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"We Don't Follow, We Lead": How New York City Will Save Mortgage Loans by Condemning Them

Robert Hockett

INTRODUCTION[1]

Many cities across the nation have begun to consider exercising their eminent domain authority to purchase, then write-down principal on, otherwise unmodifiable home mortgage loans facing foreclosure.[2] I and several others have advocated this method and cognate uses of government authority to stabilize troubled housing markets for some years now,[3] but the eminent domain

1. The quoted words in the title figured into a chant uttered at the New York City Hall steps during an event held the 25 of June this past summer. See *infra* note 4.

2. For samplings of media reports covering sundry cities' interest in the idea, see *Cities Begin Moving on Hockett "Municipal Plan*," CORNELL UNIV. L. SCH. SPOTLIGHTS (July 31, 2013), http://www.lawschool.cornell.edu/spotlights/Cities-Begin-Moving-on-Hockett-Municipal-Plan.cfm [http://perma.cc/HBG9-CRUS]; *New York Fed Report by Hockett Revives Discussion of His "Municipal Plan" to Revive Housing and the Macroeconomy*, CORNELL UNIV. L. SCH. SPOTLIGHTS (June 13, 2013), http://www.lawschool.cornell.edu/spotlights/NY-Fed-Report-by-Hockett-Revives-Discussion-of-His-Municipal-Plan.cfm [http://perma.cc/96HS-DZX5]; *Hockett Reveals Municipal Plan to Address "Underwater" Mortgage Loans*, CORNELL UNIV. L. SCH. SPOTLIGHTS (July 11, 2012), http://www.lawschool.cornell.edu/spotlights/Hockett-Reveals-Plan-to-Address-Underwater-Mortgage-Loans.cfm [http://perma.cc/M9HX-5KUZ]. A glance at the American Securitization Forum's (ASF) catalogue of its own efforts to dissuade cities from acting on the idea is also instructive. *See Eminent Domain*, AM. SECURITIZATION FORUM ISSUES, http://www.americansecuritization.com/Issues.aspx?taxid=6587 (last viewed Sept. 13, 2014). For more on the plan itself, see Hockett sources cited *infra* notes 7-11, and accompanying text. See also the informative notes published by a number of students who reached out to me once the plan began to draw interest from cities, for example, Alec Harris, Note, *Redemption and Return on Investment: Using Eminent Domain in the Underwater Mortgage Fight*, 8 HARV. L. & POL'Y REV. 437 (2014); Ngai Pindell, Note, *Nevada's Residential Real Estate Crisis: Local Governments and the Use of Eminent Domain to Condemn Mortgage Notes*, 13 NEV. L.J. 888 (2013); and Marissa Schaffer, Note, *Stemming the Tide of Foreclosure: Evaluating the Use of Eminent Domain to Relieve Underwater Homeowners*, 2014 COLUM. BUS. L. REV. 215 (2014).

3. *See, e.g.*, Daniel Alpert, Robert Hockett & Nouriel Roubini, *The Way Forward: Moving from the Post-Bubble, Post-Bust Economy to Restored Growth and Competitiveness*, NEW AM.

approach to the problem nevertheless remains unfamiliar to many people. This is likely to change in the coming months. I recently joined New York City Council members on the steps of New York City Hall as they announced their intention to embrace some version of the eminent domain plan to address the City's negative equity challenges.[4] If they and fellow Council Members follow through on that intention, then many more Americans are likely to hear about the plan. This plan calls for cities to purchase "underwater" mortgage loans out of securitization trusts in order to prevent foreclosures, stabilize communities, and benefit (or avoid harming) mortgage investors in the process.[5]

In this Essay I hope to explain why the eminent domain plan is necessary in New York and other cities, how the plan works, and why it is sound as a matter of law and policy. Part I addresses the plan's necessity. Part II covers the plan's basic mechanics. Part III discusses the plan's legal grounding and policy propriety. Part IV concludes.

FOUND. 32 (Oct. 2011), http://newamerica.net/sites/newamerica.net/files/policydocs/NAF—The_Way_Forward—Alpert_Hockett_Roubini.pdf [http://perma.cc/6B9Y-RQMR] (federal eminent domain authority to purchase second liens); Robert Hockett, *Bailouts, Buy-Ins, and Ballyhoo*, 52 CHALLENGE 36, 48-51 (2009) (federal TARP authority, supplementable if necessary by eminent domain authority, to purchase mortgage loans and MBS); Howell Jackson, Op-Ed, *Build a Better Bailout*, CHRISTIAN SCIENCE MONITOR, Sept. 25, 2008, http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html [http://perma.cc/WH59-L5HH] (federal eminent domain authority to purchase home mortgage loans); Brad Miller, *UnHAMPered*, NEW REPUBLIC, Feb. 24, 2010, http://www.newrepublic.com/article/unhampered [http://perma.cc/9LMQ-T5AT] (federal eminent domain authority to purchase mortgage loans); Robert C. Hockett, *Six Years On and Still Counting: Sifting Through the Mortgage Mess* 0, 5, 28, 41-44, 54 (Cornell Legal Stud. Res. Paper No. 12-11, Mar. 26, 2012), http://ssrn.com/abstract=2029262 [http://perma.cc/TT5N-7Q4R] (state eminent domain authority to purchase mortgage loans); Lauren E. Willis, *Stabilize Home Mortgage Borrowers, and the Financial System Will Follow* (Loyola-LA Legal Studies Paper No. 2008-28, Sept. 24, 2008), http://ssrn.com/abstract=1273268 [http://perma.cc/AN8J-8CC4] (federal eminent domain authority to purchase homes); Robert Hockett, *Treasury's Planned 'Bailout' is FHA's Bailiwick*, DORF ON LAW (Sept. 25, 2008), http://www.dorfonlaw.org/2008/09/treasurys-planned-bailout-is-fhas.html [http://perma.cc/7WBC-X4ME] (federal TARP authority, supplementable if necessary by eminent domain authority, to purchase mortgage loans and MBS); *see also infra* notes 7, 10, and 11 (state eminent domain authority to purchase mortgage loans).

