COUNCIL OF FEDERAL
HOME LOAN BANKS

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FHLBANKS
A NATION OF LOCAL LENDERS

August 31, 2012

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street, SW
Eighth Floor
Washington, DC 20024

RE: Request for Input on the Use of Eminent Domain to Restructure Performing Loans

Dear Mr. Pollard:

I am writing on behalf of the Council of Federal Home Loan Banks (Council) in response to your request for input on the use of eminent domain to restructure performing loans. The Council is a trade association representing the twelve Federal Home Loan Banks (FHLBanks). We appreciate the opportunity to present our views for your consideration, and for the reasons explained below, urge you to take action to deal with the concerns noted in your Federal Register publication.[1]

As we understand it, several localities are considering passing ordinances whereby a local governmental entity may seize performing mortgages in which the amount of the outstanding loan principal exceeds the current value of the collateral. The local governments would acquire the mortgage loans under their eminent domain powers. The holders of these mortgages, which could be individual lending institutions, a Government-Sponsored Enterprise (GSE), or private investors (directly or through their holdings of mortgage-backed securities), would be compensated based on the local government's determination of the fair market value of these instruments. The mortgage loans so acquired would be restructured, with the principal reduced, and the interest rate adjusted, and as restructured sold to private investors. The proceeds of these sales would be used to pay administrative costs and to compensate the original mortgage holders. There is considerable concern - which we share - that the compensation offered for the mortgages will be below true market value, resulting in losses to the original mortgage holders. This potential use of eminent domain authority to confiscate a financial asset would be very unlike the usual context for eminent domain – the purchase of land – where the government's need for a forced sale is driven by the unique nature of the property being seized. And unlike the case of land, which is real property located in the jurisdiction of the acquiring entity, mortgage loans are held by entities throughout the world and are often parts of carefully constructed trusts, such that their removal from the trust may cause damage above the loss on individual loans. It is possible that the impact from restructuring loans in one locality could impact holders of mortgage-backed securities and owners of other mortgages across the country.

We have experienced a dramatic decline in the value of homes across the nation, and in certain localities the economic devastation caused by this decline has been severe. The cities, towns, and communities that have been hardest hit are understandably looking for solutions to ease the problems that result when homes have lost considerable value, additional foreclosures are anticipated, and housing developments are unoccupied. These are serious problems, and call for innovative remedies. However, it

[1] 77 Fed. Reg. 47652 (2012).

is important to consider all of the consequences of any proposed remedy. A solution that may be viewed as a positive in one community may in fact reduce housing finance availability in that community in the long run. And a solution proposed in one city or town could have a negative impact on the *national* housing market. We believe that the use of eminent domain authority to seize performing mortgages would have both a local and national negative impact on the cost and availability of mortgage loans.

The FHLBanks have a strong interest in the health of our mortgage finance system. The strength of that system, including lenders' ability to offer long-term mortgage products and investors' willingness to invest in those loans, depends upon legal certainty. There must be legal certainty that a mortgage will be protected by collateral until the mortgage is repaid. Similarly, there must be legal certainty that the mortgages supporting a mortgage-backed security will continue to protect the bond holder for the life of the security, unless replaced pursuant to the terms of the securitization agreement. And there must be legal certainty that the collateral supporting an FHLBank advance will not be taken away before the advance is repaid.

If legal certainty is questioned, the availability of mortgage finance will be disrupted, and the cost of mortgage loans will increase. The use of eminent domain power to seize performing mortgage loans will have this effect. It will undermine the legal certainty necessary to finance a long-term mortgage loan. It would have a significant adverse impact on the availability of mortgage credit within the local communities that seize performing mortgages, since any lender or investor would be concerned that their security could be seized. These local proposals will have nationwide repercussions on the housing finance markets because of concern that the precedent could be copied under other jurisdictions. Thus, the impact of these local ordinances will be felt across the country.

The proposals also would raise concern among lenders and investors that similar proposals could extend to other situations in which local constituents would prefer to have their mortgage restructured, even if the value of the property exceeds the principal amount of the loan. For example, if interest rates decline, a city or town could seize mortgages that have higher rates, on the theory that allowing local residents to pay a lower rate will benefit the local economy. Alternatively, a city could use eminent domain to seize variable rate mortgages because local government officials believe that fixed rate loans would be economically beneficial to the community. The legal precedent of seizing underwater mortgages would create a slippery slope that could lead to these and other actions that would further interfere with the settled expectations of mortgage holders. The impact of these proposals could also cause lenders and investors to question the security of other loans as well. If mortgage loans are seized to promote local economic goals, lenders might question whether the same tactic could be applied to auto loans, credit card loans, business loans, and other extensions of credit. The associated uncertainty regarding enforceability of lender's rights might well cause a contraction of credit generally and result in a decline in national economic activity.

In addition to the harm that would be caused to the housing markets generally, the FHLBanks would be negatively affected in several ways. The FHLBank System has important holdings of mortgage-backed securities, and the value of these securities would decline if the underlying mortgages were seized by local governmental entities. The FHLBanks' acquired member asset (AMA) mortgage programs could also be adversely impacted. In addition, the FHLBanks hold mortgages as collateral for their advances, and the value of this collateral would be impaired if the loans were seized. The FHLBanks might have to ask for additional collateral or reduce the amount of advances; either action would reduce the funds available for residential mortgages.

The Federal Register notice did not specify what action the Federal Housing Finance Agency (FHFA) is considering with respect to this issue. However, the notice did explain that the use of eminent domain could adversely impact the Enterprises under conservatorship, as well as the FHLBanks. As noted, the use of eminent domain authority to seize performing mortgages can also interfere with the provision of mortgage finance in the United States, including the existence of liquid and efficient national housing finance markets.

In closing, besides the obvious questions of constitutionality, which we leave to others to address, we believe that these local proposals could have a significant and lasting negative impact on the health and restoration of our country's housing markets, as well as on the health and safety of the federal instrumentalities under the FHFA's jurisdiction. We appreciate the opportunity to give our input on this important matter.

Sincerely,

Carl Wick

Carl F. Wick
Chairman, Council of FHLBanks