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Giving Local Municipalities the Power to Affect the National Securities Market: Why the Use of Eminent Domain to Take Mortgages Should Be Subject to Greater Regulation

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Giving Local Municipalities the Power to Affect the National Securities Market

WHY THE USE OF EMINENT DOMAIN TO TAKE MORTGAGES SHOULD BE SUBJECT TO GREATER REGULATION

INTRODUCTION

The power of eminent domain is one of the oldest and most controversial sovereign rights¹ by which governments can relieve citizens of their property without their permission.² While the most common use of eminent domain is for governmental seizure of real property—land and buildings³—the power has been broadly interpreted to reach many other forms of property, including both the tangible and the intangible.⁴ Furthermore, while eminent domain is grounded in the sovereignty of the individual states, each state has delegated this power to local governments,⁵ including some of “the smallest government entities like townships and school districts.”⁶ Thus, as the power is more broadly dispersed and its reach expanded, the threat to citizens’ property rights is arguably increased.⁷

¹ See 26 AM. JUR. 2D *Eminent Domain* § 3 (2012); see also 26 AM. JUR. 2D *Eminent Domain* § 21 (2012) (addressing the possession of “the sovereign power of eminent domain” by the states).

² 26 AM. JUR. 2D *Eminent Domain* § 3, *supra* note 1.

³ David C. John, *San Bernardino County’s Loan Seizures Would Destroy Its Mortgage Market Just as Housing Starts to Recover*, HERITAGE FOUND. (July 13, 2012), <http://report.heritage.org/ib3665> (“Eminent domain is usually used to take property that is in the way of a proposed road, government building, or similar project . . .”).

⁴ 29A C.J.S. *Eminent Domain* § 51 (2012).

⁵ 26 AM. JUR. 2D *Eminent Domain* § 23 (2012). Eminent domain is also grounded in the sovereignty of the federal government, which in turn has the ability to delegate the power to its agencies. See 7 FED. PROC., L. ED. *Condemnation of Property* § 14:1.

⁶ MICHAEL SAUVANTE, *EMINENT DOMAIN: HOW TO USE EMINENT DOMAIN TO STOP FORECLOSURES, RESCUE HOMEOWNERS AND SAVE COMMUNITIES 2* (Vari MacNeil ed., 2012).

⁷ Senate Representative from Idaho, Jim Guthrie, introduced a bill to increase the number of checks placed on local governments to use the power of eminent domain to take the property of their constituents, on the basis that the local governments had been granted too much autonomy over decisions to use the power of

Citizens are not left entirely unprotected. The Fifth Amendment of the U.S. Constitution limits the exercise of eminent domain to “property acquired . . . for a ‘public use’” for which “just compensation” is paid.⁸ Any governmental seizure that does not meet these requirements is deemed an unconstitutional taking.⁹ However, this constitutional provision has proven to be unreliable in protecting property rights.¹⁰ The Supreme Court has increasingly and unpredictably interpreted the public use requirement more liberally, granting significant deference to the government’s determinations of what constitutes a suitable public use.¹¹

At the same time, the states have maintained a policy of liberally granting eminent domain authority to local governments, arguably valuing the reduced responsibility of overseeing “the appropriation of property in every instance”¹² above the increased threat to individual citizens’ property rights and the lost ability to regulate local policy-making. Because the power of eminent domain is delegated through legislation, the states (or federal government) must use legislative means to limit an otherwise constitutional exercise of the power by authorized public sub-entities.¹³ Thus, without legislating otherwise, the states do not have the authority to overturn local government decisions to exercise eminent domain.

The collective impact of the use of eminent domain power to seize more complex categories of properties, and the nebulousness and narrowed scope of the Supreme Court’s

eminent domain. Jim Guthrie, *Eminent Domain is a Threat*, IDAHO STATE J. POL. (Apr. 1, 2011, 4:19 PM), http://www.pocatelloshops.com/new_blogs/politics/?p=7764.

⁸ 26 AM. JUR. 2D *Eminent Domain* § 6 (2012) (citing U.S. CONST. amend. V).

⁹ See 26 AM. JUR. 2D *Eminent Domain* § 6, *supra* note 8.

¹⁰ CATO INST., CATO HANDBOOK FOR POLICYMAKERS 345 (David Boaz ed., 7th ed. 2008).

¹¹ Lynda J. Oswald, *The Role of Deference in Judicial Review of Public Use Determinations*, 39 B.C. ENVTL. AFF. L. REV. 243, 261-62 (2012). Each State Constitution has its own variety of the Fifth Amendment “takings” clause, to which the exercise of eminent domain by an entity within the state must conform. Some of these state clauses are slightly more restrictive, but they do not vary significantly enough from the Fifth Amendment to warrant additional discussion for the purposes of this note. 29A C.J.S. *Eminent Domain* § 67 (2012); 32 TEX. JUR. 3D *Eminent Domain* § 125 (2013). Furthermore, federal constitutional law is the law of last resort, which sets the outermost boundaries of constitutional law for the American people (and thus the state governments). Hence, this note will focus on the Federal Constitution “takings” clause as a common point of reference for takings law applicable to all of the states. See Joseph Blocher, *What State Constitutional Law Can Tell Us About the Federal Constitution*, 115 PENN ST. L. REV. 1035, 1035 (2011); *infra* Part III for further discussion of the parameters of current takings law under the Fifth Amendment.

¹² 51 N.Y. JUR. 2D *Eminent Domain* § 13 (2013).

¹³ 26 AM. JUR. 2D *Eminent Domain* § 37 (2012).

interpretations of the Fifth Amendment limitations, should stir the states to review this value structure.¹⁴ A hedge fund proposal for local governments to use the power of eminent domain to seize underwater mortgages¹⁵ provides a perfect case study on the dangers posed by local governments' use of eminent domain to take complex securities. The proposal, currently being considered by several counties and cities across the nation, presents an unprecedented use of eminent domain to take mortgages without a concomitant taking of the land to which the mortgage is attached.¹⁶

The proposal, donned the "Homeownership Protection Program,"¹⁷ comes years into and in response to an ongoing "foreclosure crisis" that has forced millions of American homeowners "underwater" on their mortgages.¹⁸ The crux of the proposal is to force the banking industry to significantly reduce the principal owed on selected underwater mortgages by compelling them to part with the mortgages for just compensation payments that proponents estimate will be even less than the current market value of the attached homes.¹⁹ Under the plan, participating cities will refinance possessed mortgages to closer match the homes' market value, while also securing federal backing for the loans, thus "leaving the homeowner with a

¹⁴ Guthrie, *supra* note 7.

¹⁵ Bos. Herald Editorial Staff, *Mortgages No Game*, BOS. HERALD (July 15, 2012), http://bostonherald.com/news_opinion/opinion/editorials/2012/07/mortgages_no_game; see also MORTGAGE RESOLUTION PARTNERS, HOMEOWNERSHIP PROTECTION PROGRAM: A SOLUTION TO A CRITICAL PROBLEM 4, available at <http://op.bna.com/der.nsf/r?Open=sfre-8wdqld> (last visited Nov. 19, 2013).

¹⁶ In the past, mortgages have been extinguished by a concomitant taking of the property to which they are attached, but nonetheless satisfied out of the just compensation award for the property. As a result, some authorities have referred to this process as seizure of the mortgage by eminent domain. See 26 AM. JUR. 2D *Eminent Domain* § 240 (2013); 154 A.L.R. 1110 (1945). However, under the mortgage proposal, "the actual property would not be touched; only] the mortgage itself that was used to finance its purchase would be seized." John, *supra* note 3.

¹⁷ MORTGAGE RESOLUTION PARTNERS, *supra* note 15 at 1. See *infra* Part I for a detailed explanation of the proposal.

¹⁸ MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com/> (last visited Jan. 16, 2013). A "borrower is said to be holding an underwater mortgage" "when [the] mortgage loan is more than the value of the home." *What is an Underwater Mortgage*, GOBANKINGRATES.COM (July 8, 2010), <http://www.gobankingrates.com/mortgage-rates/what-is-an-underwater-mortgage/>. For a discussion on the mortgage crisis and the role underwater and defaulted mortgages play in the crisis, see Robert Hockett, *Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery* at 4-14 [hereinafter Hockett Memo], available at <http://online.wsj.com/public/resources/documents/EMINENT-legal-brief.pdf> (visited Aug. 24, 2012).

¹⁹ John, *supra* note 3 (noting that an underwater property "is worth less than it was when the mortgage was first made").

mortgage insured by the Federal Housing Administration (FHA) and owing less” on their home mortgage.²⁰

The mortgage industry has predictably pushed back on the proposal since San Bernardino County and two of its cities, Ontario and Fontana, showed signs of interest in 2012.²¹ The Federal Housing Finance Agency (FHFA)²² openly expressed its “significant concerns about the use of eminent domain to revise existing financial contracts,” and the negative response it could and already had invoked from the lending community.²³ Both the FHFA and the private banking and investment industry, asserting strong positions against the constitutionality of the proposal,²⁴ threatened legal and institutional action if the proposal were to move forward.²⁵ These threats have been

²⁰ John, *supra* note 3. Proponents argue that this procedure will likely secure the purported goal as “those who owe more than the[ir] house is worth are more liable to end up in foreclosure.” *Id.* Furthermore, “by reducing foreclosures, they hope to stabilize neighborhoods, since a foreclosure is likely to result in reducing the property values of the homes around it.” *Id.*

²¹ Amy Loftsgordon, *The Underwater Mortgage Problem: A Solution in California? San Bernardino County, Ontario, and Fontana Have Proposed a Way to Help Underwater Homeowners*, NOLO, LAW FOR ALL, <http://www.nolo.com/legal-encyclopedia/the-underwater-mortgage-problem-a-solution-california.html> (last visited Nov. 4, 2013).

²² In a notice dated August 9, 2012, the agency stated:

The Federal Housing Finance Agency (FHFA) oversees the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (Banks). Fannie Mae and Freddie Mac (the Enterprises) are operating in conservatorships with a core mission of supporting the housing market. FHFA’s obligations, as conservator, are to preserve and conserve assets of the Enterprises and to minimize costs to taxpayers. The Enterprises purchase a large portion of the mortgages originated in the United States and they hold private label mortgage backed securities containing pools of non-Enterprise loans. The Banks likewise have important holdings of such securities. In addition, the Banks accept collateral that consists of mortgages of member financial firms pledged in exchange for advances of funds.

Notice on Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47652 (Aug. 9, 2012) [hereinafter FHFA 2012 Notice], available at www.gpo.gov/fdsys/pkg/FR-2012-08-09/pdf/2012-19566.pdf.

²³ *Id.*

²⁴ See Jayant W. Tambe et al., *They Can’t Do That, Can They? Constitutional Limitations on the Seizure of Underwater Mortgages*, JONES DAY COMMENTARY (June 2012), available at http://www.jonesday.com/they_cant_do_that/; Memorandum from Walter Dellinger et al., O’Melveny & Myers LLP, to Securities Industry and Financial Markets Association 6 (July 16, 2012) [hereinafter O’Melveny Memo], available at <http://www.sifma.org/issues/item.aspx?id=8589939523> (commissioned by the Securities Industry and Financial Markets Association (SIFMA)).

²⁵ See David Dayen, *Financial Services Industry Threatens Retaliation at Municipalities Who Use Eminent Domain to Fix the Housing Crisis*, FDL NEWS DESK (July 20, 2012, 8:55 AM), <http://news.firedoglake.com/2012/07/20/financial-services-industry-threatens-retaliation-at-municipalities-who-use-eminent-domain-to-fix-the-housing-crisis/>; Matthew Goldstein & Jennifer Ablan, *California County Began Eminent Domain talks in Secret*, REUTERS (JULY 13, 2012), <http://www.reuters.com/article/>

made good in response to the City of Richmond's 2013 approval of the proposal.²⁶ The FHFA has renewed its institutional threats²⁷ and both the city and Mortgage Resolution Partners (MRP), the hedge fund that put forward the plan and will be financing the takings,²⁸ now face lawsuits from key players in the banking industry.²⁹

The mortgage industry's response has some merit beyond institutional preservation. The proposal poses consequences that reach beyond the generally limited effect of a taking on an individual property owner.³⁰ The danger of the proposal lies in the multilayered ownership structure of most mortgages in the United States. Most American mortgages are securitized.³¹ Securitized mortgages are those which are "held by trusts" and organized into mortgage pools in which "thousands of investors" purchase and hold shares.³² As a result, any individual mortgage-taking under eminent domain would impact a broad cross-section of investors, many of whom would be located beyond the borders of any individual municipality.³³ Furthermore, the mortgage banks have come to depend on the purchase of these loans by securitization trusts to continue extending substantial amounts of credit.³⁴ In its simplest iteration, the shares of mortgage-backed

2012/07/13/us-sanbernardino-eminentdomain-idUSBRE86C14K20120713; Al Yoon, *New Roadblock for Eminent Domain Bid: Housing Regulator*, WSJ BLOG, WALL ST. J. (Aug. 8, 2012, 3:02 PM), <http://blogs.wsj.com/developments/2012/08/08/new-roadblock-for-eminent-domain-bid-housing-regulator/>; see also *infra* Part III for some of the arguments and threats made by the banking industry.