4. *See New York Eyes Hockett's Eminent Domain Approach to Underwater Mortgage Debt*, CORNELL UNIV. L. SCH. SPOTLIGHTS (July 3, 2014), http://www.lawschool.cornell.edu/spotlights/NY-Hockett-Underwater-Mortgage-Debt.cfm [http://perma.cc/AL8K-J6DG] (providing links to recent media coverage of New York City's interest in the plan). "Negative equity" refers to the amount by which an amount owed on a home mortgage loan exceeds the value of the home purchased with the loan. Loans that have negative equity in this sense are often said to be "underwater."

5. As elaborated below, underwater loans are subject to high default risk, such that lowering principal on them can raise their actuarial values. However, many are also subject to contractual and structural impediments that prevent even write-downs that are both debtor- and creditor-friendly.

I. NECESSITY OF THE EMINENT DOMAIN PLAN

The necessity of the eminent domain approach to underwater home mortgage debt rests on two facts. The first is that principal—that is, the base amount owed—on underwater home mortgage loans must be written down in order to prevent default, foreclosure, and consequent neighborhood blight. The second is that, for a large fraction of underwater loans, eminent domain is the only way to access the loans so as to write down the debt. I explain both points below.

A. *Necessity of Principal Write-Downs*

Twenty percent of the nation's outstanding mortgage loans remain deeply underwater, meaning that borrowers owe significantly more on these loans than the homes that they purchased with the loans are now worth.[6] This is true despite the fact that the national housing price crash began more than seven years ago. Moreover, because underwater loans are heavily concentrated in low-to-middle income neighborhoods and communities of color, many American cities suffer underwater mortgage loan rates near or above 50%.[7]

Although unique in many respects, New York City has not escaped the negative equity problem. Manhattan fares well, but the other four boroughs do not. According to a June 2014 report by New York Communities for Change and the Mutual Housing Association of New York, 60,000 NYC home-owning families have underwater loans, and this constitutes 12% of total outstanding

6. Another twenty percent of the nation's outstanding mortgage loans are *effectively* underwater, meaning that loan balances are so close to depressed home prices as to leave homeowners with little-to-no positive equity in their homes. This in turn means that they cannot refinance their home loans or sell their homes with a view to pursuing job opportunities in other cities. *See, e.g.*, Robert C. Hockett, *Geithner, Mian and Sufi on the Crisis*, THE HILL: FIN. BLOG (May 28, 2014, 6:04 AM), http://thehill.com/blogs/pundits-blog/finance/207353-geithner-mian-and-sufi-on-the-crisis-monday-morning-quarterbacking [http://perma.cc/8ZWK-D5L6].

7. *See, e.g.*, Robert Hockett, *Accidental Suicide Pacts and Creditor Collective Action Problems: The Mortgage Mess, the Deadweight Loss, and How to Get the Value Back*, 98 CORNELL L. REV. 55, 66-71 (2013) [hereinafter Hockett, *Accidental*]; *see also* Robert Hockett & John Vlahoplus, *A Federalist Blessing in Disguise: From National Inaction to Local Action on Underwater Mortgages*, 7 HARV. L. & POL'Y REV. 253 (2013).

NYC mortgage loans.[8] As elsewhere in the nation, communities of color are disproportionately represented in these statistics.[9]

One notable reason why such numbers are worrying is that deeply underwater loans have an approximately 70% chance of defaulting and ultimately going into foreclosure.[10] This means there is an approximately 70% chance that the borrowers on these loans will lose their homes; that the lenders on the loans will lose their investments and incur millions of dollars in loan losses and foreclosure costs; that the borrowers' neighbors will undergo neighborhood blight and gaping property value losses; and that the cities in which the blighted neighborhoods are located will incur onerous property abatement costs even as property tax bases precipitously decline.[11] Moreover, reduced spending by underwater homeowners is likely to affect local economies.[12] Such far-reaching effects mean that when underwater loans *can* be written down, they typically *are* written down, because doing so benefits all stakeholders.[13] The problem is that most underwater mortgage loans *cannot* currently be written down, and this provides an impetus for the eminent domain plan.

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8. *See Thousands of Homeowners Still Drowning in Underwater Mortgages: How Toxic Loans Keep Fueling Foreclosures and the Need for Eminent Domain*, N.Y. COMMUNITIES FOR CHANGE (June 2014), http://www.popularresistance.org/wp-content/uploads/2014/07/NYC-Foreclosure-Eminent-Domain-Report-June-2014.pdf [http://perma.cc/4RY2-HX45].

9. *Id.*; *see also* Robert Hockett, *Post-Bubble Foreclosure-Prevention and Mitigation Options in Seattle* (Sept. 16, 2013) (unpublished manuscript), http://ssrn.com/abstract=2326775 [http://perma.cc/GLE8-VHRH] [hereinafter Hockett, *Post-Bubble*]; sources cited *supra* note 7.

10. *See* Hockett, *Accidental*, *supra* note 7, at 66; Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt*, 19 CURRENT ISSUES IN ECON. & FIN. 1, 4 (2013), http://www.newyorkfed.org/research/current_issues/ci19-5.pdf [http://perma.cc/NZ4J-MEVN] [hereinafter Hockett, *Paying Paul*]; *Form 10-Q*, FED. NAT'L MORTG. ASS'N (FANNIE MAE) 111 (2012), http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q22012.pdf [http://perma.cc/5D-D5LW] (projecting near-70% default rates for subprime and alt-A mortgage loans of the kind that figure largely in private label securitized mortgage loan portfolios).

11. See Robert C. Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121 (2012) [hereinafter Hockett, *It Takes a Village*], for more on the relations among foreclosure, neighboring property prices, and neighborhood blight.

12. *See id.* at 134; *see also* sources cited *supra* notes 7, 10.

13. See sources cited *supra* notes 7, 10, 11, for more on when and how write-downs occur. See also *Strengthening the Housing Market and Minimizing Losses to Taxpayers: Hearing Before the Subcomm. on Housing, Transportation & Community Development of the S. Comm. on Banking, Housing & Urban Affairs*, 112th Cong. (2012) (statement of Laurie S. Goodman, Senior Managing Dir., Amherst Sec.).

