing land use restrictions and containment).

244. *See* Schill, *Uniformity or Diversity*, *supra* note 39, at 1302-04 (noting that "real estate values and mortgage defaults are more closely tied to local than to national conditions").

Revesz argues in favor of a presumption that rests environmental regulation with more local governments.[245] Understandable regional variations in the importance of environmental quality, the expense of achieving it,[246] and in home ownership underscore the applicability of that presumption in the context of state superlien regulation. Moreover, two standard justifications for uniform federal environmental regulation – the dangers of a race-to-the-bottom situation and of interstate environmental externalities – are absent here.

The question arises whether securitization's preference for uniformity might justify overcoming this presumption. I describe above how securitization magnifies the costs associated with superlien statutes.[247] It appears that states have determined, in the face of pressure from Fannie Mae and Freddie Mac, that these heightened costs outweigh the benefits of superlien statutes in the context of residential mortgage lending.

Pressure to restrict and to eliminate superlien statutes in the context of commercial mortgage lending is likely to increase, perhaps beyond the level of pressure to eliminate them in the residential context, as commercial mortgage securitizations continue to expand.[248] However, it is also true that commercial properties are much more likely to become environmentally contaminated and therefore to require environmental cleanup.[249] Therefore, application of superlien statutes to the commercial, as opposed to the residential, mortgage lending context is more likely to serve the primary goal underlying superlien statutes – greater environmental quality at less cost to the government. Accordingly, I cannot conclude that the presumption in favor of vesting environmental regulatory authority more in state and local governments necessarily can be overcome in the context of commercial mortgage lending.

VIII. Conclusion

In this Article, I have analyzed the arguments for and against superlien statutes that are applicable to residential properties. I explained, but did not quantify, the likely benefits of such statutes. I also analyzed the costs of these statutes and argued that those costs, in the absence of securitization and of secondary mortgage markets, are not great. By contrast, securitization magni-

245. *See* Revesz, *A Response*, *supra* note 233 (arguing for presumption of decentralization of environmental regulation).

246. *See* Rabe, *supra* note 1 (describing extent and diversity of challenges to environmental quality in New Jersey).

247. *See supra* Part V.D.

248. *See supra* notes 220-26 and accompanying text (explaining why pressures for uniformity are increasing in the commercial mortgage context).

249. *See supra* Part VI.B (arguing that activities at residential sites are exceedingly unlikely to cause environmental contamination).

fies the costs of these statutes because it places a high premium on uniformity of state law. Superlien statutes introduce a nonuniformity in state law which, in the context of residential mortgage lending, tends to undermine the predictability of lien priority upon which the residential mortgage lending and, by extension, securitization industries rely.

As opposed to superlien statutes applicable to residential properties – which are few in number and greatly circumscribed as an apparent result of opposition by lenders and securitization promoters – superlien statutes applicable to commercial properties are more numerous and better established. This difference is due to the relatively slow development of secondary markets in commercial mortgage loans. Now that the commercial mortgage secondary market is expanding at a fast pace, it is reasonable to expect the opposition of lenders and securitization promoters to superlien statutes to increase. That opposition one day might exceed opposition to superlien statutes in the residential context insofar as commercial mortgage loans tend to be much larger than their residential counterparts, making it harder for commercial loan securitization promoters to include commercial loans from states with superlien statutes as small pieces of large, diverse mortgage pools.

Superlien statutes are an example of a type of state law that affords residents of a state greater protection (here, specifically, greater environmental protection) but that goes against the demands of a developing national marketplace. In this sense, the battle over superlien statutes is typical of efforts to make real estate laws more uniform – market pressures seek to impose a national ceiling on state regulation. By contrast, this discussion differs from the typical setting in which academics debate which level of government should promulgate environmental regulation. There, a standard justification for federal environmental regulation is that states, left to their own devices, would respond to economic pressures and engage in a race to the bottom in environmental regulation. Advocates for federal intervention argue that the possibility of such a race makes appropriate the federal government's setting a national floor on state regulation. The debate over superlien statutes poses an important counterexample to these scholars' arguments, insofar as states in fact have tried to resist market forces and to set higher environmental standards. I argued here that the economic pressure of the securitization industry is not sufficient justification to preempt states from enacting superlien statutes applicable to commercial properties. State decision-makers rationally might conclude that the benefits of a superlien statute outweigh its costs in their state.