



2111 Wilson Blvd., Suite 350 | Arlington, VA 22201 | p: (866) 730-0150 f: (703) 224-3201

September 4, 2012

Federal Housing Finance Agency OGC
400 Seventh St., SW, Eighth Floor
Washington, DC 20024
File Code: FHFA-2012-0020

Americans for Prosperity Foundation Comments Regarding: Use of Eminent Domain to Restructure Performing Loans

To the Office of General Counsel for the Federal Housing Finance Agency:

Americans for Prosperity Foundation (AFPF) is a free market non-profit organization committed to educating and engaging grassroots citizen activists across the country about the virtues and efficiency of free markets. We adamantly affirm every individual's right to his own property as the foundation for a free economy under a just rule of law. We believe that such a society is and always has been the true path to prosperity. With the nation struggling to regain its economic footing following the recent recession, AFPF believes reinvigorating the core American values of entrepreneurship, voluntary exchange, and constitutionally restrained government are central to the nation's resurgence. AFPF currently has more than 2 million activists in all 50 states, including our 34 chapter and affiliate states.

Much speculation has arisen over the proposal by Mortgage Resolution Partners (MRP) to utilize the power of eminent domain to allow local governments to seize underwater mortgages at less than their actual value in order to allegedly provide relief to homeowners. One of the first local governments to consider the move was the city council of San Bernardino, California, but the idea has gained traction in more than a dozen cities and counties across the country. Indeed, a national debate has sparked on this issue in light of its implications for housing policy, the taxpayers, and the powers of government.

It is in this context that AFPF submits comments with regard to the issue of whether the use of eminent domain to restructure performing loans is an acceptable solution to the current problems in the housing market.¹ This comment will be presented in four sections, covering various issues related to the eminent domain proposal. The first section addresses the unconstitutional nature of the application of the eminent domain power under this plan. The second section addresses how this plan will increase costs to the taxpayer and how that relates to the Agency's statutory obligations as conservator of the GSEs. The third section addresses why AFPF believes that this proposal will cause instability in lending markets. The fourth section addresses why AFPF is

¹ Use of Eminent Domain to Restructure Performing Loans, 77 FED. REG. 47,652 (Aug. 8, 2012).

worried that this plan will advance crony corporate interests at the expense of the housing market, taxpayers, and banks.

I. Unconstitutional Use of Eminent Domain Power

The Takings Clause of 5th Amendment to the U.S. Constitution states: “nor shall private property be taken for public use, without just compensation.”² From this amendment arises the limited power of eminent domain. However, AFPP does not believe that eminent domain authorizes local governments to seize performing underwater mortgages for less than their actual value, pass them through a different private company for a fee, and then reissue them to borrowers, as an allegedly public purpose. If this exercise of power were allowed, it would severely undermine the integrity of our legal system by striking at the heart the individual right of property.

There are three criteria that should be considered when evaluating the appropriate constitutional use of eminent domain. The first is whether the object of confiscation can be considered private property. The second is whether that private property is actually being taken. And the third is whether that private property being taken is for a public purpose.

AFPP believes that this proposal can be argued to meet the first two criteria. It seems fairly obvious that the mortgages held by the mortgage servicers (and agreed to by contract with the borrowers) constitute private property. These mortgage servicers are relying upon the payments that they receive from the borrowers on these loans in order to finance their day-to-day operations and maintain their balance sheets. The second criterion is also probably met because, under MRP’s proposal, these mortgages will be condemned, seized, and refinanced by another entity, meaning that private property is being taken.

However, AFPP does not believe that this proposal meets the requirements of the third criterion for legitimate use of eminent domain. Eminent domain can be used to satisfy a public purpose if the property being seized will be either used by the public or be to the advantage of the public.³ However, this proposal does not meet the first test for public use because the mortgages will not be used by the public once they are seized. Rather, they will be refinanced under the advice and direction of MRP (itself, a private investment company), which will receive a set fee for each refinanced mortgage. Consequently, the proposal does not utilize the power of eminent domain for public use (*infra* Section IV).

Advocates of this plan argue that if the proposal is to the advantage of the public, then it may still be justified under eminent domain, attempting to fulfill the second test for public purpose. In reality, this argument falls short. MRP’s plan is a potentially significant cost to the public because of the high number of loans that are currently held by the GSEs. Since 2008, 95-99% of new loans were issued by the GSEs under the conservatorship of the Agency.⁴ Consequently, taxpayers have a large exposure to the home mortgage market and face the risk of bailing out the GSEs should they sustain more losses (*infra* Section II). Although some private homeowners and MRP may receive benefits from this plan, the general public will not share in that benefit. Therefore, this proposal fails both the public use and public benefit tests required to achieve a public purpose.

² U.S. CONST. amend. V.

³ Lawrence Berger, *The Public Use Requirement in Eminent Domain*, 57 OR. L. REV. 223 (1978).

⁴ FED. HOUS. FIN. AGENCY, CONSERVATOR’S REPORT ON THE ENTER. FIN. PERFORMANCE: FIRST QUARTER 2012, available online http://www.fhfa.gov/webfiles/24016/Conservator'sReport1Q2012061512_FINAL.pdf.

AFPF believes that our Constitution is one of limited and enumerated powers. Through the incorporation of the 5th Amendment against the states via the 14th Amendment, the rights of citizens are protected not only from abuses of the eminent domain power by the federal government, but also by state and local governments.⁵ The use of this eminent domain proposal would amount to a deprivation of property for those investors and financial institutions that are in a contractual relationship with the borrower. Simply put, this proposal is unconstitutional.