B. Impediments to Write-Downs Without Eminent Domain

There are several reasons that underwater mortgage loans cannot typically be voluntarily written down. Most stem from the complex legal and financial structures developed by the private mortgage lending industry during the recent housing price bubble.[14]

The principal relevant structure is that of the private-label securitized (PLS) mortgage loan.[15] Pursuant to this structure, loans, once extended, are pooled into a legal trust managed by a trustee. The trustee ensures that loan servicers collect monthly mortgage payments from borrowers, which the trustee then disburses to the investors—typically bondholders—who supplied the initial funds used to purchase the loans pooled in the trust.[16] This structure thus interposes a middleman—the trust—between the borrower (the homeowner) and the creditor (the bondholder). As a result, the creditor and debtor cannot voluntarily work out a principal write-down on an underwater mortgage loan even when doing so would be mutually beneficial.

This write-down problem could have been avoided had the contracts pursuant to which mortgage loans were pooled and securitized during the housing bubble years provided for large-scale principal write-downs by trustees or servicers in the event of a housing price crash. Unfortunately, they did not.[17] The securitization industry apparently did not anticipate a nationwide housing price crash of the scale that occurred. Like many others, individuals in the industry seem to have believed that housing prices could only go up.[18] And unfortunately, creditors are too geographically scattered to come together to amend the contracts in order to authorize trustees or servicers to modify more underwater loans than they are presently authorized to do.[19] In consequence, mortgage loan securitization contracts now function as unintended "suicide pacts" among creditors.[20]

The situation is tragic in the classical Greek sense of the word: everyone loses, but no interested party is able to change things. Only a party empowered

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14. See Hockett, *It Takes a Village*, *supra* note 11, at 139-42, for comprehensive enumeration and discussion of the impediments.

15. *Id.*; *see also* Hockett, *Six Years On and Still Counting*, *supra* note 3; *supra* notes 7, 10 & 11.

16. *See* Hockett, *It Takes a Village*, *supra* note 11; *see also* Hockett, *Six Years On and Still Counting*, *supra* note 3; sources cited *supra* notes 7, 10.

17. Such contracts at best seem to permit write-downs or sales of only small percentages of pooled loans. *See* Hockett, *Paying Paul and Robbing No One*, *supra* note 10, at 3; Hockett, *It Takes a Village*, *supra* note 11, at 139-40.

18. Hockett, *Paying Paul and Robbing No One*, *supra* note 10, at 3 (noting that "few foresaw a marketwide housing price bust"); Hockett, *It Takes a Village*, *supra* note 11, at 126-128.

19. Hockett, *It Takes a Village*, *supra* note 11, at 139.

20. *See* sources cited *supra* notes 6, 9, 11.

to act on behalf of all interested parties—in the present case, a governmental authority—is able to end the tragedy and solve the problem for all.[21]

II. MECHANICS OF THE EMINENT DOMAIN PLAN

The eminent domain plan would solve the underwater mortgage loan and associated foreclosure problem by substituting a governmental authority, which has the power to amend dysfunctional contracts, for the powerless middleman—that is, the loan servicer or securitization trustee. The governmental authority would thereby enable the homeowner and bondholder to do for themselves what contract-bound trustees and servicers cannot do for either: rewrite underwater mortgage loans in a manner that salvages value for both, maintaining homeownership and rescuing communities in the process.[22]

The key move in the eminent domain plan is for the governmental authority to purchase underwater loans out of the legal trusts in which the loans are presently locked.[23] Once the loans are out of the pool and no longer subject to the modification restrictions imposed by the current securitization contract, they can be modified in a manner that benefits homeowner, bondholder, and community alike.[24] The modified loans then can be re-conveyed to the bondholders, who supply the funds used by the governmental authority to purchase the loans that are to be modified on their behalf and on behalf of the homeowners. This will leave bondholders with more valuable assets than they had before, since they are now more or less free of default risk, and will leave homeowners with positive equity in their homes. It will also, for the reasons noted above, benefit neighbors, municipalities, and local economies.[25]

Because New York and other cities bear the brunt of the nation's ongoing underwater mortgage loan troubles, cities are well-situated to act as the gov-

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21. *See* Hockett, *Paying Paul and Robbing No One*, *supra* note 10, at 2-3; Hockett, *It Takes a Village*, *supra* note 11, at 146-48.

22. *See* Hockett, *It Takes a Village*, *supra* note 11; Hockett, *Paying Paul and Robbing No One*, *supra* note 10.

23. *See* Hockett, *It Takes a Village*, *supra* note 11, at 28-35. Eminent domain is suggestively—and more helpfully—called "compulsory purchase" in the United Kingdom. *See, e.g.*, BARRY DENYER-GREEN, COMPULSORY PURCHASE AND COMPENSATION (8th ed. 2005).

24. The homeowner benefits by avoiding default and foreclosure and retaining the home. The bondholder benefits by being able in effect to enter into value-salvaging write-downs of needlessly high-risk underwater loans. The community benefits from the blight-preventing, property-value-maintaining, and neighborhood-stabilizing effects that foreclosure-prevention yields. *See* sources cited *supra* notes 7, 10, 11; *see also* Robert C. Hockett, *Response: The Eminent Domain Solution*, BOS. REV., Nov.-Dec. 2012, http://www.bostonreview.net/forum/sweet-forgiveness/eminent-domain-solution [http://perma.cc/KA4V-52FD].

