From: David Katz <dhkatz@castlerockllc.com>
Sent: Friday, August 17, 2012 11:05 AM
To: Eminent Domain OGC
Subject: No. 2012–N–11 "Use of Eminent Domain to Restructure Performing Loans"
Attachments: How Eminent Domain Can Save our Cities v3-081412.pdf; 2012-0817-Washington's highest court rules MERS cannot foreclose on homeowners.pdf

To the Office of General Counsel of the Federal Housing Finance Agency,
On August 9, 2012 I sent the following email to your office:

From: David Katz <dhkatz@castlerockllc.com>
Date: August 9, 2012 5:59:46 AM PDT
To: eminentdomainOGC@fhfa.gov
Subject: How Eminent Domain Can Save our Cities
To the Office of the General Counsel for the Federal Housing Finance Agency:

Pursuant to your notice No. 2012-N-11 entitled "Eminent Domain to restructure performing loans", please see the attached proposal. While my proposal is intended to address resolution of non-performing loans, I believe the same rules could apply, in concept to a certain qualified subset of performing loans as well, e.g., loans whose current LTV or CLTV exceeds 130%.
By way of background, I'm a lawyer by education and former partner in a Memphis, Tennessee based law firm. I've been a Managing Director in Mortgage Finance for a Wall Street Investment Banking Firm, I've been an executive officer of a multigenerational family mortgage banking business that was servicing 300,000+ residential mortgage loans in 1995 when the company was sold to what is now part of Bank of America, and I've represented investment bankers, banks, real estate investors and mortgage lenders and servicers in the early 1980s and 1990s in securitizing residential mortgage loans. I have drafted scores of Pooling and Servicing Agreements during my professional career. I've been following the national debate and I've drafted a memo/article on the subject which I've attached in pdf format.

I, along my a few of my colleagues are in the process of forming Municipal Assistance Advisors, an advisory firm to municipalities to assist in assessing, evaluating and executing the plan described in my article/memo (or some variant thereof) and would pleased to speak with you at your convenience. Due to family personal health issues, I've relocated to Santa Monica, California and can be reached any time after 6 a.m. PDT via email or on my mobile phone at 917-363-6187 if you'd like to discuss. I look forward to receiving your feedback.

Sincerely,
David H. Katz

At that time I attached a proposal which I've updated and attached to this email which explains the proposal and how it would work for loans that are current by permitting interested homeowners to "opt-in" or request that a municipality condemn their homes to allow them to refinance their homes based on the current value.

However, yesterday afternoon, the Washington State Supreme Court issued a ruling which I

believe will send tremors around the globe affecting the real estate market, the mortgage backed securities markets, the title insurance industry, the federal government, Fannie Mae, Freddie Mac and the entire financial system. A copy of the article is attached. If the Washinton Supreme Court's decision is upheld, the most effective way from stopping the title defect "virus" from spreading to future lenders, owners and title insurors. Condemnation will mitigate any potential future damage for all real estate property foreclosed by a lender whose mortgage was assigned through the MERS system to a trust for an MBS issuance. Once a property has been condemned the potential future title problems should be eliminated. It now seems that instead of fighting condemnation as a solution, Wall Street and the FHFA should be asking the municipalities to condemn all real estate to protect the integrity of the land title registration system to prevent a complete meltdown of the real estate markets. Just food for thought.

Sincerely,
David H. Katz

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How Eminent Domain Can Save our Cities

By David H. Katz
August 14, 2012
(Revision of Memo Dated December 18, 2007)

Recent headline news in the U.S. has centered on the novel use of eminent domain as a possible solution to the current housing crisis. One solution that seems to be receiving the most public attention is a proposal advanced by Steven Gluckstern of Mortgage Resolution Partners ("MRP"). MRP's principals have been advanced a unique proposal to assist the City of San Bernardino, California in solving its current housing crisis. MRP's proposal proposed solution involves municipal condemnation of "mortgages" on residential real estate through the exercise of eminent domain. MRP wants San Bernardino to condemn mortgages, force the holder of the loan to accept the net proceeds on the basis of the property's current appraised value and subsequently refinance the "condemned mortgage" through MRP. While this proposal is interesting, novel and quite creative, it is quite possible there will be a multi-year delay from concept to execution of this plan because the parties seem to be preparing for a lengthy court battle. The issue will likely end up in the U.S. Supreme Court as to whether the framers of the U.S. Constitution intended to include mortgages as *condemnable* interests in land.

Since 2007, residential housing values have been spiraling downward. While the dramatic decline in housing prices could have been averted, the "eminent domain solution" is attracting serious attention for the first time in US history. Every novel solution has its detractors and any proposal to using eminent domain as a public policy tool is and will be controversial. Due to the sheer volume and magnitude of the housing crisis, every rescue plan will be complicated and costly. However, there is an eminent domain structured solution that, while requiring coordinated policy objectives among the cities, states and federal government, is built upon existing precedent and can and should be considered in evaluating a comprehensive solution to our nation's housing woes.