²⁶ Alejandro Lazo, *U.S. Warns Against Eminent-Domain Mortgage Seizures*, L.A. TIMES (Aug. 8, 2013, 7:41 PM), <http://www.latimes.com/business/la-fi-eminent-domain-lawsuit-20130809,0,6390434.story>.

²⁷ *Id.*

²⁸ MORTGAGE RESOLUTION PARTNERS, *supra* note 15 at 9.

²⁹ Alejandro Lazo, *Mortgage Holders Sue Richmond Over Eminent Domain Plan*, L.A. TIMES (Aug. 7, 2013, 7:55 PM), <http://www.latimes.com/business/money/la-fi-mo-eminent-domain-20130807,0,5887956.story>.

³⁰ See *infra* Part III addressing some of these consequences.

³¹ Andreas Fuster & James Vickery, *Securitization and the Fixed Rate Mortgage*, 594 FED. RESERVE BANK OF N.Y. STAFF REPORT 1 (Jan. 2013), available at http://www.newyorkfed.org/research/staff_reports/sr594.pdf ("Even in the wake of the subprime crisis, most U.S. mortgages are pooled into mortgage-backed securities (MBS) . . .").

³² Imran Ghori, *San Bernardino County: Mortgage Aid Expanded*, PRESS-ENTERPRISE (Sept. 6, 2012, 6:55 PM), <http://www.pe.com/local-news/politics/imran-ghori-headlines/20120906-san-bernardino-county-mortgage-aid-expanded.ece>.

³³ See, e.g., Mark Fogarty, *Pension Fund Power to Explode in Mortgage Market*, AM. BANKER (Jan. 16, 2013, 2:00 AM), http://www.americanbanker.com/magazine/110_11-137045-1.html?zkPrintable=1&nopagination=1; see also Mathias Hoffmann & Thomas Nitschka, *Financial Globalization and Securitization in Mortgage Markets*, VOX (June 20, 2009), <http://www.voxeu.org/article/macroeconomic-benefits-mortgage-backed-securities> (indicating the international nature of the securitized mortgage market).

³⁴ See generally Letter from Tom Deutsch, Deputy Executive Director, American Securitization Forum to Elizabeth M. Murphy, Secretary, Sec. & Exch. Comm'n (Aug. 2,

securities are valued based on the range of quality of the mortgages pooled together to spread the risk of default.³⁵ As a result, banks are able to market loans that otherwise would be considered unmarketable, and are able to “continue to provide credit to consumers even in downturns, thus effectively providing consumption risk sharing to private households.”³⁶ Thus, any threat levied at these trusts is arguably also a threat to both the local, national, and even international mortgage markets.³⁷

As this note will show, however, despite heated arguments to the contrary,³⁸ the mortgage proposal is likely constitutional under current takings law,³⁹ and the constitutional debate over the proposal has been merely a necessary pretext to underlying fundamental differences in opinion on the wisdom of using eminent domain to address the foreclosure crisis. Opponents and proponents of the proposal have, first and foremost, made policy arguments that are unsurprisingly aligned with their positions on its constitutionality.⁴⁰ Parties have likely nevertheless argued over the constitutionality of the proposal both out of recognition that the Fifth Amendment is a legal hurdle the proposal must pass, and that there will be no other potential recourse for mortgagees if the proposal is in fact implemented. As mentioned earlier in this introduction, local control over policy decisions pertaining to the use of eminent domain has been endemic to the states’ delegation of this power. But the complex nature of the mortgage market raises the stakes of such a policy decision

2010) [hereinafter ASF Letter], *available at* <http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf>.

³⁵ “[B]uyers of mortgage-backed securities can take security in the knowledge that the value of the bond doesn’t just rest on the creditworthiness of one borrower, but on the collective creditworthiness of a group of borrowers.” Chris Wilson, *What is a Mortgage-backed Security? The financial Instrument That Destroyed Bear Sterns*, SLATE (Mar. 17, 2008, 7:09 PM), http://www.slate.com/articles/news_and_politics/explainer/2008/03/what_is_a_mortgagebacked_security.html.

³⁶ Hoffman & Nitschka, *supra* note 33.

³⁷ Letter from Am. Bankers Ass’n to Alfred Pollard, Gen. Counsel Fed. Housing Fin. Agency (Sept. 7, 2012) [hereinafter ABA Letter].

³⁸ See David J. Reiss, *Comment on the Use of Eminent Domain to Restructure Performing Loans*, BROOK. L. SCHOOL RESEARCH PAPERS WORKING PAPER SERIES (2012), *available at* <http://ssrn.com/abstract=2144786>; see also Hockett Memo, *supra* note 18.

³⁹ See *infra* Part II.

⁴⁰ For example, the vast majority of Cornell Law Professor Robert Hockett’s lengthy article on the proposal deals exclusively with policy arguments in support of the proposal. Hockett Memo, *supra* note 18. Conversely, the most prominent and detailed statements against the proposal’s constitutionality have been issued by law firms commissioned by members of the banking and investment industries to supplement their policy arguments in opposition. See generally Tambe et al., *supra* note 24; O’Melveny Memo, *supra* note 24 (commissioned by the Securities Industry and Financial Markets Association (SIFMA)).

significantly,⁴¹ and lends credence to many of the concerns voiced by the banking and investment industries.

Through an examination of MRP's mortgage-seizure proposal, this note argues that, though likely constitutional under current law, municipal use of eminent domain to take complex forms of property, such as mortgage securities, should be subject to greater regulation. Part I of this note will introduce MRP and discuss the details of the proposal through a brief recounting of the controversy surrounding it. Part II will delineate the constitutional arguments against the MRP proposal itself and those against mortgage takings by municipal governments, showing that, at least under current Supreme Court takings doctrine, mortgage takings and even the MRP proposal are likely constitutional. Part III will discuss some of the potential incidental effects such takings could have on the mortgage securities market, arguing that mortgage takings require greater governance than current takings law provides. And finally, Part IV will propose potential governmental action that could be taken to address this lack of governance issue.

I. MORTGAGE RESOLUTION PARTNERS AND THEIR "HOME OWNERSHIP PROTECTION PROGRAM"

MRP, a private California company, was formed in January 2012 with the goal of implementing their "Home Ownership Protection Program," a mortgage seizure proposal which the company claims will "stabilize local housing markets and economies by keeping as many homeowners with underwater mortgages in their homes as possible."⁴² The company's plan is easily summarized: "form[] partnerships with local governments"⁴³ to seize underwater mortgages, such that the government can refinance them into new federally guaranteed loans to be resold to MRP's "large, private sector investors."⁴⁴ These investors will provide the necessary funding for the takings as well as pay MRP's per mortgage service fee in exchange for securities in pools of the

⁴¹ See Yves Smith, *The Mortgage Condemnation Plan: Fleecing Municipalities as Well as Investors (Updated)*, NAKED CAPITALISM (July 11, 2012, 5:14 AM), <http://www.nakedcapitalism.com/2012/07/the-mortgage-condemnation-plan-fleecing-municipalities-as-well-as-investors.html#cf141uF4t4SmrIaT.99> (commenting that there is a "general tendency of municipalities to be easy prey for clever bankers").

⁴² MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com/> (last visited Sept. 9, 2013).

⁴³ *Id.* at 9.

⁴⁴ *Id.* at 4.

restructured FHA-backed loans.⁴⁵ While the members of the investment community that stand to lose their property are understandably less than enthused about the plan's implementation, there are details of the plan that have otherwise raised eyebrows and attracted opposition. A large part of the controversy surrounding the proposal is the enormous profit MRP and its investors stand to gain if they are selected by local governments as partners for the venture.⁴⁶ MRP will secure this profit through a combination of the type of loans it proposes to target—those held in privately securitized trusts that are underwater but performing (that is, “not in default”)⁴⁷—and the low just compensation payments it predicts will be owed for the mortgages. Though MRP has subsequently reported, in an attempt to quell the cries of foul play, that the program will be open to some defaulted loans,⁴⁸ by all accounts, non-defaulted loans will still be the greater and earlier targeting priority.⁴⁹ Moreover, MRP has not budged on its borrower requirement that only borrowers “with the ability and creditworthiness to make payments on their restructured loans” will qualify for the program.⁵⁰

By limiting its selection to performing loans, MRP is securing a quality of loan that is more likely to remain performing, particularly with the decrease in principal that

⁴⁵ *Id.*

The Federal Housing Administration, generally known as ‘FHA’, provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA insures mortgages on single family and multifamily homes including manufactured homes and hospitals. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

Federal Housing Administration (FHA), HUD.GOV, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory (last visited Nov. 11, 2012). It is difficult to imagine how the cities will attain this federal backing for these seized loans in light of the response from the FHFA, which has included threats to boycott jurisdictions that implement this plan. Federal Housing Finance Agency, FHFA Statement on Eminent Domain (Aug. 8, 2013) [hereinafter FHFA Statement], available at <http://www.fhfa.gov/webfiles/25419/FHFASmtEminentDomain080813.pdf>.

⁴⁶ Hudson Sangree, *Experts Debate Legality of Plan to Apply Eminent Domain to Mortgages*, SACRAMENTO BEE, Aug. 17, 2012 at A1, available at <http://www.loansafe.org/experts-debate-legality-of-plan-to-apply-eminent-domain-to-mortgages> (“The fees and profits could add up to tens of millions of dollars in Sacramento County alone.”).

⁴⁷ MRP and its investors “preliminarily screen[] for loans qualifying for modification and refinancing” prior to the seizures. MORTGAGE RESOLUTION PARTNERS, *supra* note 15, at 9.

⁴⁸ See Ghori, *supra* note 32.

⁴⁹ See MORTGAGE RESOLUTION PARTNERS, *supra* note 15, at 9.

⁵⁰ *Id.* at 4.

will result from the proposed refinancing. Furthermore, by requiring the cities to secure FHA backing for the loans,⁵¹ the value of the loans to MRP's investors and in the mortgage market will greatly increase. This is because federally backed loans guarantee shareholders timely dividend payments irrespective of whether mortgagors make their monthly mortgage payments.⁵² In other words, the FHA takes on the risk of individual mortgage default. In contrast, "[p]rivate label mortgage securities . . . are the sole obligation of their issuer and are not guaranteed by any governmental entity."⁵³ As a result, private label mortgage-backed securities are more risky, as well as cheaper for and less valuable to investors than their federally backed counterparts.⁵⁴ The potential profit to be made is exponentially larger if MRP's prediction of the just compensation purchase price is correct—"a purchase price [of] between 75-80% of the homes' market value."⁵⁵ However, even if the municipalities do not secure this low price, as critics submit they won't, FHA backing will secure for MRP investors a significant profit on these loans. In essence, MRP is facilitating the purchase of more valuable FHA-backed mortgages at the discounted price of their private-label alternatives.

MRP and its proponents have defended private-sector funding, and hence involvement, as necessary to the financing of the program, and have touted that, to the benefit of the American public, the initiative will not involve any taxpayer dollars.⁵⁶ Indeed none have questioned the program's unaffordability for targeted cities acting on their own. Expectedly, most of the cities that have suffered the worst from the mortgage crisis are also under critical financial constraints.⁵⁷ Some skeptics, however,

⁵¹ See *id.* at 4 ("[G]overnments will be able to restructure the mortgage loans acquired th[r]ough eminent domain and refinance severely underwater homeowners . . . into new loans to be sold to large, private sector investors as FHA GinnieMae securities.").

⁵² FANNIE MAE, BASICS OF FANNIE MAE SINGLE-FAMILY MBS 1, available at <http://www.fanniemae.com/resources/file/mbs/pdf/basics-sf-mbs.pdf>.

⁵³ BOND MARKET ASSOCIATION, AN INVESTOR'S GUIDE TO PASS-THROUGH AND COLLATERALIZED MORTGAGE SECURITIES 12 (1997), available at http://www.freddiemac.com/mbs/docs/about_MBS.pdf.

⁵⁴ Indeed, after the mortgage market crashed in 2008, the market for these so called "private-label mortgages" became and continues to be, as one journalist put it, "moribund." Joe Nucera, *The End of Fannie and Freddie?*, N.Y. TIMES (June 26, 2013).