25. *See supra* note 11 and accompanying text.

ernmental authorities just noted.[26] In particular, cities with significant concentrations of underwater mortgage loans in specific neighborhoods or zip code areas will have both the greatest reason to adopt the plan and the greatest justification to pursue it, since such areas are most vulnerable to foreclosure-led blight of the sort that tends to prompt and warrant legal use of the eminent domain power.[27] To adopt the plan in a legal manner, cities must satisfy two requirements: first, they must provide a public purpose for exercising their eminent domain authority; second, they must pay fair value for the loans they purchase from trusts.[28]

Because current bondholders benefit from loan write-downs, these bondholders, supplemented if necessary by federal funds, nonprofits, and other investors, have reason to supply the funds necessary to pay "fair value."[29] Moreover, because modifying mortgages will allow cities both to end their foreclosure and homelessness crises and to reverse neighborhood blight—arguably the most well established "public purpose" to justify the use of eminent domain authority—the cities will likely satisfy the "public purpose" requirement.[30]

The following diagram represents the foregoing description of the eminent domain plan pictorially, starting from the upper left and following the single-headed arrows counterclockwise.[31]

26. See Hockett, *Accidental*, *supra* note 7, at 66-69; and Hockett & Vlahoplus, *supra* note 7, at 256-59, for more detail on the locally concentrated nature of the problem.

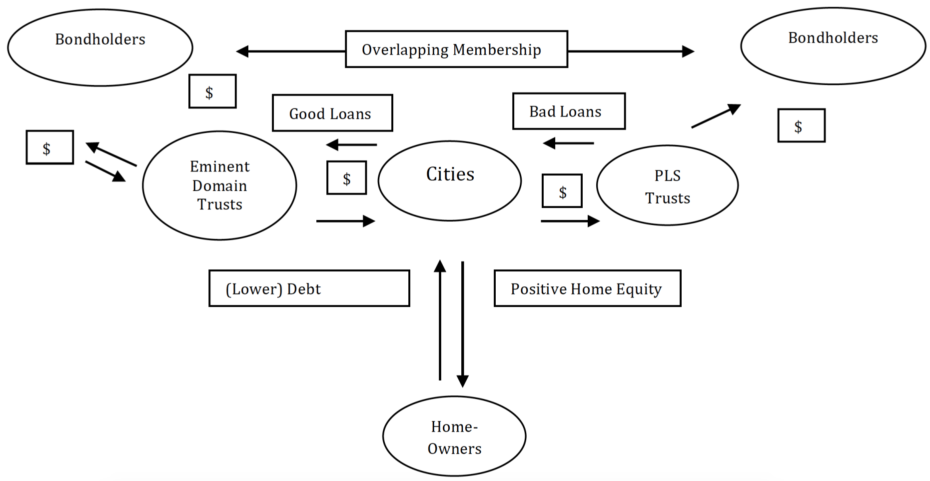
27. *See* Hockett, *It Takes a Village*, *supra* note 11, at 157-71, for fuller elaboration of the legal and practical significance of blight on municipal exercises of eminent domain authority.

28. These are requirements both of the Takings Clause of the U.S. Constitution's Fifth Amendment and of state constitutions and statutory codes. *See* U.S. CONST. amend. V ("nor shall private property be taken for public use without just compensation"); Hockett, *Paying Paul*, *supra* note 10, at 6; Hockett, *It Takes a Village*, *supra* note 11, at 167-70.

29. *See* Hockett, *Paying Paul*, *supra* note 10, at 6-7; Hockett, *It Takes a Village*, *supra* note 11, at 152-56 & nn.101-104. In effect, the current bondholders pay themselves for the loans that the cities purchase out of the trusts and then modify and re-convey to the bondholders. This is simply an indirect, two-step way of writing down loans that would ordinarily be written down directly, in a single step, were it not for the middleman that is the trust—which bubble-era securitization arrangements inserted between ultimate creditors and debtors.

30. *See* Hockett, *Accidental*, *supra* note 7, at 72-73 & n.92; Hockett, *Paying Paul*, *supra* note 10, at 6 & n.14; Hockett, *It Takes a Village*, *supra* note 11, at 167-70 (discussing the particular significance of blight in establishing "public use" or "public purpose").

31. *See* Hockett, *Paying Paul and Robbing No One*, *supra* note 10, at 5 (providing a similar diagram).



Following the arrows, current bondholders convey funds to eminent domain trusts established and managed by cities or by the joint powers authorities (JPAs) that they have established. The trusts then purchase deeply underwater (in the diagram, "bad") loans out of current PLS trusts. Following this, the cities, advised if necessary by the Federal Housing Agency (FHA) or legal and financial professionals, work with homeowners to write new mortgages, allowing borrowers to replace their current negative equity loans with new, modestly positive ones.[32] Finally, the new (in the diagram, "good") loans are conveyed to city-established trusts, which distribute monthly loan payments to all parties (including current bondholders) that have worked with the cities to supply the funds used to purchase the "bad" loans out of the original trusts.

The diagram represents merely the basic structure of the plan. Additional details of the plan as adopted by various cities will be determined by those cities themselves as they develop their own variants.[33] These questions include (a) how to select and appraise the fair values of qualifying loans;[34] (b) how to ap-

32. Preferably "plain vanilla," federally insured 30-year fixed-rate mortgages of the kind that FHA itself effectively invented in the 1930s, which dominated the American mortgage market until the coming of "subprime" PLS loans introduced by the securitization industry and predatorily lent during the bubble years of the late 1990s and early 2000s. Freeing the loans from their PLS trusts, it bears noting, also renders them amenable to the FHA Short Refinance and HAMP Principal Reduction Alternative programs. *See* Hockett, *Accidental*, *supra* note 7; Hockett, *It Takes a Village*, *supra* note 11; Hockett, *Paying Paul and Robbing No One*, *supra* note 10.

33. For a sample set of proposals specifically requested for one city—Seattle—see, for example, Hockett, *Post-Bubble Foreclosure-Prevention and -Mitigation Options in Seattle*, *supra* note 9.

34. The city of Richmond, California has retained for this purpose the appraisal firm most often used by the banking and other financial service industries: the Mortgage Industry Appraisal Corporation ("MIAC"). *See* Letter from City Manager, City of Richmond CA, to Mortgage Servicers (July 31, 2013), https://www.aclu.org/files/racialjustice/foia/04012014/45-%20City

proach current bondholders and other investors, as well as federal agencies offering assistance to foreclosure-plagued cities;[35] (c) how to commence and carry out the legal proceedings pursuant to which local eminent domain authority is exercised;[36] (d) how to modify and then re-securitize qualifying loans once purchased; (e) how to approach and work with homeowners throughout the process;[37] and (f) how to compensate current bondholders and other investors at appropriate stages.