What is Eminent Domain?

Eminent Domain in an action of a local, state or federal government to seize a citizen's real or personal private property, or seize a citizen's rights in property with due monetary compensation, but without the owner's consent. The property is taken either for governmental use or by delegation to third parties who will devote it to public or civic use or, in some cases, economic development.

The Constitution's Fifth Amendment imposes limitations on the exercise of eminent domain: the taking must be for "public use" and "just compensation" must be paid. Under the terms of the U.S. Constitution, the government is legally entitled to appropriate a private citizens' property provided the private citizen is justly compensated. The exercise of eminent domain by a governmental agency is commonly referred to as "condemnation". The US Supreme Court has addressed

the issue of what constitutes a "public use" on many occasions without stirring too much controversy. However, in 2005 the Supreme Court expanded the scope of the "Public Use Doctrine" to include purposes that many argue were never intended.

In *Kelo v. City of New London*, 545 U.S. 469 (2005) the Court affirmed the authority of New London, Connecticut, to take non-blighted private property by eminent domain, and then transfer it for a dollar a year to a private developer solely for the purpose of increasing municipal revenues. This 5-4 decision received heavy press coverage and inspired a public outcry that eminent domain powers were too broad. In reaction to *Kelo*, several states enacted or are considering state legislation that would further define and restrict the power of eminent domain.

Why Use Eminent Domain Now?

One can only speculate whether the Supreme Court's ruling in the *Kelo* case contemplated such an expansive application of the "Public Use Doctrine" in *Kelo* would serve as the foundation for applying the doctrine of eminent domain to save our cities. Even if they didn't anticipate this novel approach to condemnation, the law of unintended consequences should work in favor of a national solution this time. In order to understand why eminent domain is the best solution, it would be best to provide the historical context that led us to the quagmire in which we find ourselves today.

At the height of the housing "bubble" in 2006 a number of "private label securities" and exotic, new private label derivative securities (like "collateralized loan obligations" and "collateralized debt obligations") were being issued by Wall Street investment banking firms and sold around the world to institutional investors such as banks, insurance companies, sovereign wealth funds and hedge funds. These instruments bundled mortgages and/or mortgage-backed securities (MBS) into securities themselves. These derivative securities were selling the cash flows from the principal and interest payments received on mortgages that were paid to the holders of the MBS who, in turn, pooled the MBS themselves and sold the MBS cash flows to the institutional investor.

Bundling these cash flows was extremely profitable for everyone involved. The institutional investors were buying these securities as fast as Wall Street could issue them. Everyone was making a lot of money as long as housing prices continued to rise. Every time a home were sold or refinanced, the mortgage would be paid off and the investors of the MBS would be repaid.

The problem is that no one ever thought housing values would decline and the rating agencies thought the best solution for hedging a foreclosure or default risk was to "over-collateralize" the pools of loans. In other words, in order to issue $100 Million in MBS, the issuer (like Goldman Sachs, Bear Stearns or Lehman Brothers) had to deposit $115 Million in mortgages in the pool. Therefore, if 7% of an MBS pool defaulted, the investor shouldn't suffer a loss because they had

collateralized the pool with 15% more than the actual issuance creating a "buffer" to absorb the losses. Sounds like a plan, right?

The Other Shoe Drops

It was a good plan as long as housing prices continued to rise. However in order to meet the rising demand from institutional investors, Fannie Mae, Freddie Mac and the rest of the Wall Street MBS issuers started including mortgage loans with questionable (and ultimately no) underwriting guidelines.

The script went something like this:

> No credit-no problem. Bad credit-no problem. Don't make enough money for the loan you're requesting? Non-problem, we'll just provide you with a "teaser rate" adjustable rate mortgage (ARM) your payment will be low and affordable for the next 3 years. By the time the interest rate on your loan is ready to re-set, property values will be higher and we'll refinance you again.

So what happened in 2007? Property values stopped increasing, the interest rate on these "teaser-rate" ARMs re-set and a number of these derivatives were so exotic no one knew who owned the actual underlying mortgage. Why was this important? Because in a number of states, in order to commence a judicial foreclosure action, the lender has to prove it owns the loan and therefore has the right to foreclose on the mortgage. Well.... who owns the mortgage?