⁵⁵ O'Melveny Memo, *supra* note 24, at 6.

⁵⁶ According to MRP, "[n]o taxpayer funds will be used in connection with the Program." *Id.*

⁵⁷ Riverside, California, is listed as both one of the top 100 cities that continues to suffer the worst from the financial crisis in 2012, as well as one of the worst managed cities in the country. Foreclosures: 100 Hardest Hit Neighborhoods, CNN Money, <http://money.cnn.com/interactive/real-estate/foreclosure-rate/2013/> (last

have expressed doubt over whether MRP's proposal can be implemented as free of any public tax burden as the company has promised. For example, Laurie Nelson of Dechert LLP commented that, "if courts ultimately find that the fair market values for the mortgage notes are substantially different than MRP's valuation, [participating municipalities] may well be liable for paying the difference to the securitization trusts as just compensation."⁵⁸

The uncertainty, evoked in Ms. Nelson's statement, as to whether MRP will pay more than they would like is predicated on MRP's proposal that local governments utilize "quick take" condemnation proceedings to seize the mortgages.⁵⁹ "Quick take" proceedings will allow the government to seize and dispose of mortgages prior to a determination by the court as to whether the seizure is permissible.⁶⁰ Part of the procedure is placing an appraised value of the seized property in trust with the court.⁶¹ Walter Dellinger of O'Melveny & Myers argues that "the proposal clearly does not contemplate raising and holding in reserve until all litigation is concluded funds that are sufficient to compensate the trusts for the full value of the notes . . ."⁶² MRP estimates that the courts will discount the mortgage values for the likelihood of default, telling investors to expect to pay a value significantly less than that of the underlying homes.⁶³ However, it is ultimately up to the court to determine the just compensation award,⁶⁴ and if the amount awarded is

visited Nov. 5, 2013) [hereinafter CNN Foreclosure Map]; Samuel Weigley, Michael B. Sauter & Alexander E.M. Hess, *The Worst Run Cities in America*, 24/7 WALL ST., HUFFINGTON POST (Jan. 19, 2013, 5:22 PM), http://www.huffingtonpost.com/2013/01/19/worst-run-cities_n_2506894.html. Meanwhile, San Bernardino City, the central city of San Bernardino County, is listed as the number one worst managed counties in the country, and the city of Fontana, one of the two cities to outright join the County of San Bernardino in considering the MRP Proposal back in 2012, was also listed as one of the top 100 cities that has been hardest hit by foreclosures. *Id.*

⁵⁸ See Laurie Nelson, Dechert LLP, *California Authorities Consider Seizing Mortgages Secured by Residential Properties*, CRUNCHED CREDIT (July 24, 2012), <http://www.jdsupra.com/legalnews/california-authorities-consider-seizing-47365>; see also Elizabeth L. McKeen et al., *The Use of Eminent Domain to Write Down Mortgage Notes*, O'MELVENY & MYERS LLP (Sept. 5, 2012), <http://www.omm.com/the-use-of-eminent-domain-to-write-down-mortgage-notes-09-05-2012/>.

⁵⁹ MORTGAGE RESOLUTION PARTNERS, *supra* note 15 at 12; O'Melveny Memo, *supra* note 24, at 13 ("The 'quick take' procedure . . . exposes the municipalities to substantial liabilities if MRP's valuation assumptions are not adopted by courts.").

⁶⁰ See 2 AM. LAW. ZONING § 17:15 (5th ed. 2012).

⁶¹ *Id.*

⁶² O'Melveny Memo, *supra* note 24, at 15.

⁶³ *Id.* at 6.

⁶⁴ 26 AM. JUR. 2D *Eminent Domain* § 271 (2012).

more than the escrowed funds, it is unlikely that MRP's investors, who would have already procured the mortgages, would be willing to pay any more for them.⁶⁵ Thus, Mr. Dellinger reaches the same conclusion as Ms. Nelson, and contends that the potential additional payments the municipalities will have to make, "multiplied by thousands of loans, easily could result in hundreds of millions of dollars in liabilities."⁶⁶ Still, private-sector funding at least indicates that the required tax expenditure on the proposal will be much lower than if the governments were to attempt to fund these seizures on their own.

The quick take aspect of the proposal is also highly disquieting to investors. As a result of the quick take procedure, the mortgages will have already been restructured and likely sold well before the courts determine what compensation is adequate to indemnify the target mortgagees.⁶⁷ Thus, not only do current investors in these trusts stand to lose what they argue are some of their "best loans"—performing loans being paid off by creditworthy homeowners—at a substantial loss through the takings,⁶⁸ they will also see their seized investments immediately resold to another pool of investors.

Nevertheless, a growing number of cities, following in the wake of the City of Richmond's approval of MRP's proposal, are seriously analyzing the feasibility of such a plan.⁶⁹ And

⁶⁵ See O'Melveny Memo, *supra* note 24, at 2. See *infra* Part III addressing "just compensation."

⁶⁶ O'Melveny Memo, *supra* note 24, at 15.

⁶⁷ *Id.* ("The option to abandon the taking if the price proves larger than anticipated does not exist under the MRP proposal because the notes will be extinguished and replaced with new, smaller notes, before the fair value litigation is resolved.")

⁶⁸ Sangree, *supra* note 46.

⁶⁹ The City of El Monte is considered to be the next California city most likely to implement the proposal. Alejandro Lazo, *El Monte Considers Eminent Domain Plan for Underwater Mortgages*, L.A. TIMES (Aug. 6, 2013, 6:30 AM), <http://www.latimes.com/business/money/la-fi-mo-el-monte-eminent-domain-20130805,0,7256185.story>.

At least three other California municipalities—La Puente in Los Angeles County, and Orange Cove and San Joaquin in Fresno County—are also consulting with Mortgage Resolution Partners. Half a dozen other cities in the state have engaged in less formal discussions with the firm. North Las Vegas, Nev., has also approved a plan to move forward with the firm on a similar plan.

Lazo, *supra* note 26. Furthermore, on September 11, 2013, in the face of litigation instigated by the banks and threats to stop lending to homeowners in the City, "[t]he City Council of Richmond, Calif., rejected a challenge to the city's proposal to seize and write down troubled mortgages, instead voting 4 to 3 to invite other local governments to join its radical approach to slowing a wave of foreclosures." E. Scott Reckard, *Richmond Refuses to Kill Proposal to Seize Underwater Mortgages*, L.A. TIMES (Sept. 11, 2013, 12:13 PM), <http://www.latimes.com/business/money/la-fi-mo-richmond-eminent-domain-mortgages-20130911,0,2179786.story>.

though some elements of the plan may change, private-public partnership, like that proposed by MRP, is unlikely to be one of them. As MRP contends, the plan simply lies outside the budget of any municipality.⁷⁰ The city of Richmond is certainly dependent on MRP's funding to make implementation of the proposal feasible, as has already been made clear by the piling costs of litigation against the city's mere approval of the program, which are all being covered by the private firm.⁷¹ Thus, while interested cities may not specifically grant MRP the opportunity to partner with them, the governments contemplate a similar arrangement with a consultancy firm of their choice.⁷²

II. *JUST THE MORTGAGE, NOT PLUS THE MORTGAGE?* – AN UNINTENTIONAL LOOPHOLE IN TAKINGS LAW

The debate over the constitutionality of the MRP proposal has evoked fervent opinions on both sides of the fence. Debaters address two main arguments: (1) whether mortgages are properties that can be seized through eminent domain, and (2) whether the proposal meets the standards set out in the Fifth Amendment.⁷³ This section will survey both, drawing the distinction between those arguments that question the constitutionality of mortgage takings themselves and those that pertain to extraneous elements of the MRP proposal. Though introduced by MRP, the mortgage takings proposal neither requires interested jurisdictions to choose MRP as the

⁷⁰ Hockett Memo, *supra* note 18, at 31.

⁷¹ See Doug Badger, *Richmond Seizure Program: Dangerous Idea From a Dangerous City*, A BRIEF CASE (Aug. 21, 2013), <http://www.dougsbriefcase.com/blog/richmond-seizure-program-dangerous-idea-from-a-dangerous-city/> (“The city will rely on its banking partner, Mortgage Resolution Partners (MRP), a private investment fund, to raise money to buy the loans from bond trusts at the price established by the city.”); Staff Writer, *Richmond Moving Forward With Eminent Domain Plan For Underwater Mortgages*, CBS SAN FRANCISCO & BAY AREA NEWS SERV. (Sept. 11, 2013, 11:23 PM), <http://sanfrancisco.cbslocal.com/2013/http://www.loansafe.org/experts-debate-legality-of-plan-to-apply-eminent-domain-to-mortgagesdomain-plan-for-underwater-mortgages/> (“MRP executive chairman Steven Gluckstern noted . . . that the firm is covering legal costs associated with any litigation against the city related to the partnership and said a joint powers authority would provide further protection.”).

⁷² Andrew Edwards, *Mortgage Resolution Partners Executive Defends Eminent Domain Proposal*, SUN (July 26, 2012, 5:30 PM), http://www.sbsun.com/ci_21168357#ixzz2ICdfDcQz; Ben Hallman, *San Bernardino Eminent Domain Fight Closely Watched By Other Struggling Communities*, HUFFINGTON POST (Sept. 1, 2012, 4:25 PM), http://www.huffingtonpost.com/2012/09/01/eminent-domain-mortgages_n_1836710.html.

⁷³ The constitutionality of the proposal has also been contested under the contracts clause and commerce clause, neither of which have attracted significant attention nor detailed arguments, and which will not be addressed in this note. For those arguments, see generally Tambe et al., *supra* note 24; O'Melveny Memo, *supra* note 24.

consultancy firm with which to work nor ties jurisdictions implementing the plan to the specific requirements identified by MRP.⁷⁴ This distinction is important because, if the MRP proposal is deemed unconstitutional, but mortgage takings themselves are not, the potential for future takings of mortgage securities or other similar properties remains.

A. *Are Mortgages Property Interests That Can Be Seized through Eminent Domain?*

Opponents of the MRP proposal have questioned the constitutionality of seizing mortgages on the basis of the unprecedented nature of the proposed takings. Arguably, the Supreme Court explicitly deemed mortgages a property interest for the purpose of government taking under the Fifth Amendment in the 1935 case of *Louisville Joint Stock Land Bank v. Radford*.⁷⁵ In striking down a federal statute that forced mortgagees to forgive debt above the appraised value of foreclosed farm land, Justice Brandeis, writing for the court, commented:

[I]f the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.⁷⁶

The mortgage proposal relies on this statement for support.⁷⁷

However, a historical survey of mortgage takings law evinces that it is undeniably unprecedented to take mortgages

⁷⁴ The City of Richmond is in fact currently working with MRP on potentially serving as their consultants for the proposal. However, the City is not using it as a first point of attack. Instead, it has made offers to purchase the mortgages on approximately 650 homes, with the underlying threat of using eminent domain to seize the loans if the banks do not agree to the sales. Alejandro Lazo, *Richmond Adopts Eminent Domain Mortgage Plan*, L.A. TIMES (July 30, 2013), <http://articles.latimes.com/2013/jul/30/business/la-fi-mo-richmond-eminent-domain-20130730>. The San Bernardino County JPA, however, defined its purpose in considering the MRP proposal as broader than just determining whether to enter into a contractual relationship with MRP, indicating that the County was interested in the concept of the proposal and not necessarily the wholesale product MRP was presenting. See Nelson, *supra* note 58 (quoting Gregory Devereaux, CEO of San Bernardino County and chairperson of the JPA, explaining that “the JPA was formed to explore ideas and programs to address the housing crisis openly and with the community as a whole” (internal quotations omitted), and stating that “there are currently no proposals or programs before this body”).

⁷⁵ 295 U.S. 555, 602 (1935); see also 26 AM. JUR. 2D *Eminent Domain* § 240, *supra* note 16 (citing *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), for the proposition that “[a] mortgagee’s lien is a property interest within the meaning of the Fifth Amendment.”).

⁷⁶ *Radford*, 295 U.S. at 602.