These questions can be addressed in many different ways, as I have detailed elsewhere.[38] For example, New York City might combine its version of the program with a land bank program for already-foreclosed homes, as I have recommended to other cities such as Seattle.[39] In this Essay, however, I limit myself to conveying only the fundamentals of the plan.

III. LEGALITY AND POLICY ADVISABILITY OF THE EMINENT DOMAIN PLAN

Although the eminent domain plan appears to be a "win-win," some have argued against it. In this Part, I describe the arguments of those who do not favor the plan and highlight the inadequacies of these views.

%20of%20Richmond%20sample%20letter%20with%20General%20Counsel's%20notes%20%20redacted(Redacted%20pursuant%20FOIA%20Rule%20(b)(5))%207-31-13.pdf [http://perma.cc/RXX5-UVTM]; *see also* Susanna Kim, *Richmond, Calif. Proponents and Critics: Q & A*, ABC NEWS (Aug. 2, 2013) http://abcnews.go.com/blogs/business/2013/08/richmond-calif-eminent-domain-proponents-critics-qa/ [http://perma.cc/UGL3-FMR3].

35. The author and various colleagues—some in housing and community advocacy groups, others in the mortgage and financial services industries—have worked together in a number of states across the country to perform the function of making these introductions.

36. Thus far, the author and various colleagues—most of them local attorneys in a number of states across the country—have provided this information gratis to all cities that have chosen to pursue the plan.

37. Housing advocacy groups such as the Home Defender's League, along with other housing and community advocacy groups that are active in most of the nation's hardest-hit cities, will likely be particularly helpful here. So, in all likelihood, will be the FHA.

38. *See* Hockett, *It Takes a Village*, *supra* note 11; Hockett, *Paying Paul*, *supra* note 10.

39. *See* Hockett, *Post-Bubble*, *supra* note 9. Land banks purchase foreclosed and repossessed homes from financial institutions with a view to converting them to low-income housing units available for sale or for rent. They can purchase these homes in voluntary market transactions or, if endowed with governmental authority, by eminent domain. In theory, such homes can be sold back or rented to their original inhabitants if the latter can be found. For more on such programs, see *id*.

A. *The Contract Clause*

First, some opponents of the plan argue that purchasing local loans through eminent domain would violate the Contract Clause of the U.S. Constitution.[40] But the Supreme Court, in its leading and most recent decision interpreting the Contract Clause, unanimously ruled out the Clause's applicability to exercises of eminent domain. In *Hawaii Housing Authority v. Midkiff*, the Court held that "the Contract Clause has *never* been thought to protect against the exercise of the power of eminent domain."[41] City attorneys, therefore, should not be fazed if faced with Contract Clause arguments raised by objectors to the eminent domain plan.[42]

B. *The Due Process Clause*

Some opponents of the eminent domain plan also argue that the loans that cities would purchase pursuant to the plan would be legally located outside those cities and accordingly outside their jurisdiction.[43] In consequence, the opponents continue, cities' exercising their eminent domain authority over the loans would violate the Due Process Clause of the U.S. Constitution.[44] Supreme Court and other court decisions that apply to debt instruments, however, indicate that loans are, in general, legally located where borrowers are domiciled,[45] while mortgage loans in particular are legally located where the

40. *See, e.g.*, Memorandum from O'Melveny & Myers, LLP, to Sec. Indus. & Fin. Mkts. Ass'n 2, 8-9 (July 16, 2012), http://www.sifma.org/issues/item.aspx?id=8589939523 [http://perma.cc/4PLS-T86W]. This memorandum does not cite Supreme Court authority on the applicability of the Clause to municipal uses of eminent domain authority.

41. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243 n.6 (1984) (emphasis added).

42. In two suits against Richmond, California in August 2013, industry groups' lawyers tried to use the Contract Clause argument, finally citing to *Midkiff* and attempting to distinguish it. Plaintiffs' Motion for Preliminary Injunction at 15-16 n.11, Wells Fargo Bank, Nat'l Ass'n v. City of Richmond, No. C 13-03663 CRB (N.D. Cal. Sept. 16, 2013). Both suits were dismissed soon after being filed. *See* Wells Fargo Bank, Nat'l Ass'n v. City of Richmond, No. C 13-03663 CRB (N.D. Cal. Sept. 16, 2013); Bank of New York Mellon v. City of Richmond, No. C 13-03664 CRB, 2013 WL 5955699 (N.D. Cal. Nov. 6, 2013).

43. *See, e.g.*, Plaintiffs' Motion for Preliminary Injunction, *supra* note 42.

44. *See, e.g.*, *id.*

45. *See, e.g.*, Rush v. Savchuk, 444 U.S. 320 (1980); Harris v. Balk, 198 U.S. 215, 222 (1905); Chicago, R.I. & P. Ry. Co. v. Sturm, 174 U.S. 710, 714 (1899). See also typical state UCC provisions, *e.g.*, N.M. STAT. ANN. § 42-9-3 ("The situs of debts and obligations for the purpose of attachment shall be the domicile of the debtor or obliger and the situs of intangible interests in property, real or personal, legal or equitable, shall be the place where such property is located.").

mortgaged properties securing the loans are located.[46] In the case of home mortgage loans, of course, both standards converge on the same result. New York City home mortgage loans are legally located in and subject to the jurisdiction of New York; San Francisco home mortgage loans are legally located in and subject to the jurisdiction of California; and so on.[47]

c. The Dormant Commerce Clause

Some opponents of the plan also argue that municipal use of eminent domain would violate the Dormant Commerce Clause by (a) regulating loans located outside of city limits, (b) discriminating against out-of-state financiers, and (c) unnecessarily burdening interstate commerce.[48] As noted above, however, under applicable precedent the loans are legally located in the cities that will be taking them in eminent domain. The cities, moreover, will not be engaging in regulation, let alone regulating out-of-state creditors differently than in-state creditors or otherwise burdening commerce, as a Commerce Clause violation would require.[49] Indeed, given the drag that unmodifiable toxic loans impose upon mortgage markets, clearing such loans out of PLS trusts would actually *enable* commerce.[50]