That's an interesting legal question. Quite often the original lender sold the loan or transferred it to a Trustee who held the loan "in trust" for the benefit of the securities holders who bought MBS. Normally, when an MBS is created, they execute a tri-party agreement called a "Pooling and Servicing Agreement" (PSA). The parties to the PSA are (1) the Servicer, who collects payments of principal, interest, taxes and insurance from the homeowner each month and (a) deposits the taxes and insurance into a separate escrow account to pay the taxes and insurance premiums when they become due and (b) remits the principal and interest payment to the Trustee; (2) the Trustee who receives payments of principal and interest from the Servicer and remits the payments to the owner of the MBS when they are due; and (3) the Investor who pays for the MBS and receives principal and interest from the Trustee as the return on its investment.

The PSA is a very long document which contains very detailed, strict instructions on the scope of authority and discretion the Servicer and Trustee have in its dealing with the homeowner. These detailed instructions are designed to leave little or no discretion on the part of the Servicer or Trustee in how to deal with the homeowner defaults, foreclosures, bankruptcies, loan modifications and how to

dispose of foreclosed property. While this may sound harsh, it is actually intended to benefit everyone involved. If the Servicer follows the PSA instructions, the Servicer is insulated from liability from the investor. The Trustee is also shielded from liability as long as it follows the instructions from the investor and the investor is comforted with the knowledge that a process is in place to protect its investment.

So far so good, right? Yep. But who owns the loan? In many states the Courts require proof of ownership to commence a foreclosure action. In 2008-2009, this became a serious problem. Servicers commenced foreclosure proceedings in many state courts only to be told that if they couldn't prove ownership of the loan, they were unable to use the courts to commence a foreclose.

To compound the problem, the exotic derivatives didn't consist of pools of mortgages, where you might be able to prove that a trust owned the loan. The exotic derivatives were pools of MBS, not mortgages. So now the answer to "who owns the mortgage" has gone from bad to worse because the derivatives securities only represented an ownership interest in the cash flows coming from the MBS and the MBS cash flows were coming from the pooled mortgages. So the question the courts were asking is "Who owns the loan? If you can't prove who owns the loan, who's in charge of advising the servicer on how to handle the foreclosure?" Foreclosures were in a holding pattern until someone could figure out a solution.

The MERS Problem

Another major contributing factor creating confusion about loan ownership is the mortgage industry's adoption and utilization of the Mortgage Electronic Recording System (MERS) to assign and transfer ownership of mortgage loans. Under the MERS system, a lender assigns the loan to MERS and MERS would be the "gatekeeper" as to who owned the mortgage loan by reflecting transfers of ownership on its books rather than recording mortgage assignments. MERS was not the owner of the mortgage; it is merely the record keeper using a "book entry" system to evidence transfers of mortgage loans. In theory it is a great idea because it eliminates the need to deliver the physical assignments to the buyer every time a transfer occurs. It creates efficiency and allows for liquidity in trading mortgages.

However, in the world of mortgages, ownership transfers the seller to deliver and/or record an Assignment of Mortgage and have the seller endorse the promissory note to the buyer. Without recording the assignment in the local county recorder's office, as required by most state laws, there's no way to tell who owns the mortgage loan and therefore who's entitled to commence a foreclosure.

"Book entry" transfers of mortgage loans are not (or shouldn't be) a practical solution because the system actually hides the name of the actual owner of the mortgage. While it was created to serve a dual purpose, i.e., to create liquidity and speed in trading mortgages, and avoid paying any fees and /or taxes in connection with recording the assignment, it also created a nightmare in determining

ownership of the mortgage loan. For example, when a loan is sold and the registered ownership is only reflected utilizing the book entry method, the MERS system undermines the purpose of the recording statutes which is to put everyone on notice about a claimed lien so a third party can contact them owner if necessary.

This is a very important component to the land registration and transfer system. It provides third party prospective lenders, junior lien holders, attorneys, buyers and title companies with vital information about who to contact for information about the lien. Why? Among the many reasons, second mortgage lenders need to know information about the status, the outstanding principal balance, the escrows for taxes and insurance being collected by the first mortgagee and other vital information which they need to know before lending money to a prospective borrower. MERS substantially limited access to the information for which the recording statutes were enacted; to make this public information. Who owns the loan when MERS is the "holder of record"? Good question. And that's what the courts thought as well.

Pouring Salt into the Wound

During the "go-go" days of the MBS and private label securities, mortgage lenders and banks were overwhelmed with loan demand and didn't have adequate personnel to handle the volume of loan demand. So instead of slowing down the process greed took over. Wall Street's demands for more product pushed loan servicers and banks into satisfying loan demand by engaging in unorthodox behavior (to put it mildly). The loan originators, mortgage banks and banks hired people to forge the signatures of authorized loan officers on mortgage assignments so the MBS could be issued quickly to meet the ever increasing investor appetite for MBS. No one would have known the scope of the "robo signing" fraud as long as home prices continued to increase. Foreclosures were a remote possibility but in market of ever increasing property values, refinancing was a more likely scenario and no one would be the wiser once the loan was paid off.