⁷⁷ See Reiss, *supra* note 38, at 3.

without also a concomitant taking of the attached real property.⁷⁸ In the past, mortgage takings were only effected to relieve lenders (or mortgagees) in circumstances where the underlying securities for their mortgages—the mortgaged properties—had been seized.⁷⁹ In effect, the takings granted the mortgagees the right to the portion of the just compensation payment paid to the prior property owners that was equivalent to the remaining mortgage debt.⁸⁰ This was not a perfect form of relief as mortgagees were not guaranteed full payment of the debt owed. Mortgagees could not demand further compensation above that made to individual property owners,⁸¹ and valuations to determine just compensation were not made based on the value of the mortgages but rather on the market value of the properties.⁸² Indeed, for those who argue that the value of a mortgage incorporates more than the value of the underlying security, the just compensation valuation for separate mortgage takings will be different from the valuation of homes.⁸³ Thus, many argue that the power of eminent domain has, in fact, never been used to seize mortgages.⁸⁴

Furthermore, it is indeterminable whether the court had such a purpose in mind when it made its statement in *Louisville Joint Stock*.⁸⁵ Up to now, a majority of courts has arguably read the *Louisville Joint Stock* dicta as, at the very least, indicating that “a mortgagee’s lien is a property interest [in the real estate to which it is attached] within the meaning of the Fifth Amendment.”⁸⁶ This is the only reading that

⁷⁸ See generally 154 A.L.R. 1110, *supra* note 16 (providing a table of sample cases, the laws and rules involving the mortgage takings in all federal circuits and state courts).

⁷⁹ 26 AM. JUR. 2D *Eminent Domain*, *supra* note 16, at § 240.

⁸⁰ *Id.* (“When the mortgaged property is taken by eminent domain or damaged to such an extent that the security of the mortgage is impaired, the mortgagee’s rights against the land follow the award, so the mortgagee may have the mortgage debt satisfied out of the award in advance of other creditors of the mortgagor.”).

⁸¹ *Id.*

⁸² 17B CARMODY-WAIT 2D § 108:96 (2012) (“A preexisting mortgage lien on the appropriated property is extinguished as of the date the condemnor takes title, and, if the mortgage is then enforceable, there is substituted in its place an equitable lien against the eminent domain award to the extent of the mortgagee’s claim.”).

⁸³ See O’Melveny Memo, *supra* note 24.

⁸⁴ See Andrew Edwards, *California’s Lieutenant Governor Steps into Mortgage Debate*, SAN BERNARDINO COUNTY SUN (July 28, 2012), http://www.sbsun.com/breakingnews/ci_21177556/californias-lieutenant-governor-steps-into-mortgage-debate (“People on both sides of the issue say using eminent domain to buy mortgage loans is unprecedented.”); O’Melveny Memo, *supra* note 24, at 1. See *infra* Part II for further discussion on the constitutionality of mortgage takings.

⁸⁵ 29 U.S. at 602.

⁸⁶ 26 AM. JUR. 2D *Eminent Domain* § 240, *supra* note 16.

explains the majority's subsequent reasoning that a mortgagee should "have the mortgage debt satisfied out of the [just compensation] award [for the seized home] in advance of other creditors of the mortgagor."⁸⁷ The majority view does not encompass a separate valuation of the mortgage but, rather, only provides relief for the mortgagee up to the determined just compensation payment for the home that has been subject to condemnation or governmental foreclosure.

Yet, there is some indication that a minority of jurisdictions has made the distinction between the mortgage and the property securing it, viewing them as separate interests in the context of Fifth Amendment takings law. As *American Jurisprudence* summarizes:

In states following the lien theory of mortgages and deeds of trust, under which the mortgagor or trustee has a lien against the property but not legal title to it, the mortgagee or trustee does not have an "ownership" interest in the real property taken and, thus, is not normally constitutionally entitled to compensation.⁸⁸

The article goes on to note, however, that, while "[o]nly those with ownership interests are generally entitled to compensation when the property is condemned," these jurisdictions nevertheless provide the mortgagees with relief under theories of the mortgagee's "contract right distinct from title."⁸⁹ This treatment, in spite of state doctrine that the attaching mortgage does not create a contractual property right to underlying land, seems to indicate that these states recognize that the mortgage may, on its own, be seized. Thus, in light of this minority treatment, bolstered by the Supreme Court's open-ended statement in *Louisville*, and the precedential use of eminent domain to take other intangible forms of property,⁹⁰ mortgages are likely properties that may be subject to seizure under eminent domain.

B. Does a Mortgage Seizure Proposal Meet Fifth Amendment Standards of Constitutionality?

While the requirements of the Fifth Amendment are simply stated in its text—"nor shall private property be taken

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ Matthew S. Bethards, *Condemning a Patent: Taking Intellectual Property by Eminent Domain*, 32 AIPLA Q.J. 81, 84 (2004).

for public use, without just compensation”⁹¹—Supreme Court interpretations of the constitutional boundaries of the public use requirement have grown increasingly less restrictive, and it is consequently more difficult to prove a breach.⁹² In reviewing a purported public use, the Court has employed a general rule of deference to the government under which the Court requires little more than proof that the motive behind the public purpose is legitimate:

Our review of whether a taking is for “public use” is necessarily deferential: “When the legislature’s purpose is legitimate and its means are not irrational, . . . empirical debates over the wisdom of takings . . . are not to be carried out in the federal courts.”⁹³

The Court has otherwise entrusted the determination of the kinds of projects that will satisfy the public use requirement solely to the government, excusing itself from exercising judgment on the basis of policy.⁹⁴

Moreover, if mortgages are property interests that can be reached by eminent domain, the constitutionality of mortgage takings, and the MRP proposal, under the Fifth Amendment is determined solely based on whether the seizure was for a public use.⁹⁵ The just compensation prong of the Fifth Amendment test only serves to indicate what will adequately compensate the property owner for their loss, or, as it is generally otherwise seen, what will spread the burden of providing a public benefit amongst the public.⁹⁶ Thus, while the determination of just compensation has economic implications for both the prior property owner and the government, it could only affect the constitutionality of the takings if the governments exercising eminent domain refused to pay the mortgagees what the court determined to be fair market value of the seized mortgage liens.⁹⁷

⁹¹ U.S. Const. amend. V.

⁹² See generally Charles E. Cohen, *Eminent Domain After Kelo v. City of New London: An Argument for Banning Economic Development Takings*, 29 HARV. J.L. & PUB. POL’Y 491 (2006).

⁹³ *Fideicomiso De La Tierra Del Caño Martin Peña v. Fortuno*, 604 F.3d 7, 18 (1st Cir. 2010) (citing *Haw. Housing Auth. v. Midkiff*, 467 U.S. 229, 242-43 (1984)), cert. denied, 131 S. Ct. 1600 (2011).

⁹⁴ Oswald, *supra* note 11, at 261-62.

⁹⁵ See Reiss, *supra* note 38, at 3 (arguing that, while what the courts determine to be just compensation will be of “great import [to] investors, it is not relevant for purposes of evaluating the constitutionality of the use of eminent domain in this context”).

⁹⁶ 26 AM. JUR. 2D *Eminent Domain* § 6 (2012).

⁹⁷ The economic implications of the just compensation determinations should play a role in the local governments’ analyses as to whether to go forward with this

The most recent evolution of the public use doctrine is embodied in the highly provocative Supreme Court ruling in *Kelo v. City of New London*,⁹⁸ in which the Court took “an expansive [and highly controversial] view of the ‘public [use]’ requirement.”⁹⁹ In *Kelo*, “property owners sued the City of New London and the New London Development Corporation (NLDC), a nonprofit development corporation established by the city, to enjoin use of the eminent domain power in furtherance of a comprehensive economic development plan.”¹⁰⁰ Under the plan, the seized land would be leased to “various private developers, who would then develop the parcels in accordance with the plan.”¹⁰¹ This included the building of “a waterfront hotel and conference center, marinas, a public walkway along the river, residences, a Coast Guard museum, space for high technology research and development office space, additional office and retail space, and parking.”¹⁰² The plan was “projected to create in excess of 1,000 jobs, to increase tax and other revenues, and to revitalize an economically distressed city, including its downtown and waterfront areas.”¹⁰³

Many saw the *Kelo* proposal as nothing more than a transfer of property rights from one set of private citizens to another. The *Kelo* property owner petitioners argued that the development did not constitute a public use under the Fifth Amendment:

The petitioners contended that a “public benefit” is not equivalent to a “public use,” asserting, “[I]f nothing more is required to constitute a public use than listing expected tax revenue and job growth that might result from private development, then there is scarcely any private use or business for which the power of eminent domain could not be used.”¹⁰⁴

The court nevertheless ruled in favor of the city.

Kelo has been read to establish that even as broad a purpose as “economic development” is sufficient to satisfy the

proposal. As a result, the just compensation issue will not be addressed in this section but in Part III *infra*, in discussing the potential problems created by the proposal.

⁹⁸ 545 U.S. 469 (2005).

⁹⁹ See Reiss, *supra* note 38, at 3 (citing *Kelo v. City of New London*, 545 U.S. 469 (2005)).

¹⁰⁰ Cohen, *supra* note 92, at 516.

¹⁰¹ *Id.* at 517.

¹⁰² *Id.* at 516-17.

¹⁰³ *Kelo*, 545 U.S. at 472.

¹⁰⁴ Cohen, *supra* note 92, at 518 (citing Brief of Petitioners at 10, *Kelo v. City of New London*, 125 S. Ct. 2655 (2005) (No. 04-108)).

Fifth Amendment.¹⁰⁵ However, this is a narrow reading of the case's holding. While the *Kelo* decision did permit a taking promulgated on the basis of general economic development for the surrounding area, the court did not focus on the specific question of whether "economic development itself constituted a public use under the Fifth Amendment."¹⁰⁶ The *Kelo* holding instead seemed to broaden the scope of the definition of "public use" to encompass cases where the use of seized property, though thought to be generally beneficial for the public, was not necessarily open to all members of the public.¹⁰⁷ However, even prior to *Kelo*, the Supreme Court had made some capacious assertions as to what would satisfy the public use requirement of the Fifth Amendment. Most significantly, the Court had reinterpreted the phrase "public use" to require nothing more than a "public purpose."¹⁰⁸

Kelo's most significant doctrinal addition is its narrowing of the longstanding restriction placed on takings for private use to merely prohibiting takings for "strictly," or only, private use.¹⁰⁹ *Kelo* made it clear that takings that result in the reaping of private benefits do not per se fail under the public use test.¹¹⁰ Even under *Kelo*, the government may not simply assert a public purpose; the court has indicated that it will look to ensure that the public use is "paramount," and the bestowment of a private interest is merely incidental.¹¹¹ Nevertheless, as was the case in *Kelo*, a taking which essentially encompasses a transfer from one private party to another may still be constitutionally permissible if there is an "underlying"¹¹² or "justifying public purpose."¹¹³

¹⁰⁵ Eric Rutkow, Comment, *Kelo v. City of New London*, 30 HARV. ENVTL. L. REV. 261, 261 (2006), available at http://www.law.harvard.edu/students/orgs/elr/vol30_1/rutkow.pdf.

¹⁰⁶ *Id.* at 263 (internal quotations omitted). In *Kelo*,

the Court held by a vote of 5 to 4 that the Takings Clause allowed Connecticut and the City of New London to seize a private home and transfer it to private developers. The purpose of this transfer was to establish a private research facility whose development might stimulate the depressed local economy.

Tambe et al., *supra* note 24.

¹⁰⁷ See Cohen, *supra* note 92, at 518-19.

¹⁰⁸ Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 241 (1984).

¹⁰⁹ 29A C.J.S. *Eminent Domain* § 27 (2012) (citing *Kelo v. City of New London*, 545 U.S. 469 (2005); Hawaii Housing Authority v. Midkiff, 467 U.S. 229 (1984)).

¹¹⁰ See Cohen, *supra* note 92, at 518-19.

¹¹¹ Rutkow, *supra* note 105, at 263.

¹¹² 29A C.J.S. *Eminent Domain* § 27, *supra* note 109 (citing Key Properties Group, LLC v. City of Milford, 995 A.2d 147, 152 (Del. 2010)).

¹¹³ Fideicomiso De La Tierra Del Caño Martin Peña v. Fortuno, 604 F.3d 7, 17 (1st Cir. 2010), *cert. denied*, 131 S. Ct. 1600 (2011).

Thus, under these rules, the question presented by the mortgage seizure proposal is whether the government has (1) a bona fide public purpose that justifies the transfer of the mortgages from the former private owners to new private investors, which (2) is not merely an incidental benefit to a more primary private benefit afforded to the private investors who will purchase the refinanced mortgages.