D. The Federal and State Takings Clauses

Another set of legal arguments proffered against the eminent domain plan is that there cannot be any public purpose in having a city purchase underwater mortgage loans and that it is not possible for the cities to pay fair value for the loans—both of which the U.S. and all state constitutions require of government takings.[51] But as noted in Part II, rescuing a local community from blight,

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46. *See, e.g.*, Carpenter v. Longan, 83 U.S. 271, 274 (1872); *Hyde v. Mangan*, 88 Cal. 319, 327 (1891); Eaton v. McCall, 29 A. 1103, 1104 (Me. 1894) ("[D]isposition of real estate, whether by deed, descent, or any other mode, must be governed by the law of the state where the same is situated"); *see generally* EUGENE S. SCOLES & PETER HAY, CONFLICT OF LAWS § 19.1, at 743 (2d ed. 1992).

47. *See* Hockett, *supra* note 11, at 165.

48. *See, e.g.*, Memorandum from O'Melveny & Myers, *supra* note 40; sources cited *supra* note 42.

49. *See* Robert Hockett, Memorandum on Inapplicability of the 'Dormant' Commerce Clause to Municipal Exercise of Eminent Domain Authority to Purchase Underwater Mortgage Loans (May 2013) (on file with author). The author prepared this memorandum to supply to any city officials or advocates who might have to rebut plan opponents' Commerce Clause argument.

50. *Id.*

51. *See, e.g.*, Memorandum from O'Melveny & Myers, *supra* note 40; sources cited *supra* note 42.

crime, municipal bankruptcy, and other ravages wrought by thousands of deeply underwater home mortgage loans is an established public purpose under both federal and most state court precedent.[52] Furthermore, courts generally accept a community's determination of public purpose as long as it bears a rational relation to a conceivable public purpose.[53]

As for whether it is possible to pay fair value for the loans, it is not only *possible* to pay the full value of the loans as noted in Part III, it is also constitutionally *required* to do so under both federal and state law. The eminent domain plan provides for full value to be paid, as discussed in Part II.

E. The Slippery Slope Argument

Some industry representatives make the policy argument that use of the eminent domain authority to address the underwater mortgage loan crisis will set us on a slippery slope at the bottom of which cities exercise the eminent domain power much too broadly.[54] History, however, does not support this claim. The eminent domain authority has already been used in this nation for centuries to purchase many intangible assets, including railroad stocks, mortgage liens, insurance policies, bond covenants, and even sports franchises and going concern values of firms.[55] This point seems to be little-known, and this may arguably be evidence that such uses of eminent domain authority have natural legal limits and do not result in government overreach.

F. The Mortgage Credit Withdrawal Argument

Another policy argument made by some members of the securitization industry is that using eminent domain to purchase loans will dry up the sources of mortgage credit, rendering the American dream of homeownership unattainable.[56] The financial services industry and its legislative supporters have

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52. *See supra* notes 29-33 and accompanying text (discussing the significance of blight-prevention and blight-mitigation in the exercise of the eminent domain authority).

53. *See* Hockett, *supra* note 11, at 167-70.

54. *See, e.g.*, Derek Prall, *Cities Explore Eminent Domain To Help Homeowners*, AMERICAN CITY & COUNTY (Dec. 4, 2013), http://americancityandcounty.com/housing/cities-explore-eminent-domain-help-homeowners [http://perma.cc/QF2V-WR6R] ("'Where do you stop?' Cameron asked, adding, 'If we do it with homes, why couldn't we do it with credit cards?'" (quoting Tim Cameron, director of the Securities Industry and Financial Markets Association)).

55. *See* Hockett, *It Takes a Village*, *supra* note 11, at 164.

56. *See, e.g.*, SEC. INDUS. & FIN. MARKETS ASS'N (SIFMA), *Overview: Eminent Domain Resource Center*, http://www.sifma.org/eminent-domain [http://perma.cc/KCF9-5XC4]; *see also Fix for Mortgages: Condemn Them?*, CNBC (July 16, 2012, 4:42 PM), http://video.cnbc

made this kind of claim against regulatory and consumer protection proposals emerging from national, state, or municipal legislatures.[57]

One problem with this argument is that private credit has not flowed to non-wealthy mortgage borrowers since the crash. Federal lenders and guarantors are nearly the only game in town, and they are likely to remain so until the underwater PLS loan logjam is cleared.[58]

Another problem with the credit withdrawal argument is that it characterizes a benefit as a burden. The housing bubble was, like most of the more devastating bubbles through history, the upshot of an over-extension of credit.[59] Lenders extended excess credit through reverse redlining and other predatory lending practices perpetrated or aided and abetted by participants in the securitization industry itself.[60] Hence the securitization industry's warning[61] that credit might not be overextended in the future is a warning of something that might well be desirable.

G. The Endless Litigation Argument

A third policy argument proffered by industry opponents of the eminent domain plan is that embarking on the plan will confront municipalities with

.com/gallery/?video=3000103238&play=1# [http://perma.cc/8MTJ-6CXL] (statements of SIFMA CEO Tim Ryan).

57. *See, e.g.*, Holden Lewis, *Georgia's on Mortgage Industry's Mind*, BANKRATE (Dec. 19, 2002), http://www.bankrate.com/brm/news/mortgages/20021219a.asp [http://perma.cc/PDA8-5HDF] (noting that industry groups warn Georgia's new anti-predatory lending law will "harm the people it was designed to protect" by drying up mortgage credit); *see also* Brad Tuttle, *Will the New Consumer Financial Protection Agency Actually Protect Consumers?*, TIME (June 24, 2010), http://business.time.com/2010/06/24/what-the-heck-is-the-new-consumer-financial-protection-agency-going-to-do-anyway [http://perma.cc/75PC-G3MB] ("Republican critics call the watchdog agency (which has yet to actually have a chance to do anything) a 'monster' and the 'Office for Credit Contraction and Job Loss.'").

