

Underwater Mortgages Deserve More Than Eminent Domain

Law360, New York (June 06, 2013, 11:22 AM ET) -- A number of industry groups^[1] raised concerns recently when Mortgage Resolution Partners (MRP) entered into contracts with two additional municipalities to formalize the use of eminent domain programs to seize or restructure underwater residential mortgages, which are often part of securitization trusts. In response to these actions, the industry groups sent joint letters to these municipalities outlining their concerns.

Background

The discussion of the use of eminent domain to seize underwater residential mortgages began last summer when several California municipalities began discussing the potential use of this power as a tool to kick-start local housing market recoveries and to assist homeowners who were struggling to pay their mortgages.

Under the proposals, local governments would take title to mortgages (not the underlying real property) and pay the mortgage holders “fair market value” using money provided by institutional investors. The government and investors would then issue new mortgages to homeowners by writing down the loan amounts to slightly below the fair market value of the home, so that distressed homeowners could lower their monthly payments and begin to rebuild equity in their homes. The restructured mortgages would then be sold to investors.^[2]

The movement to use eminent domain for this purpose is spearheaded by MRP, which recently added Richmond, Calif., and North Las Vegas, Nev., to its roster of participating jurisdictions. MRP appears to earn a \$4,500 fee on every loan that is restructured.^[3] In response to the growing acceptance of this practice, the industry groups have gone on the offensive, appealing to lawmakers and policymakers to explain why these policies may actually be illegal and detrimental to the local economies and housing markets where they are adopted.

Legal and Economic Questions

In addition to the Fifth Amendment issues that have previously been raised,^[4] recent joint industry letters^[5] to public officials in Richmond and North Las Vegas raised additional issues of state and local law. For example, the letters argue that in both California and Nevada, the eminent domain power of local municipalities only permits them to take the property of private owners who are domiciled within that municipality, and certainly not from owners who are not even within that state. The letters point out that as the mortgages, and not the underlying property, are the assets to be seized under these plans, this may lead to legal challenges.

Most residential mortgages are primarily held in securitization trusts, which themselves are likely not California entities. More importantly, the beneficiaries of these securitization trusts are national and international investors who are domiciled all over the country and the world. The letters caution that this will inevitably lead to complicated and costly legal battles over whether these municipalities had the right to seize the mortgages in the first place, which will only hinder the ability of individual homeowners and local housing markets to recover.

The letters also reiterated the destructive power the use of eminent domain would have on the housing and mortgage markets in those local markets and on the general economic recovery. The letters point out that any damage to the sanctity of contract between private parties, especially as between a borrower and a creditor, will undermine the ability of future borrowers to obtain mortgages on favorable terms, as creditors will be forced to change their underwriting standards in response, especially in communities which employ the use of eminent domain mortgage programs. The letters caution that this contraction of credit could significantly hamper the economic recovery which has begun in many areas.

The North Las Vegas letter also raised additional aspects of Nevada law that could prohibit the use of eminent domain in this manner. As a result of voter initiatives in 2006 and 2008, the Nevada Constitution contains additional restrictions on the use of eminent domain by municipalities. Specifically, the North Las Vegas letter states that it is against Nevada law to use eminent domain to directly or indirectly transfer property from one private party to another.

The North Las Vegas letter suggests that using eminent domain to seize underwater residential mortgages, however, would result in the direct transfer of property from the securitization trusts or other secured parties to MRP or other private parties. Additionally, as a result of the voter initiatives, the North Las Vegas letter states that the property must be valued at its highest and best use, and compensation must monetarily place the property owner in the same position as if the property had never been taken.

The North Las Vegas letter noted that, by the terms of MRP's own proposal and examples, MRP would value the property at a loss to the secured party, then turn around and sell or restructure the loan to make tens of thousands of dollars per loan.[6] The North Las Vegas letter points out that by not allowing the secured party to participate in the potential upside of the properties, MRP and the municipalities are participating in a system that would deprive other private parties of their contractual bargain and leave them with only the potential downside, without any hope of an upside.