Though the proposal has been shelved in San Bernardino and some of its constituent local governments (ostensibly due to lack of public support, but also likely in response to industry and FHFA pressures),¹¹⁴ the San Bernardino County Board of Supervisors had in fact gone so far as to form a Joint Exercise of Powers Authority (JPA), including the county and the cities of Fontana and Ontario,¹¹⁵ “to devise a Homeowners Protection Plan”¹¹⁶ to address the MRP proposal.¹¹⁷ The participating constituencies laid out a comprehensive public purpose for the proposed takings in the Recitals to the Joint Exercise of Powers Agreement Homeownership Protection Program that they signed last year:

For the past four years, the communities within the Parties’ jurisdiction have been adversely affected by an unprecedented economic downturn. Unemployment has reached record high levels, revenue to local governments throughout California has dropped to historic lows, and [there has been] a drop in household income particularly for working families Concomitantly, home values in the Parties’ jurisdictions have plummeted, resulting in “underwater loans” or “negative equity” . . . and accordingly increasing the likelihood of further foreclosures, inhibiting the ability to refinance, and dampening consumer confidence and economic activity.

The Parties wish to enter into a joint powers agreement that will establish a joint powers authority (“Authority”) to assist in preserving home ownership and occupancy for homeowners with negative equity within the Parties’ jurisdictions, avoid the negative impacts of underwater loans and further foreclosures, and enhance the economic vitality and the health of their communities (the . . . “Program”). The

¹¹⁴ Alejandro Lazo, *San Bernardino County Abandons Eminent Domain Mortgage Plan*, L.A. TIMES (Jan. 24, 2013), <http://articles.latimes.com/2013/jan/24/business/la-fi-mo-eminent-domain-20130124>.

¹¹⁵ See Ghori, *supra* note 32, at 2.

¹¹⁶ Eminent Domain Resource Center, *The County of San Bernardino, California is Considering a New Plan to Use “Eminent Domain” As a Solution to Help Underwater Borrowers and Address the Country’s Housing Crisis*, SIFMA, www.sifma.org/issues/capital-markets/securitization/eminent-domain/overview/. For a copy of the draft agreement, see Joint Exercise of Powers Agreement: Homeownership Protection Program [hereinafter JPA Agreement], *available at* <http://online.wsj.com/public/resources/documents/EMINENT-jpa-agreement.pdf> (last visited Sept.12, 2103).

¹¹⁷ See Ghori, *supra* note 32.

Program may include the Authority's acquisition of underwater residential mortgage loans by voluntary purchase or eminent domain and the restructuring of these loans to allow homeowners to continue to own and occupy their homes.¹¹⁸

These paragraphs clearly explicate the crisis faced by the participating areas, the purpose of the proposed mortgage takings, and how they will address the needs of the public. Significantly, they do not include any reference to sale of the loans to private entities, evidencing the bona fide nature of the purported public purpose.

Furthermore, even if the final proposal involves funding and sale to private investors, as the Richmond proposal does and as is allowed under current takings doctrine, the court may nonetheless find that the purported public purpose is bona fide. The concern for addressing the mortgage crisis appears to be paramount to any profit that may be gained as a result of the program. Like many of the cities in San Bernardino County, the city of Richmond is similarly ridden with underwater homes¹¹⁹ and has expressed frustration with the inability to help residents out of the crisis.¹²⁰ The plethora of support for the program from disinterested parties also bolsters the honesty of the belief that the use of eminent domain in this circumstance will help to alleviate the foreclosure crisis.¹²¹

The potential involvement of MRP and its investors poses some countervailing challenges to a finding of a bona fide public purpose. As opponents have pointed out, the fact that the MRP investors both fund the program and immediately receive returns as a result of the program appears devious. Open accusations have been cast against MRP that it "designed [the program] for the express purpose of creating profits for

¹¹⁸ JPA Agreement, *supra* note 116, at 1.

¹¹⁹ Alejandro Lazo, *supra* note 74.

¹²⁰ One commentator noted that the Chairman of the San Bernardino JPA did not even seem "married to the eminent domain plan of attack," but rather "appeared to be pleading that . . . solutions to the housing mess in San Bernardino County be presented to the JPA." Nelson, *supra* note 58. Similarly, Mayor of Richmond, Gayle McLaughlin, in relation to the City of Richmond's approval of the eminent domain proposal, commented that "Richmond and its residents have been badly harmed by this housing crisis," "[t]he banks have been unwilling or unable to fix this situation, [and] so the city is stepping in to provide a fix." Carolyn Said, *Richmond to Pursue Eminent Domain on Mortgages*, SFGATE (Sept. 11, 2013, 10:29 PM), <http://www.sfgate.com/bayarea/article/Richmond-to-pursue-eminent-domain-on-mortgages-4807122.php> (quoting Mayor Gayle McLaughlin of Richmond, Ca.).

¹²¹ See, e.g., David Reiss, *Eminently Reasonable*, NAT'L L.J. (Sept. 24, 2012) ("The financial industry is alarmed by this proposal, claiming that the sky will fall if it is implemented. But this proposal is constitutional, beneficial and administratively feasible. Local governments should give it a try as they seek to stabilize their communities.").

[its] investors [and itself], and not primarily for a public purpose.”¹²² The problem with this argument is that MRP, as a private entity, is allowed to have a private motive, which does not prevent the municipalities from partnering with the company for the public good.¹²³ Under *Kelo*, the question becomes whether the private gain outweighs the public benefit and, given the Court’s deference to the government in determining the extent of the public benefit, it is unlikely that MRP’s economic benefit from the proposal will counter the weight of the government’s arguments for the substantial public benefit they believe the proposal will create.

The most constitutionally disadvantageous aspect of the MRP proposal, however, is the focus on and limitation to non-defaulted underwater mortgages. Despite MRP CEO Steven Gluckstern’s explanation that “those loans have the best chance of being refinanced and helping the plan succeed,”¹²⁴ a more cynical journalist has proffered that “the attempt to ‘pluck low-hanging fruit’ at a steep discount might not fly with the courts.”¹²⁵ In other words, the proposal’s target of only non-defaulted loans may more strongly indicate that the true purpose of the plan is to serve private interests. Cutting against these arguments is MRP’s indication that it will consider extending its program to include defaulted mortgages.¹²⁶ However, it is reported that the City of Richmond has only made offers on performing loans, as originally contemplated, a fact that may work significantly to the city’s detriment in litigation.¹²⁷

¹²² Tambe et al., *supra* note 24.

¹²³ MRP is not the body authorized to use nor the body using eminent domain to effect the takings. Thus, its private aspirations for the proposal are irrelevant, provided that the cities’ primary purpose is not to satisfy MRP’s private goals, but rather to benefit the public. See 29A C.J.S. *Eminent Domain* § 27 (2012). However, in the case of Richmond, it is further alleged that the city is to receive a partnership cut of the MRP profits from the resale of the loans, a fact that plaintiffs Wells Fargo and Deutsche Bank argue point to an unconstitutional private interest of the City itself in implementing the proposal. Complaint for Declaratory and Injunctive Relief at 9, Wells Fargo Bank, Nat’l Assoc. v. City of Richmond, 13 CV 3663, 2013 WL 4016499 (N.D. Cal. Aug. 7, 2013).

¹²⁴ Sangree, *supra* note 46.

¹²⁵ *Id.* (quoting Gideon Kanner, a professor emeritus at Loyola Law School in Los Angeles who specializes in eminent domain law).

¹²⁶ Ghori, *supra* note 32.

¹²⁷ See David Levine, *The Housing Crisis in Richmond, California and the Debate Over Eminent Domain*, WORLD SOCIALIST WEB SITE (Sept. 2, 2013), <http://www.wsws.org/en/articles/2013/09/17/cali-s17.html> (“MRP has selected 624 residences for the program—less than 15 percent of the city’s residences with underwater mortgages. Even more telling are the criteria by which the residences were selected. Over 70 percent of those selected are current on their payments, and those that are not current have, for the most part, missed only one or two payments.”).

Some opponents have also asserted that the *Kelo* holding is limited to its context, arguing that, under *Kelo*, governments may only use their eminent domain power to transfer seized property to private parties in cases in which the taking is part of a broader, comprehensive plan for economic development.¹²⁸ Thus, they argue that the transfers of the property to a private party such as MRP render the plan unconstitutional because the MRP proposal seems to contemplate that the takings will encompass the sum total of the Homeownership Protection Program, as opposed to being a part of a comprehensive plan.¹²⁹ But there is no indication that the *Kelo* court meant to limit the allowance to such cases. Furthermore, there is no implication, either from the Recitals to the JPA, quoted above, or the City of Richmond, that the mortgage takings will be the summation of the cities' plans to address the crisis facing targeted communities.¹³⁰

Therefore, in comparing the arguments, in light of current political views on the proposal (particularly in California) and judicial liberalness in the application of current takings law, the proposal will likely be found constitutional.

III. POTENTIAL PROBLEMS CREATED BY APPROVAL AND IMPLEMENTATION OF THE MORTGAGE TAKINGS PROPOSAL

As Part II illustrates, the courts will categorically ignore all issues of policy in determining the constitutionality of the mortgage seizure proposal. Thus, though a proposal to use the power of eminent domain could be held constitutional, it may still not be advisable as a matter of policy. The heated debate over the wisdom of implementing a mortgage seizure proposal was well documented in the months following the public exposure of the MRP proposal, and of San Bernardino County's interest in the plan.¹³¹ This debate has continued with the proposal's resurgence in the City of Richmond.¹³² Opponents ardently maintain that the use of eminent domain to take mortgages "would hurt the very people [it] is supposed to help,"¹³³ and unnecessarily forces losses on investors across a national platform.¹³⁴ Proponents, on the

¹²⁸ Tambe et al., *supra* note 24.

¹²⁹ *Id.*

¹³⁰ For example, the Recitals to the Joint Powers Agreement specifically states that "the program may include" mortgage takings. JPA Agreement, *supra* note 116, at 1.

¹³¹ Goldstein & Ablan, *supra* note 25.

¹³² See Lazo, *supra* note 80.

¹³³ John, *supra* note 3.

¹³⁴ Yoon, *supra* note 25.

other hand, argue that the program would benefit “cities, investors, and borrowers alike.”¹³⁵ The common feature among both sets of debaters, however, is the complexity of the arguments made, illustrating the greater sophistication of both mortgages as a form of property and the considerations that should be taken into account in determining whether to move forward with such a plan. This section aims to highlight some of the key concerns with respect to the proposal.

The main policy argument in favor of the mortgage proposal is that it facilitates principal reduction. MRP’s chief legal consultant, and Cornell Law School professor, Robert Hockett argues that “[d]ebt must be trimmed back” to right the collapsing mortgage market.¹³⁶ Evidently supported by his colleagues at MRP, who individually have impressive backgrounds in the field of finance,¹³⁷ he has also gained the support of leading economists such as Robert Shiller from Yale University and L. Randall Wray, a professor of economics at the University of Missouri-Kansas City, who have remarked that homeowner “debt reduction is necessary to reignite the economy,” and “[e]minent domain may be the only way local governments can try to resolve the crisis.”¹³⁸

The excitement surrounding this unusual approach to achieving debt reduction stems from an ongoing frustration with the challenges faced in achieving principal reduction on securitized mortgages. Hockett argues that the main obstacle in the path toward principal reduction is not the reluctance of primary mortgagees (such as the banks) to consider it, but rather “the collective action challenges” posed by the nature of the mortgage-backed securities market.¹³⁹ Because the securities are owned by numerous and dispersed investors, it is difficult and arguably often impossible to get all of the investors to agree to a course of action that, on the face of it, reduces the value of their investments.¹⁴⁰ Furthermore, without “combined orchestration,” each investor will wait to see how other investors revalue the

¹³⁵ Robert Hockett, PREPARED REMARKS FOR THE FINANCIAL SERVICES PANEL SERIES, THE HONORABLE MAXINE WATERS (CA-35) PRESENTING THE HOUSING CRISIS AND POLICY SOLUTIONS: SHOULD EMINENT DOMAIN BE USED TO SAVE UNDERWATER HOMEOWNERS? 10 (2012), available at http://mortgageresolution.com/sites/default/files/attachments/testimony_of_robert_hockett_11_september_2012.pdf.

¹³⁶ *Id.*

¹³⁷ For bios of the MRP partners, see *Partners*, MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolutionpartners.com/partners> (last visited Jan. 16, 2013).

¹³⁸ Goldstein & Ablan, *supra* note 25.

¹³⁹ Hockett Memo, *supra* note 18, at 15-17.

¹⁴⁰ *Id.* at 28.

mortgages, thus resulting in inaction by all.¹⁴¹ Correspondingly, Hockett argues that:

Eminent domain clears title to the loan, to the security interest, and to the just compensation proceeds of the action. In one consolidated action, the local government clears up all of these paperwork problems and makes literally everyone better off—just as it more broadly makes communities, investors and homeowners all better off by paying fair value for the loans, reducing principal, and keeping Americans in their homes.¹⁴²

Though principal reduction, the underlying goal of the proposal, has long been discussed as one of the main ways in which the mortgage crisis should be addressed,¹⁴³ as Professor Hockett himself points out, it is not a perfect solution; a major issue with “principal forgiveness is that it leaves the lender or guarantor with one-sided, continued default risk.”¹⁴⁴ That is, “[i]f the property goes up in value the homeowner benefits, but if the property goes down in value then the homeowner might still default, and the lender or guarantor bears the cost.”¹⁴⁵ Professor Hockett claims that “[e]minent domain eliminates this one-sided risk by paying the lender fair value for the loan.”¹⁴⁶ Thus, he argues, eminent domain will also be in the interest of the mortgagees.