58. *See, e.g.*, Tim Ryan, *Mortgage Seizures Are a Bad Idea*, SIFMA (July 26, 2014), http://www.sifma.org/pennsylvania-and-wall/mortgage-seizures-are-a-bad-idea [http://perma.cc/AP36-289N] ("Currently, 95% of mortgages are backed by government entities such as Fannie Mae and Freddie Mac."); *see also* Christopher Matthews, *Feds Say No Way to Using Eminent Domain To Help Underwater Homeowners*, TIME (Aug. 9, 2013), http://business.time.com/2013/08/09/feds-say-no-way-to-using-eminent-domain-to-help-underwater-homeowners [http://perma.cc/BXZ7-XVKS] ("As it stands now, Fannie and Freddie own or guarantee 90% of all new mortgages issued in the U.S.").

59. *See* Hockett, *Paying Paul*, *supra* note 9, at 8.

60. For more on this, see Richard Vague & Robert Hockett, *Debt, Deflation, and Debacle: Of Private Debt Write-Down and Public Recovery*, GLOBAL INTERDEPENDENCE CTR. (Apr. 9, 2013), http://cdn.interdependence.org/wp-content/uploads/2013/04/Debt-Deflation-and-Debacle-RV-and-RH1.pdf [http://perma.cc/VGK2-UE63].

61. *See Fix for Mortgages: Condemn Them?*, *supra* note 56, ("[SIFMA] run[s] the TBA market . . . .").

"costly and lengthy litigation."[62] This claim is a bit like the credit withdrawal argument in that it purports to be a prediction when in fact it is a threat. Fortunately, as with credit withdrawal, the threat is an idle one.

First, as soon as the first cities begin to condemn loans pursuant to the eminent domain plan and secure rapid dismissals of industry group suits—as Richmond, California did to two suits merely days after they were filed in the summer of 2013[63]—groups that sue are likely to find few followers. Second, regional offices of the American Civil Liberties Union (ACLU) have already begun supporting cities in their eminent domain plans, meaning that cities need not fret that the "endless litigation" will be expensive to them.[64] Indeed, in light of both the weakness of opponents' likely legal arguments and the support that the cities now have from the ACLU, it would seem that would-be plaintiffs are the ones who face the prospect of exorbitant legal expenses incurred for no appreciable purpose.

H. Putative Federal Objections

From the summer of 2012 to the summer of 2013, some securitization industry groups succeeded in obtaining the sympathetic ear of then-Acting Director of the Federal Housing Finance Agency (FHFA) Edward DeMarco.[65] DeMarco was widely known to object to mortgage loan principal reductions of *any* sort on ideological grounds.[66] He rejected reductions for the portfolios that

62. *See, e.g.*, *SIFMA Statement to the San Bernardino, CA Joint Powers Authority on Eminent Domain Proposal*, SEC. INDUSTRY & FIN. MARKETS ASS'N (Aug. 16, 2012), http://www.sifma.org/news/news.aspx?id=8589939947 [http://perma.cc/6KY9-QSJF] ("'We also believe that the use of eminent domain raises serious legal and constitutional issues that subject the County to substantial liability and would, at a minimum, result in costly and lengthy litigation.").

63. *See* Wells Fargo Bank, Nat'l Ass'n v. City of Richmond, No. C 13-03663 CRB (N.D. Cal. Sept. 16, 2013); Bank of New York Mellon v. City of Richmond, No. C 13-03664 CRB, 2013 WL 5955699 (N.D. Cal. Nov. 6, 2013).

64. *See, e.g.*, Peter Schroeder, *ACLU Sues Housing Regulator over Eminent Domain Blockade*, HILL (Dec. 5, 2013, 12:51 PM), http://thehill.com/policy/finance/192200-aclu-sues-housing-regulator-over-eminent-domain-blockade [http://perma.cc/PG77-3M87].

65. *See, e.g.*, Christopher Matthews, *Is Fannie and Freddie Honcho Ed DeMarco 'America's Most Dangerous Man?'*, TIME, Apr. 11, 2012, http://business.time.com/2012/04/11/is-fannie-and-freddie-honcho-ed-demarco-americas-most-dangerous-man [http://perma.cc/4A3L-PEB8] (describing DeMarco's resistance to principal reduction); *SIFMA Shares FHFA Concerns with Use of Eminent Domain to Restructure Mortgages*, SEC. INDUSTRY & FIN. MARKETS ASS'N (Aug. 8, 2012), http://www.sifma.org/news/news.aspx?id=8589939853 [http://perma.cc/RT68-A6AJ] (commending the FHFA for "recognizing the serious concerns market participants have voiced over the proposed use of eminent domain to seize mortgage notes and restructure them").

66. One good overview of the controversy surrounding Mr. DeMarco and its significance is Ben Hallman, *Obama's Housing Policy: Fix Is Crucial to President's Economic Legacy*, HUFFINGTON

the FHFA controlled even after learning from FHFA economists that principal write-downs on underwater loans in the Fannie and Freddie portfolios would save those agencies 1.7 billion dollars in otherwise inevitable default and foreclosure expenses.[67] DeMarco nevertheless issued vague warnings that the FHFA might intervene in its capacity as conservator for Fannie and Freddie against cities that employed the eminent domain plan.[68] Industry groups used DeMarco's statement to claim that the federal government opposed the eminent domain plan.[69]

It would not, however, have been within the FHFA's legal authority to do what DeMarco suggested.[70] Moreover, the ACLU and I were prepared to challenge the FHFA on behalf of cities pursuing eminent domain solutions.[71] In