II. Increased Cost to the Taxpayer

AFPF is significantly concerned by the potential costs that MRP's proposal may have for the taxpayer if it is implemented. As mentioned in the previous section, Fannie Mae and Freddie Mac hold a large majority of underwater mortgages that could be subject to this policy. If local governments seize Fannie Mae and Freddie Mac loans at less than their actual value, this will leave the taxpayers stuck with the cost of bailing out the GSEs yet again. Thus, AFPF is concerned that if cities and counties across the country use MRP's eminent domain proposal, it could significantly hurt the GSEs balance sheet, exposing taxpayers to more housing market risk.

Taxpayers' interests were already egregiously sacrificed to support a \$187 billion bailout of Fannie Mae and Freddie Mac while under the Agency's conservatorship.⁶ Consequently, as the Agency stated in its notice in the Federal Register, "FHFA's obligations, as conservator, are to preserve and conserve assets of the Enterprises and to minimize costs to taxpayers."⁷ AFPF is grateful that your acting director, Ed DeMarco takes this statutory obligation seriously. We believe that DeMarco, in expressing his explicit opposition to this eminent domain plan, understands the inherent financial risks. Few politicians and bureaucrats any more remember that the money that they use is not their own, but rather money that was initially taken from the taxpayers. We urge the Agency to continue to discourage MRP's eminent domain proposal for the sake of protecting taxpayers from poor policy proposals and risky financial practices.

III. Increased Instability in Lending Markets

AFPF agrees with Chris Katopis, the executive director of the Association of Mortgage Investors, that this plan "would be robbing Peter to pay Paul."⁸ Mortgage servicers have much to lose if this plan goes forward, especially since the plan will only condemn and seize underwater mortgages from borrowers who are current on their payments. These payments are revenue streams that mortgage servicers are relying upon in order to sustain their operations. Allowing city governments to seize these underwater mortgages at less than their real value is nothing short of sheer theft from the perspective of these institutions.

The execution of this proposal will produce uncertainty and fear in the banking industry that will cause them to avoid lending in localities that engage in this kind of plan. AFPF agrees with Timothy Cameron, managing director of the Securities Industry and Financial Markets, who recently said that, "We believe using eminent domain would reduce access to credit for

⁵ *Missouri Pacific Ry. Co. v. Nebraska*, 164 U.S. 403 (1896).

⁶ FED. HOUS. FIN. AGENCY, *supra* note 4.

⁷ 77 FED. REG. at 47,652, *supra* note 1.

⁸ Ben Hallman, *San Bernardino Eminent Domain Proposal Arousing Concern From Mortgage Industry*, HUFFINGTON POST, Aug. 16, 2012, available online http://www.huffingtonpost.com/2012/08/16/san-bernardino-eminant-domain_n_1791773.html.

borrowers and would, at a minimum, result in lengthy and costly litigation.”⁹ All in all, 18 different representatives of the banking and lending industry have come out with serious concerns about MRP’s proposal.¹⁰

IV. Serving the Interests of Cronyism

AFPF is also very concerned with this proposal because it utilizes the power of government to serve the special interests of cronyism. AFPF is worried by the fact that MRP was formerly run by Phil Angelides, chairman of the Financial Crisis Inquiry Commission, who has significant political ties in both California and national politics. Although Angelides is no longer a part of MRP’s executive leadership, it is no secret that MRP advertised its “legal and political leverage” as a part of its “secret formula” to generate 20% returns in a letter that it sent out to investors last winter while Angelides still served as MRP’s chief executive.¹¹ Today, MRP continues to push for implementation by local governments, expecting to receive a set fee for the “services” it provides in helping to virtually steal these loans from mortgage servicers and private investors.

This is clearly an example of public-private collusion that will result in benefit for specific parties to the detriment of countless financial institutions, small banks, and taxpayers. Although MRP tries to justify its position by talking about how its proposal will help home owners, it cannot be overlooked that a part of their sales pitch to investors was their employment of “political and legal leverage.” AFPF strongly believes that this is not an example of a private company providing a mutually beneficial service in a competitive free market, but rather, an example of corrupt cronyism in which a private company earns its profits by using the force of government. This is completely unacceptable.

Conclusion

AFPF is very concerned that this proposal will damage the already volatile housing market. We urge the Agency to consider the likely effects of implementing this proposal, including: the unconstitutional use of eminent domain, the cost to the taxpayers, increased instability in lending markets, and serving the interests of cronyism.

Sincerely,

Jason Hughey
Policy Analyst
Americans for Prosperity Foundation

Americans for Prosperity Foundation (AFP) is a nationwide organization of citizen-leaders committed to advancing every individual’s right to economic freedom and opportunity. AFP believes reducing the size and intrusiveness of government is the best way to promote individual productivity and prosperity for all Americans. AFP educates and engages citizens to support restraining state and federal government growth and returning government to its constitutional limits. AFP is more than 2 million activists strong, with activists in all 50 states. AFP has 34 state chapters and affiliates. More than 90,000 Americans in all 50 states have made a financial contribution to AFP or AFP Foundation. For more information, visit <http://www.americansforprosperityfoundation.com>

⁹ Hallman, *supra* note 8.

¹⁰ Alison Frankel, *Eminent domain, MBS and the U.S. Constitution: a one-sided fight?*, REUTERS, July 11, 2012, available online <http://www.reuters.com/article/2012/07/11/us-sanbernardino-bankruptcy-eminent-idUSBRE86A1EM20120711>.

¹¹ Matthew Goldstein and Jennifer Ablan, *Exclusive: Angelides to lead distressed mortgage firm*, REUTERS, Jan. 13, 2012, available online <http://www.reuters.com/article/2012/01/13/us-usa-housing-angelides-idUSTRE80C26820120113>.