However, while eminent domain indeed removes default-risk from the hands of the original mortgagees, it only does so by placing the risk in the hands of new mortgagees—at first, the hands of the state and, in the case of the MRP proposal, the hands of a new set of private investors—on nonnegotiable terms that the original mortgagees may not consider favorable. In other words, the use of eminent domain strips mortgagees of a right that ordinary principal reduction does not—the right to choose which mortgages to assume this risk on, which mortgages to sell, and the value at which the mortgages should be sold. This in turn produces incidental negative consequences that will be discussed below.

¹⁴¹ *Id.* at 17. Professor Hockett also discusses other perverse results of the second lien market—created by homeowners that take out additional mortgages on their home—that have proven disadvantageous to the process of principal reduction. *Id.* at 20-24.

¹⁴² Hockett, *supra* note 135, at 10.

¹⁴³ Hudson Sangree, *Lenders Less Leery of Reducing Homeowners' Principal*, SACRAMENTO BEE, May 13, 2012, at 1A, available at http://www.tmsspecialtyproducts.com/article/Lenders-less-leery-of-reducing/201205170803MCT____NEWSERV_BC-REAL-PRINCIPAL-SA_446.

¹⁴⁴ Hockett, *supra* note 135, at 9.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

The right to choose is a central tenet of the industry pushback on the mortgage seizure proposal. Professor Hockett's reasoning that eminent domain will "be in the interest of the mortgagees" is only sufficient if (1) the loans seized are likely to default, and (2) what a court determines to be fair value (or just compensation) for the loans align with or even surpass the value to the investors of holding the loan. The former point is undermined by the specific loans the MRP program is currently targeting—underwater loans that are least likely to be defaulted. As Walter Dellinger, of O'Melveny and Myers, argued, "there is no basis for assuming [a performing] loan will default Indeed, the data show that a clear majority of loans that have been performing for years will *not* default."¹⁴⁷ In fact, 2012 data indicated that "[t]he majority of underwater homeowners continue to make regular payments on their mortgage, with only 10.1 percent of the 31.4 percent nationwide being delinquent."¹⁴⁸

Additionally, how close the court's valuation will be to an acceptable just compensation payment in the eyes of the mortgagees is contingent on the means the court employs to value the mortgages. It is uncertain whether the courts will look more to (1) the underlying security—the home—or (2) to other factors—such as the performance of or the interest rate on the loan—in determining the value of the mortgages.¹⁴⁹ It is also unclear whether the court will (1) consider the value of the individual mortgage or (2) the value of the loss to the mortgage pool from which the mortgage was taken to determine its value.¹⁵⁰ The latter in both sets of options would likely closer approximate the mortgagees' valuation of the mortgage, and the former, the just compensation MRP hopes the courts will award.

But why should we care about investors' satisfaction coming out of these transactions, particularly if the terms of the takings in fact turn out to be more favorable to them than expected, and furthermore, if the result is to lift communities out of severe financial distress? Opponents contend that we care because of the long-term effects on the market of

¹⁴⁷ O'Melveny Memo, *supra* note 24, at 6-7.

¹⁴⁸ Stan Humphries, *Despite Home Value Gains, Underwater Homeowners Owe \$1.2 Trillion More Than Homes' Worth*, ZILLOW REAL ESTATE RESEARCH (May 24, 2012), <http://www.zillow.com/blog/research/2012/05/24/despite-home-value-gains-underwater-homeowners-owe-1-2-trillion-more-than-homes-worth/>.

¹⁴⁹ "The value of a mortgage to the lender or owner of the loan depends largely on its performance (i.e., payment history) and interest rates, rather than on the appraised value of the real property being mortgaged." O'Melveny Memo, *supra* note 24, at 6.

¹⁵⁰ Andrew M. Grossman, *San Bernardino Mortgage Seizure Plan Raises Serious Constitutional Concerns*, HERITAGE FOUND. ISSUE BRIEF, (July 16, 2012).

introducing the threat of the use of eminent domain. For example, David Sterns, President of the Mortgage Banker's Association, among others, argues that implementation of the proposal will signal to current and future investors that their investments are under threat of seizure by eminent domain.¹⁵¹ This threat is predicated on a perceived unpredictability as to when the power of eminent domain will be exercised.¹⁵² This concern is not entirely unfounded; the plan does not conceive a time frame during which these takings will occur. While one could make assumptions that the power will only be exercised for the duration of the crisis, that is an ambiguous time block and supposes that investors will trust the government to use the power only during this isolated crisis and not every time the housing market takes a dip.

The perceived risk is inflated by the potential that, if investors' performing mortgages are seized, investors may not receive the value of the loans to them. Because underwater mortgages may not default, mortgagees also likely attach a subjective value to the risk of holding onto these loans—based on weighing the risk of default against the potential that these underwater mortgages will be paid off, and that they will realize the full face value of the lien.¹⁵³ However, in determining just compensation, the court does not incorporate the subjective valuation of the mortgagees, but rather the objective current fair market value of the asset, “what a willing buyer would pay in cash to a willing seller at the time of the taking.”¹⁵⁴

Of course, the obvious pushback is that, realistically, crises of this nature are highly infrequent, though, given the courts' deference to agency determination of public use, it is imaginable that there is some room for abuse of discretion in determining what constitutes a sufficient downturn in the market to warrant the use of eminent domain.¹⁵⁵ Furthermore,

¹⁵¹ Letter from David H. Stevens, President and Chief Exec. Officer, Mortgage Bankers Assoc. to Alfred Pollard, Gen. Counsel, Federal Housing & Fin. Agency (Sept. 7, 2012) [hereinafter MBA Letter], available at <http://www.mba.org/files/MBAEDLettertoFHFA.pdf>.

¹⁵² John, *supra* note 3 (“By adding a new level of uncertainty about whether the mortgages will be repaid according to the original contract, future investors would see all mortgage-backed securities as riskier than before.”).

¹⁵³ See Nelson, *supra* note 58.

¹⁵⁴ Grossman, *supra* note 150 (citing U.S. v. 564.54 Acres of Land, More or Less, Situated in Monroe and Pike, 441 U.S. 506, 511 (1979)).

¹⁵⁵ Kevin McCoy, *2008 Financial Crisis: Could It Happen Again?*, USA TODAY (Sept. 9, 2013, 12:20 PM), <http://www.usatoday.com/story/money/business/2013/09/08/legacy-2008-financial-crisis-lehman/2723733/> (While predicting that a crisis as major as the 2008 implosion was “far less likely, [David] Hirschmann[,] president and

investors' memories tend to be short, rendering the likely long-term impact of the occasional use of eminent domain to be small if not negligible.¹⁵⁶

Nevertheless, in the securities market, on which so much of the housing market has come to depend,¹⁵⁷ how the investors "feel" about their prospects of realizing a return on investments plays an exceptionally large role in the survival of the current mortgage system. The added risk of not only having their investments seized, but having to surrender those investments at an exceptional loss, may prove either (1) too large for investors, or (2) too expensive for prospective mortgagees to bear. As one opponent argued:

The fundamental flaw underlying the . . . proposal is the mistaken assumption that violating the property rights of unpopular parties—those holding mortgage-backed securities—can somehow strengthen the real estate market without causing massive collateral damage. But the reality is that weakening property rights ultimately increases uncertainty, undermines markets, and often fails to accomplish the government's goals.¹⁵⁸

This response is a bit of an overstatement, but it points to some realistic potential market reactions, particularly if the use of eminent domain becomes a frequent or expected occurrence in certain communities.

Many, from the FHFA to a large number of the most experienced institutional financial players, have expounded on some of the ways in which this risk may undermine the market and hurt homeowners.¹⁵⁹ According to the Mortgage Bankers Association, "[i]n essence, the Government entity is writing itself a 'call option' on the mortgage, which they can then exercise when home values decline to their lowest points, seizing the mortgage and locking the lender and servicer into an assured loss."¹⁶⁰ As the Association noted, to date, this risk has not been included in the pricing of mortgages, but in areas where the power to seize mortgages is realized, and worse so utilized, "those who invest in mortgages [may either] refuse to buy loans originated in these communities" (and lenders would resultantly

CEO of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness warn[s], "That doesn't mean there won't be failures."").

¹⁵⁶ See, e.g., *Short Memories, Deep Pockets: Investors Desperate for High Yields Are Piling into High-Risk Bonds. Here we go again*, ECONOMIST (June 10, 2003), <http://www.economist.com/node/1840188>.

¹⁵⁷ See generally ASF Letter, *supra* note 34.

¹⁵⁸ Grossman, *supra* note 150.

¹⁵⁹ E.g., ABA Letter, *supra* note 37.

¹⁶⁰ MBA Letter, *supra* note 151.

refuse to lend for home purchases in these areas),¹⁶¹ or “demand that the underlying mortgages be written with even tighter credit standards and higher down payments.”¹⁶²

Thus, as has been argued, the use of eminent domain in this context may “have a chilling effect on the extension of credit to . . . [prospective] homeowners and on investors.”¹⁶³ As one commentator pointed out, “[t]he 43.4 percent of San Bernardino County homeowners whose mortgages are underwater would find that they had fewer opportunities to sell their homes as mortgage lenders flee their communities.”¹⁶⁴ It is also suggested that “restricting the flow of credit to homebuyers” would in fact have the consequential effect of “suppress[ing] housing values,”¹⁶⁵ the very issue that created the foreclosure crisis to begin with.¹⁶⁶ Furthermore, from a social policy perspective, it is the poorer that would be most likely affected. “Potential homebuyers with lower credit ratings or lower incomes would find either that they cannot obtain a mortgage or that it would cost them more than it would have otherwise.”¹⁶⁷

In response to these threats to investors and, it is argued, homeowners, the Securities Industry and Financial Markets Association¹⁶⁸ “proposed prohibiting loans originated in areas using eminent domain from a key part of the five trillion dollar mortgage-backed securities market that is a backbone for U.S. housing finance.”¹⁶⁹ The FHFA has specifically reasserted these threats in response to the Richmond proposal,¹⁷⁰ while California

¹⁶¹ *Id.*

¹⁶² John, *supra* note 3.

¹⁶³ FHFA 2012 Notice, *supra* note 22.

¹⁶⁴ John, *supra* note 3.

¹⁶⁵ MBA Letter, *supra* note 151.

¹⁶⁶ Kristopher Gerardi et al., *Decomposing the Foreclosure Crisis: House Price Depreciation versus Bad Underwriting* (Abstract), FEDERAL RESERVE BANK OF ATLANTA WORKING PAPER (Sept. 2009), available at <http://www.frbatlanta.org/filelegacydocs/wp0925.pdf> (“We . . . conclude that the foreclosure crisis was primarily driven by the severe decline in housing prices that began in the latter part of 2005 . . .”).

¹⁶⁷ John, *supra* note 3.

¹⁶⁸ As the organization describes itself on its website, “SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. These companies are engaged in communities across the country to raise capital for businesses, promote job creation and lead economic growth.” *About*, SIFMA.ORG, <http://www.sifma.org/about/> (last visited Sept. 12, 2013).

¹⁶⁹ Yoon, *supra* note 25.

¹⁷⁰ See FHFA Statement, *supra* note 45 (“In response to an eminent domain action to restructure mortgage loans, FHFA may take any of the following steps: initiate legal challenges to any local or state action that sanctions the use of eminent domain to restructure mortgage loan contracts that affect FHFA’s regulated entities; act by order or by regulation to direct the regulated entities to limit, restrict or cease business activities within the jurisdiction of any state or local authority employing eminent domain to restructure mortgage loan contracts; or take such other actions as

Congressional Representative John Campbell has introduced a bill that “would prohibit Fannie, Freddie, FHA and the Department of Veterans Affairs from insuring or guaranteeing newly originated single-family loans in counties that use eminent domain.”¹⁷¹

But how is the inclusion of the additional risk of potential seizure by eminent domain any different from some of the other threats real estate and mortgage-backed securities investors have stomached, without any appreciable freezing on the market? Cramdown, under the Bankruptcy Code, and foreclosure, for example, are like eminent domain in the sense that the lenders will only get paid the fair market value of the seized properties, or even less under foreclosure.¹⁷² One difference, however, is that the value of a mortgage is arguably not the same as that of the underlying property.¹⁷³ Valuations for mortgage-backed securities, which are in turn based on valuations of the underlying mortgages, are very complicated, and include many factors extraneous to the market value of the property securing the mortgage.¹⁷⁴ Thus, seizures of mortgages, even as opposed to seizures of the underlying property, generally present greater issues of valuation. Another dissimilarity is that both bankruptcy and foreclosure are by nature limited to circumstances in which the mortgagor was likely already unable to pay anyway, and certainly in the case of foreclosure, would already be in default. As the MRP proposal indicates, particularly if it passes muster in the courts, eminent domain may be used to seize performing loans owed by credit-worthy mortgagors. Whether these differences will have any substantial effect on investors’ perception of this risk is unknown.