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POST (Nov. 9, 2012, 8:48 AM), http://www.huffingtonpost.com/2012/11/09/obama-housing-fix-crucial-president-economic_n_2090061.html [http://perma.cc/8VQX-GDRC]; *see also* Ben Hallman, *Ed DeMarco, Top Housing Official, Defies White House; Geithner Fires Back*, HUFFINGTON POST (July 31, 2012, 2:29 PM), http://www.huffingtonpost.com/2012/07/31/ed-demarco-principal-reduction_n_1724880.html [http://perma.cc/G96R-DRJ2] (describing DeMarco's resistance to principal reduction); Max Nisen, *Top Housing Official Ed DeMarco Rejects Principal Reduction and Tim Geithner Is Not Pleased*, BUS. INSIDER (July 31, 2012, 4:28 PM), http://www.businessinsider.com/ed-demarco-rejects-principal-reduction-proposal-2012-7 [http://perma.cc/X6ZB-MLA3] (same). DeMarco's speeches from the era discuss the putative "moral hazard" risk that principal-reduction would entail. *See Remarks of Edward J. DeMarco, Acting Director, FHFA, Before the Boston Security Analysts Society*, FED. HOUSING FIN. AGENCY (Apr. 4, 2012), http://www.fhfa.gov/Media/PublicAffairs/Pages/Remarks-Edward-J-DeMarco-Acting-Director-FHFA-Before-the-Boston-Security-Analysts-Society.aspx [http://perma.cc/Y26F-RB2F].

67. *See* Clea Benson & Cheyenne Hopkins, *DeMarco Says Principle Writedowns May Save FHFA $1.7 Billion*, BLOOMBERG NEWS (Apr. 10, 2012, 5:00 PM), http://www.bloomberg.com/news/2012-04-10/demarco-expected-to-release-new-mortgage-forgiveness-analysis.html [http://perma.cc/BKZ7-ZHPK].

68. Ben Hallman, *Edward DeMarco Threatens Action Against Communities Weighing Principal Reduction Proposal*, HUFFINGTON POST (Aug. 9, 2012), http://www.huffingtonpost.com/2012/08/09/edward-demarco-principal-reduction_n_1759767.html [http://perma.cc/K25J-UD2L].

69. *See, e.g.*, *MBA's Resource Center on Eminent Domain Use for Mortgage Property Seizures*, MORTGAGE BANKERS ASS'N, http://mortgagebankers.org/Advocacy/EminentDomainResourceCenter.htm [http://perma.cc/B4YE-4M4F] ("MBA agrees wholeheartedly with the Federal Housing Finance Authority (FHFA) that 'utilizing eminent domain in this way could undermine and have a chilling effect on the extension of credit' to prospective homeowners.").

70. For additional discussion of this point, see Robert Hockett, Memorandum on the Illegality of FHFA Threats Against Richmond, Cal. (Aug. 12, 2013) (unpublished manuscript) (on file with author). See also Kevin Whelan, *Members of Congress Stand up for Communities, Oppose Credit Discrimination Over Local Principal Reduction*, HOME DEFENDERS LEAGUE (Nov. 18, 2013), http://www.homedefendersleague.org/members_of_congress_stand_up_for_communities_doing_local_principal_reduction_oppose_credit_discrimination [http://perma.cc/VF8S-TFST].

71. *See, e.g.*, Schroeder, *supra* note 64.

consequence, the FHFA did little more than solicit public comment on the advisability of the eminent domain plan. And DeMarco was finally replaced earlier this year by a new permanent Director who favors principal reductions for underwater mortgage loans.[72] Finally, the "feds are against it" claim has never applied to any of the other federal instrumentalities with an interest in the nation's ongoing mortgage troubles, which can plausibly be thought to (a) favor principal reduction for underwater mortgage loans, and (b) maintain that municipal uses of the eminent domain authority for this purpose are essentially local matters in which the federal government should not intervene.[73]

CONCLUSION

The eminent domain approach to underwater home mortgage debt is urgently needed in many of the nation's hard-hit cities, including New York, and—I have argued—the principal legal or policy arguments made against implementing it lack plausibility.

The multitude of cities now studying or actively pursuing the plan offers evidence of its viability. We can accordingly expect more cities to act on the plan going forward. If New York now acts to lead this movement, as it well might,[74] one dares predict that many more cities will follow.

Robert Hockett is Edward Cornell Professor of Law, Cornell Law School; Fellow, The Century Foundation. He is an originator of the eminent domain approach to securitized underwater mortgage loans and a regular consultant on mortgage, finance-regulatory, and related matters to a variety of federal, state and local government legis-

72. *See, e.g.*, Hallman, *Obama's Housing Fix*, *supra* note 66; Jon Prior & MJ Lee, *Mel Watt Nomination Faces Long Odds*, POLITICO (May 1, 2013, 7:28 AM), http://www.politico.com/story/2013/05/mel-watt-to-head-fhfa-90816.html [http://perma.cc/8X6B-U7Q8]; Nick Timiraos, *Six Takeaways from Mel Watt's Speech on Housing*, WALL ST. J.: REAL TIME ECON. (May 13, 2014, 11:39 AM), http://blogs.wsj.com/economics/2014/05/13/six-takeaways-from-mel-watts-speech-on-housing [http://perma.cc/RB9X-ANCL] (on the neighborhood stabilization program).

73. This claim is grounded in the author's personal experience in some cases, while being a matter of public record in others. *See, e.g.*, Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Independent Community Bankers of America Annual Convention: Reducing Preventable Mortgage Foreclosures (Mar. 4, 2008), http://www.federalreserve.gov/newsevents/speech/bernanke20080304a.htm [http://perma.cc/9N4T-CAKK]; John Griffith, *The FHA Is on Board with Principal Reduction*, CENTER FOR AM. PROGRESS (June 11, 2012), http://www.americanprogress.org/issues/housing/news/2012/06/11/11699/the-fha-is-on-board-with-principal-reduction/ [http://perma.cc/AQK9-KGWY]; Hockett, *supra* note 6 (discussing the Treasury Department).

74. Both in the lead-up to and following the event referenced in *supra* note 4, multiple working discussions have taken place involving Council Members, Council Staff, housing advocacy groups, and the present author, and more are in planning.

lators and regulators as well as finance-concerned NGOs including Americans for Financial Reform and Public Citizen. This work is gratis, *and he is not in any way financially invested in the eminent domain plan.*

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