Alternatives Sought

Interestingly, not all municipalities are rushing to embrace such a program.[7] On April 11, 2013, Brockton, Mass., rejected a proposal to use eminent domain to acquire and restructure underwater residential mortgages. Members of the Brockton working group expressed concern that the question of whether using eminent domain was permissible was not legally clear enough to warrant further discussion at that time.[8]

While it may be understandable and desirable that community leaders should take action to help homeowners in their jurisdictions who are struggling with mortgage payments, there are less destructive tools available than using eminent domain. For example, in San Bernardino, Calif., which was one of the original municipalities to propose the use of eminent domain, officials have since rejected the idea of using eminent domain due to widespread opposition and the uncertainty and risk that would be associated with it.

Instead, officials in San Bernardino are soliciting proposals from interested groups on the creation of a Homeownership Protection Program that will help to preserve homeownership for underwater borrowers and avoid further foreclosures. San Bernardino officials have explicitly requested that any proposals not include the use of eminent domain.[9]

Conclusion

Local governments around the country continue to ponder how best to help their constituents stay in their homes and officials are considering a variety of means of assistance. With the legal uncertainties and potential economic ramifications of using eminent domain to seize underwater mortgages, there is a need for alternative proposals for action.

—By Patrick D. Dolan and Linda Ann Bartosch, Dechert LLP

Patrick Dolan is a partner with Dechert in the firm's New York office. Linda Ann Bartosch is an associate in the firm's Philadelphia office.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] “Industry Groups” means: (i) American Bankers Association, American Council of Life Insurers, American Land Title Association, Association of Financial Guaranty Insurers, American Securitization Forum, Association of Mortgage Investors, Housing Policy Council, Consumer Mortgage Coalition, Investment Company Institute, Mortgage Bankers Association, National Association of Home Builders, Securities Industry and Financial Markets Association and The Financial Services Roundtable; (ii) and with respect to the letter to Richmond, CA: Association of California Life & Health Insurance Companies, California Association of Realtors, California Bankers Association, California Escrow Association, California Land Title Association, California Mortgage Association, California Mortgage Banks Association, Richmond Chamber of Commerce and West Contra Costa Association of Realtors; and (iii) with respect to the letter to North Las Vegas, NV: Asian Real Estate Association of America, Greater Las Vegas Association of Realtors, National Association of Hispanic Real Estate Professionals, National Association of Real Estate Brokers, Nevada Bankers Association, and Nevada Mortgage Bankers Association.

[2] See our DechertOnPoint, California County Considers Using Eminent Domain to Seize Underwater Mortgages, July 2012. See also DechertOnPoint, The Fight Over the Use of Eminent Domain to Seize Underwater Mortgages: Recent Updates, October 2012.

[3] Eminent Domain to Fix Troubled Mortgages Makes a Calif. Comeback, Matthew Goldstein, April 16, 2013, www.reuters.com.

[4] See DechertOnPoint, July 2012; DechertOnPoint, October 2012.

[5] Letter re: Use of Eminent Domain to Acquire Underwater Mortgages, from Securities Industry and Financial Markets Association et. al. to Mayor Gayle McLaughlin et. al., April 18, 2013; Letter re: Use of Eminent Domain to Acquire Underwater Mortgages, from Securities Industry and Financial Markets Association et. al. to Mayor Shari L. Buck et. al., April 18, 2013 (“North Las Vegas Letter”).

[6] See North Las Vegas Letter.

[7] See Eminent Domain — San Bernardino, Asset-Backed Alert, May 31, 2013, p. 7 (noting that some municipalities have backed off from a partnership with MRP after threats of lawsuits, and other municipalities, including North Las Vegas, are expected to do the same.)

[8] Email, ASF Signs Onto Joint Industry Letter Opposing Eminent Domain in Richmond, CA and North Las Vegas, April 19, 2013, to Members of the ASF Government Relations Committee et. al.

[9] Home Ownership Protection Program Joint Powers Authority, Request for Qualifications (RFQ) For Home Ownership Protection and Foreclosure Prevention Program, available here.

All Content © 2003-2013, Portfolio Media, Inc.