Even discounting the speculative views on future investor responses to the proposal, however, it is widely agreed

may be appropriate to respond to market uncertainty or increased costs created by any movement to put in place such programs.”)

¹⁷¹ David H. Stevens, *Industry Is Lining Up To Block Eminent Domain Laws*, ARIZONA MORTGAGE LENDERS ASS’N (Sept. 8, 2013), <http://www.azmortgagelenders.com/industry-is-lining-up-to-block-eminant-domain-laws/>.

¹⁷² “A mortgage cramdown allows you to reduce the principal balance of your mortgage to the value of your real estate. It may also allow you to reduce your mortgage interest rate.” Baran Bulkat, *Mortgage Cramdowns in Chapter 13 Bankruptcy*, NOLO (last visited Nov. 5, 2013). Unless it is the homeowners’ primary residence, mortgages are subject to cramdown under the Bankruptcy Code. *Id.* “Pricing for a foreclosed home is [also] typically set at market value in an effort to move the property quickly,” but can be negotiated down. HOW TO BUY A FORECLOSED HOME, BANK OF AMERICA REAL ESTATE CENTER, http://foreclosures.bankofamerica.com/how_to_buy_a_foreclosed_home (last visited Nov. 5, 2013).

¹⁷³ This is briefly discussed in Part II, *infra*.

¹⁷⁴ See INTRODUCTION TO ASSET-BACKED AND MORTGAGE-BACKED SECURITIES, INVESTOPEDIA (Jan. 14, 2013), <http://www.investopedia.com/articles/bonds/12/introduction-asset-backed-securities.asp>, for a brief discussion of the valuation of these types of securities.

that any attempt to implement the proposal will result in “costly and lengthy litigation”¹⁷⁵ “that could drag on for years, substantially undermining any benefit the [local government] may hope to achieve.”¹⁷⁶ In response to Richmond’s approval of the program, litigation has already begun,¹⁷⁷ and attorneys “have assured the [mortgage] industry that this unprecedented use of *eminent domain* raises multiple questions under the U.S. Constitution and state laws[, a]nd they could contest any seizure and keep the matter bottled up in the courts.”¹⁷⁸ Andrew Grossman of the Heritage Foundation has stated that “[local] officials would be reckless to discount these concerns.”¹⁷⁹ Indeed, the nation is watching to see how the Richmond litigation pans out.¹⁸⁰

Furthermore, and perhaps most significant to the purpose of this note, the dispersed nature of the property rights in mortgages means that the proposal will have a national or even international impact,¹⁸¹ and some investors are not the sort of large institutional investors who have been the face of the opposition in this debate. For example, some of the largest investors in mortgage-backed securities are pension funds.¹⁸² Thus, the elderly and a broad range within the middle and working class public could also be negatively affected by this proposal.¹⁸³ Even with diversified portfolios, if the use of eminent domain by one city triggers the use of eminent domain by many more, the impact could be of some significance.

¹⁷⁵ Ghori, *supra* note 32.

¹⁷⁶ Grossman, *supra* note 150.

¹⁷⁷ Lazo, *supra* note 29.

¹⁷⁸ Stevens, *supra* note 171.

¹⁷⁹ Grossman, *supra* note 150.

¹⁸⁰ Shaila Dewan, *A City Invokes Seizure Laws to Save Homes*, N.Y. TIMES (July 29, 2013), http://www.nytimes.com/2013/07/30/business/in-a-shift-eminant-domain-saves-homes.html?pagewanted=all&_r=0 (“Richmond is about to become the first city in the nation to try eminent domain as a way to stop foreclosures. The results will be closely watched by both Wall Street banks . . . and a host of cities across the country that are considering emulating Richmond.”).

¹⁸¹ The FHFA has specifically expressed its concern with whether “critical issues surrounding the valuation . . . of complex contractual arrangements [referring to the mortgage-backed securitization trusts targeted by the proposal] that are traded in national and international markets” should be left to local governments and the courts. FHFA 2012 Notice, *supra* note 22.

¹⁸² Fogarty, *supra* note 33; Jacob Gaffney, *DLA Piper: Richmond Eminent Domain Battle Just Beginning*, HOUSING WIRE (Aug. 16, 2013, 2:48 PM), <http://www.housingwire.com/articles/26249-dla-piper-richmond-eminant-domain-battle-just-beginning>.

¹⁸³ See ABA Letter, *supra* note 37.

Indeed, MRP has a lineup of interested but cautious cities that are watching the situation in Richmond closely.¹⁸⁴

The foregoing illustrates the complexity of some of the major policy concerns created by the mortgage seizure proposal, and illuminates the extent of the power that has been placed in the hands of local governments.

IV. WITH WHOM SHOULD THE FINAL SAY LIE?: A PROPOSAL FOR GOVERNMENTAL INTERVENTION

One of the main problems created by entrusting local governments with the power to seize securitized mortgages is that they may not have reason to consider the implications of such a proposal beyond their jurisdictional borders. Moreover, even if they do, they may not have the necessary expertise or resources to make policy determinations which accurately take these considerations into account; thus, it might be unwise for states to grant local governments the autonomy to do so.¹⁸⁵ However, the issue remains as to how and by whom this power should be regulated. We can look to three main governmental units—the judiciary, the federal government, and the individual state governments—and two main sources of regulation—state legislation and the Constitution—for this oversight.

A. *The Judiciary and the Limit of Constitutional Protections*

The judiciary enforces constitutional limitations on the exercise of eminent domain. However, as discussed in Part II, the judiciary has categorically rejected reviewing or deciding on any issues of policy in determining the constitutionality of eminent domain proposals.¹⁸⁶ There is wisdom in the court's decision not to assess policy. In fact, this rule has come to play a fundamental role in the court's view of the constitutionally

¹⁸⁴ See Shaila Dewan, *More Cities Consider Using Eminent Domain to Halt Foreclosures*, N.Y. TIMES (Nov. 15, 2013), http://www.nytimes.com/2013/11/16/business/more-cities-consider-eminant-domain-to-halt-foreclosures.html?_r=0 (identifying Yonkers, New York; Newark, New Jersey; Pomona and Ontario, California; and some unidentified cities in Minnesota and Pennsylvania as cities showing strong interest in the proposal following in the wake of the approval by the City of Richmond).

¹⁸⁵ See generally Guthrie, *supra* note 7.

¹⁸⁶ *Fideicomiso De La Tierra Del Caño Martin Peña v. Fortuno*, 604 F.3d 7, 18 (1st Cir. 2010) *cert. denied*, 131 S. Ct. 1600 (2011); see also *supra* Part II.

mandated separation of powers between it and the political branches of the government.¹⁸⁷

Under the separation of powers doctrine, policy-making is constitutionally allocated to the exclusive purview of the legislature,¹⁸⁸ largely because it requires expertise which the court may not have.¹⁸⁹ Thus, the Court's deference to the political branches in eminent domain proceedings should not be considered a shirking of the court's responsibilities. Rather, it preserves the government's authority to make the policy decision inherent in determining what constitutes a public use.¹⁹⁰ For example, determining the public benefit of the mortgage proposal involves assessing whether or not the takings would actually address the goal—the stabilization of the housing market. Arguably, the executive branch, whether at the state or the federal level, is the more appropriate authority to make this determination.¹⁹¹

¹⁸⁷ The separation of powers doctrine acts to protect the autonomy of each of the three branches of government to fulfill their constitutionally mandated duties:

A fundamental principle of the American constitutional system is that governmental powers are divided among three separate and independent branches: legislative, executive, and judicial. The separation of powers doctrine provides that a department may not exercise powers not so constitutionally granted which from their essential nature do not fall within its division of governmental functions unless such powers are properly incidental to the performance by it of its own appropriate functions. Thus, the doctrine ensures that the three branches of government are distinct unto themselves and that they, exclusively, exercise the rights and responsibilities reserved unto them.

16A AM. JUR. 2D *Constitutional Law* § 237 (2012).

¹⁸⁸ Under the separation of powers doctrine:

Article I of the Constitution entrusts the legislative power of the United States to the Congress, so that democratically elected representatives will determine national policy. Article II vests the executive power in the President, in the interest of unified administration by an elected officer. Article III places the judicial power in judges appointed for life and removable only for high crimes and misdemeanors, so that cases may be decided without fear of reprisal.

M. Elizabeth Magill, *Beyond Powers and Branches in Separation of Powers Law*, 150 U. PA. L. REV. 603, 624 n.62 (2001) (quoting David P. Currie, *The Distribution of Powers After Bowsher*, 1986 SUP. CT. REV. 19, 19).

¹⁸⁹ See Richard Albert, *The Constitutional Imbalance*, 37 N.M.L. REV. 1, 24-25 (2007).

¹⁹⁰ “The eminent-domain power requires a degree of elasticity to be capable of meeting new conditions and improvements and the ever increasing necessities of society.” 26 AM. JUR. 2D *Eminent Domain* § 3 (2012) (citing *Kelo v. City of New London*, 545 U.S. 469 (2005)). Indeed the mortgage crisis, and those aspects of the mortgage market that have made it difficult to address the issues faced in the crisis, may well be the kind of “new conditions and improvements” to which the Supreme Court was alluding.

¹⁹¹ See Albert, *supra* note 189, at 24-25.

The Court's deference is also applied non-discriminatorily across the levels of state or federal authority, providing no difference in degree of oversight over the policy-making of *any* authorized governmental body—from a local township to a large federal agency. As a result, any form of policy-monitoring must originate with the legislature, either through regulation by a state¹⁹² or federal¹⁹³ agency, legislation limiting the scope of the eminent domain authority delegated to local governments, or legislation granting the states final review over the use of eminent domain to effect certain kinds of seizures.¹⁹⁴

B. The Pros and Cons of Agency Oversight: State v. Federal

It is practically implausible that either the state or federal governments would expend the cost of creating and running new agencies solely for the purpose of regulating the use of eminent domain in as narrow a circumstance as the seizure of securities. However, there are several existing state and federal agencies that could easily take on this additional regulatory purpose, due to their already-existing regulatory functions pertaining to either securities generally or mortgages specifically. These institutions likely already have the necessary expertise to assess both the benefits and the dangers of the proposal, and the responsibility of considering the implications of the proposal on a broader market—either on the state or national level.

The FHFA is the federal agency in the best position to take on such a regulatory role. The agency, which was set up to address the housing crisis, “has [in fact previously] resisted

¹⁹² Once provided for in legislation, state governments could grant the power of review over the use of eminent domain to a state agency. 26 AM. JUR. 2D *Eminent Domain* § 26 (2013). In effect, this grant of review has the effect of legislation promulgated to limit the exercise of eminent domain by entities to which the state has granted the power.

¹⁹³ The U.S. Constitution has been read to generally prohibit the federal government from interfering with internal state affairs, unless otherwise mandated by the Constitution. The federal government could likely find the authority to regulate the use of eminent domain to take securitized mortgages, due to their dispersed ownership structure, under the commerce clause. The commerce clause permits the federal government to regulate interstate commerce. 7 BUS. & COM. LITIG. FED. CTS. § 85:72 (3d ed.) (Dec. 2012).

¹⁹⁴ As DLA Piper notes, “[a]bsent a state or federal legislative solution that says the City’s program is outside the bounds of eminent domain, the legality of the City’s Seizure Program will be determined in federal court.” Paul Hall, Isabelle Ord & Charles L. Deem, *City Attempting to Seize Underwater Mortgages via Eminent Domain: Constitutional Objections, Potential Investor Losses*, DLA PIPER REAL ESTATE LITIG. ALERT, Aug. 2013 at 2, available at <http://www.dlapiper.com/city-attempts-to-seize-underwater-mortgages-via-eminant-domain/>.

mass refinancing and warned of the potential risk of doing so;¹⁹⁵ the agency has described the mortgage seizure program as “a desperate attempt to try to save a proposal that’s being rejected by smart policy-makers across the country.”¹⁹⁶ However, the FHFA currently does not have the authority to directly prohibit the mortgage takings, and must rely on either taking action to discourage the proposal’s adoption, or on litigating the issue in the courts.¹⁹⁷ The federal government could grant it this authority due to the inter-state commercial aspect of the mortgage market.¹⁹⁸

The Securities and Exchange Commission (SEC), on the other hand, is much less suitable. Asset-backed securities, such as those backed by mortgage loans, are “subject to the [SEC] and its rules and regulations as well [as] federal laws governing securities”¹⁹⁹ Generally speaking, though, the SEC regulates the market through procedural and disclosure requirements for the sale and maintenance of the securities, meant to protect investors by holding banks accountable for keeping their investors informed.²⁰⁰ The SEC does not have experience, for example, valuing or dealing in mortgage-backed securities. Thus, SEC oversight may not be the most plausible option to oversee mortgage seizures.

The benefit of dealing with the issue on the federal level is that national consequences would be given weight in the analysis of the appropriateness of the proposed mortgage takings, and implementation of takings rules would be

¹⁹⁵ John, *supra* note 3 (citing David C. John, *DeMarco Warns of the Dangers of Large-Scale Forgiving of Mortgage Debt*, HERITAGE FOUND., FOUNDRY (Apr. 15, 2012), <http://blog.heritage.org/2012/04/15/demarco-warns-of-the-dangers-of-large-scale-forgiving-of-mortgage-debt>).

¹⁹⁶ Ghori, *supra* note 32 (quoting “Chris Katopis, executive director of the Association of Mortgage Investors, a Washington, D.C.-based lobbying group”).

¹⁹⁷ Rick E. Rayl, *Eminent Domain and Underwater Mortgages: Federal Government to Weigh in on Proposal*, CAL. EMINENT DOMAIN REPORT, NOSSAMAN LLP (Aug. 9, 2012), <http://www.californiaeminentdomainreport.com/tags/hr-1433/> (“FHFA’s concerns [regarding the mortgage seizure proposal] are not new, but it is significant that FHFA has given them a formal voice. On the other hand, it’s not entirely clear what FHFA might do about these ‘concerns.’ Unless the plan violates the federal constitution . . . the plan will be debated and ultimately litigated largely under state laws. FHFA has no jurisdiction to command states on how they should interpret their own laws.”); Yves Smith, *FHFA Threatens to Kneecap Use of Eminent Domain to Condemn Mortgages*, NAKED CAPITALISM (Aug. 9, 2012, 2:39 AM), <http://www.nakedcapitalism.com/2012/08/fhfa-threatens-to-kneecap-use-of-eminent-domain-to-condemn-mortgages.html#E1jgpFoTvSQX5r4w.99>.

¹⁹⁸ See *supra* note 193.

¹⁹⁹ See *Mortgage Securitization Process*, L. OFF. GLENN F. RUSSELL, JR., http://foreclosuresinmass.com/mortgage_securitization.aspx (last visited Sept. 12, 2013).

²⁰⁰ See *Asset Backed Securities*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/spotlight/dodd-frank/assetbackedsecurities.shtml> (last visited Nov. 4, 2013).

consistent across states. The federal government would also have the opportunity to determine whether the problem could be best addressed by a national program. For example, there are currently existing but underutilized federal programs that allow borrowers to reduce their monthly payments without the negative externalities that will accompany the mortgage seizure proposal.²⁰¹ Under these programs, such as the Home Affordable Refinance Program (HARP) and the Home Affordable Modification Program (HAMP), the federal government refinances qualifying loans, reducing the rate of interest on the loan.²⁰² Thus, while these programs do not facilitate reduction of the face value (or principal) of the loan, they nonetheless “allow[] borrowers who are struggling with their payments to stay in their home while lowering their monthly payments.”²⁰³ Professor Hockett’s only argument against these programs, and HAMP specifically, is that they require “significant public expenditure” to be successful,²⁰⁴ but the MRP proposal threatens the potential for huge public expenditure as well.²⁰⁵

The most valid argument levied against federal oversight is that federal bureaucracy often acts as a detriment to efficient action, and may even end in gridlock.²⁰⁶ Indeed, several have argued that both the HAMP and HARP programs have suffered from Congress’s inability to overcome its ideological divide as to how to best address the foreclosure crisis.²⁰⁷ Professor Hockett maintains that states are in a much more suitable position to respond to the foreclosure

²⁰¹ For a list of the fourteen Federal Government Loan Modification Programs currently in existence, see *Helping Responsible Homeowners Save Money Through Refinancing Before the Subcomm. on Hous., Transportation, & Community Development of the S. Comm. on Banking, Housing and Urban Affairs*, 112th Cong. 8 (2012) (statement of Dr. Anthony B. Sanders, Professor of Finance, George Mason University School of Management), available at http://www.banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing_ID=5826e6e7-1183-4b6c-a8a9-40d6bf792da1.

²⁰² See *Home Affordable Refinance Program*, FREDDIE MAC, http://www.freddiemac.com/homeownership/educational/harp_faq.html#a5 (last visited Nov. 4, 2013); *Home Affordable Modification Program*, FREDDIE MAC, http://www.freddiemac.com/singlefamily/service/mha_modification.html (last visited Nov. 4, 2013).

²⁰³ MBA Letter, *supra* note 151.

²⁰⁴ Hockett Memo, *supra* note 18, at 26.

²⁰⁵ See *supra* Part II.

²⁰⁶ See generally Ronald N. Johnson & Gary D. Libecap, *The Problem of Bureaucracy*, in *THE FEDERAL CIVIL SERVICE SYSTEM AND THE PROBLEM OF BUREAUCRACY* 1-11 (1994), available at <http://www.nber.org/chapters/c8632.pdf>.

²⁰⁷ Hockett Memo, *supra* note 18, at 22; Douglas A. McIntyre, *HAMP Program: A Failure or a Success?*, 24/7 WALL ST. (May 18, 2010, 5:06 AM), <http://247wallst.com/2010/05/18/hamp-program-a-failure-or-success/>; Reiss, *supra* note 121 (“The federal government’s responses to the current crisis in the housing markets have been half-hearted and at cross purposes.”).

crisis,²⁰⁸ and on this point, he is likely right. The trade-off of state oversight and regulation is the likely inattention to the national or even international consequences that may result from implementing such a proposal. However, it is arguable that states would be more efficient in promulgating regulation as the urgency of local issues would likely have greater political heft.²⁰⁹ Furthermore, the individual states would be better informed as to the unique affairs of their constituents.

The states could subsume regulation of mortgage takings into the responsibilities of their own securities regulatory agencies,²¹⁰ but this poses similarly high administrative costs as on the federal level. Arguably the most apt, and certainly the most direct, way the states may address the issue is by limiting the scope of the takings power delegated to cities and agencies,²¹¹ to prevent them from effectuating the takings of complex securities either entirely, or without further state approval.²¹²

C. *State Legislative Limitations: Entire Ban v. Requirement of State Approval*

It is unclear which of these two choices a state would or should make. However, there are some basic considerations the states should bear in mind should they choose to limit the eminent domain power they have delegated to local governments. Both options operate to reduce administrative costs to different degrees, but the choice of one or the other arguably depends on the comparative weight the states place on competing values: (1) the reduced oversight over decisions of local government afforded by granting them the unrestricted right to exercise eminent domain, and (2) the ability to regulate

²⁰⁸ Hockett Memo, *supra* note 18, at 26.

²⁰⁹ *Id.* at 28-29; *see also Promoting Local Control and States Rights*, CONG. W. CAUCUS, <http://www.westerncaucus.pearce.house.gov/promoting-local-control-and-states-rights/> (last visited Sept. 12, 2013).

²¹⁰ Each state has a securities regulatory office. The list of these agencies for each state can be found on the website of the North American Securities Administrators Association. *Contact Your Regulator*, N. AM. SECS. ADM'RS ASSN., <http://www.nasaa.org/about-us/contact-us/contact-your-regulator/> (last visited Sept. 12, 2013).

²¹¹ 26 AM. JUR. 2D *Eminent Domain*, *supra* note 5, at § 23 (“In delegating the power of eminent domain, the state may exercise a certain control . . .”).

²¹² For example, in the Joint Powers Agreement creating the Homeownership Protection Program Joint Powers Authority, referenced several times in this note, the power of eminent domain granted to the agency is specifically withheld from seizure of residential homes. *See JPA Agreement*, *supra* note 116, at 1, 8. Arguably, the states could control the use of eminent domain for the purpose of taking mortgages or any other form of security by simply limiting it all together so that such considerations would have to be dealt with on the state legislative level.

local policy making.²¹³ The former value is, in essence, based on a concern about costs—the financial cost and the cost in time that is saved by giving local governments autonomy over the policy decision of whether or not to use eminent domain.

If the states only value the cost of monitoring, they will either strip the local governments of the power to use eminent domain to seize mortgages, or continue to allow them unrestricted use of the power. A downside to restricting the power altogether is that the state would nevertheless have to bear the cost of reviewing and also, if it ever saw fit, potentially implementing any proposal for the use of eminent domain to seize mortgages. Thus, the most logical choice would be the current one—to leave the power mostly unrestricted and to entrust these policy evaluations in their entirety to the local governments. Most states, though, will also likely value their ability to review these decisions, particularly in light of the mortgage proposal and the widespread response from the financial industry. As a result, legislatively retaining the right to review these decisions will be the most attractive option.

The means of implementation aside, however, direct state intervention has two powerful advantages to the other modes of regulation. It avoids the additional administrative costs of having a regulatory body oversee the process, as well as circumvents issues of federal intervention in state affairs. Most importantly, it takes the autonomy of policymaking on complex and potentially highly impactful proposals out of the hands of local governments and places it in a body that has greater resources and purview to assess the wisdom of the proposals.

CONCLUSION

While this note has focused on the potential problems that may result from the implementation of the mortgage seizure proposal, it neither supports nor opposes the proposal. Rather, it is building a case for the level and kind of authority that should have the final say in approving or disapproving a proposal to use eminent domain to seize complex securities. This note principally argues that a proposal to seize mortgages requires greater supervision from state governments, rather than the more deferential judgment afforded by judicial oversight through the application of Fifth Amendment takings law.

²¹³ This value scheme is introduced *supra* Part I.

There is, without doubt, enormous value to the goal of the MRP proposal. Both those who endorse the proposal and those who criticize it agree that the mortgage crisis is economically crippling for the areas it has most greatly affected and that it must be addressed.²¹⁴ The mortgage seizure proposal has reasonably been held up as a novel opportunity for local governments to address the mortgage foreclosure crisis in the face of relative deference from Congress.²¹⁵ However, the reality of the crisis and the opportunity the mortgage seizure proposal provides do not negate potential negative externalities created by the exercise of eminent domain to take mortgage-backed securities.²¹⁶

As Part III discussed, the complex nature of mortgage-backed securities, and the market of which they are a part, creates added layers of policy considerations different from those a municipality would usually encounter in determining whether to use eminent domain to take land. Particularly concerning are the far reaching effects mortgage seizures would have, which is part and parcel of the national, and potentially international, market of which most mortgages have become a part. Indeed, as Part III illustrated, the dispersed ownership structure of securitized mortgages (of which most American mortgages are a part) both creates the problem the mortgage seizure proposal is attempting to address—the prevention of principal reduction—and adds a layer of complexity that makes the proposal potentially dangerous to implement. The power to make decisions of this magnitude should not be liberally granted to municipal authorities, but rather should be carefully scrutinized and monitored by a higher-level authority equipped with the expertise and charged with the responsibility of taking into account the impact of the negative externalities of such a program on the securities, mortgage, and housing markets. This note concludes that the

²¹⁴ For example, California's lieutenant governor, Gavin Newsom, while not "explicitly endors[ing] the eminent domain proposal," told the San Bernardino County Sun in a telephone interview that, "[t]he economy in our state is not going to rebound until we address the number one thing holding us back, and that's these homes that are underwater[.]" Edwards, *supra* note 84 (internal quotation marks omitted).

²¹⁵ John W. Schoen, *Governments Mull Radical Solution to Underwater Mortgages: Seize Them*, NBC NEWS, available at <http://www.certifiedforensicloanauditors.com/articles/08.12/governments-mull-radical-solution-to-underwater-mortgages.html> (last visited Sept. 12, 2013) (quoting Gregory Deveraux, administrator for San Bernardino County, saying that "[f]ederal programs have not been very successful at all, and the private programs have been of limited help").

²¹⁶ See MBA Letter, *supra* note 151.

authorities best equipped to address these concerns are the states, either through directly limiting the power delegated or by retaining the power to review.

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