Other Factors Preventing a Recovery

If things weren't bad enough, here are a few additional problems exacerbating the problem to a new, unprecedented level.

a. The sheer volume of loan modification requests is so high there aren't enough hours in the day to timely and promptly respond to borrower requests for relief. As a result of this backlog lenders and servicers are continuing the foreclosure processes in order to get to the next emergency.

b. As a result of this overwhelming volume, the courts are backlogged for months, and in some cases years, with foreclosure filings. In the interim, borrowers are refusing to make payments on the theory that

since no one is paying attention to them on their loan modification request, they won't make a payment until someone takes the time to speak with them.

c. When a lender/servicer finally reaches out to the borrower and they have a conversation, the investor/owner of the loan (if you can determine who owns the loan) generally refuses to consider a loan modification request because they haven't been paid in months/years on their delinquent loan.

d. When all else fails and the borrower is on the eve of foreclosure, they frequently file bankruptcy to delay the process causing an unprecedented backlog in the bankruptcy courts.

e. Between the multitude of confusing, ambiguous and sometimes-contradictory government loan modification programs, such as HAMP, TARP and others, there's been no clear guidance for creating a uniform solution to dealing with the loan modification programs.

So Why is Eminent Domain a Solution?

In 2007, as the residential mortgage market was crumbling, primary factors attributed to the downfall included (a) mortgage origination fraud, (b) failure to underwrite the loans in a prudent, historically consistent manner, (c) the inability to prove ownership the delinquent loan, and (d) the lack of direction to the Servicer and Trustee on what to do about delinquent loans. The factors causing the mortgage mess could only be resolved if there was a solution that could be found in an existing document.

At one time Congress was contemplating legislating a forced change to existing PSAs to clear up the foreclosure backlog; however, they ultimately backed off because a Congressional mandate to amend the PSA clearly violated the U.S. Constitution's "impairment of contract" prohibition. So….now what?

The solution seemed obvious. Eminent Domain. Here's why:

1. Every mortgage loan document contains provisions under which the holder of the loan is required to accept an early payoff of the mortgage balance. The 3 that come to mind are:

    a. Casualty Loss. This means that if a house is destroyed by fire, earthquake or a covered natural disaster, the insurance proceeds are to be paid directly to the mortgagee (the holder of the loan) to pay off the loan and the excess, if any, goes to the homeowner. This isn't a real good option unless we want to burn down homes for the

insurance (which, of course, isn't covered under homeowner's policies).

b. Condemnation. This means that if a Municipality, State or the Federal Government (or any federally authorized agency) condemns property, in whole or in part, the proceeds are first used to pay off the lender and the balance, if any, goes to the homeowner.

c. Force Majeure. These involve governmental takings of property in case of war (which really could be a subset of (b) above but isn't).

2. If these provisions are in every mortgage that's written in the United States, then every MBS has to contain "risk disclosure provisions" that contemplate the possibility of a forced payoff (or prepayment) in each of these circumstances.

3. If they were contemplated and disclosed as a "risk factor" in the PSA because they were a part of every mortgage in the U.S., then no MBS investor can argue that it violates the PSA or Constitutional prohibition of impairing private consensual contract rights.

4. Of the 3 alternatives in Paragraph 1 above which is the least harmful to the homeowner, the city, the state, the federal government and the investor?

The answer: Eminent Domain.

OK Genius, if this is such a great plan, who the heck is going to condemn these properties and where are they going to get the money to pay for all these homes they want them to condemn? In other words, what's the plan?

Here's it is, step by step.

1. Whose homes should be condemned?

   ANSWER: Anyone who falls in the following categories:

   a. Delinquent Loans: A homeowner whose home is "underwater" by more than 20% and whose **loan is delinquent by 90 or more days**, i.e., any property with a current LTV and/or CLTV greater than 120%.

   b. Current Loans: A homeowner whose **loan is current** but whose home is "underwater" by more than by more than 20% and **<u>who requests</u>** that the Municipality condemn their home through eminent domain. Why would a homeowner ask for an eminent domain solution? Reasons

include circumstances under which the mortgage servicer and/or lender is either unable or unwilling to modify their existing mortgage or a junior/second mortgagee who is unwilling to consent to a modification or accept a "short payoff" leaving the homeowner without an option to refinance his/her mortgage.

WHY:

REASON 1. In the early 1980s, when the U.S. was suffering from "hyperinflation", the 30 year fixed rate mortgage was 17% and no one could qualify or afford a home loan. At that time, Fannie Mae came up with a program that permitted a borrower to make mortgage payments that weren't enough to cover the interest portion of the loan each month, and the shortfall in interest would be added to the unpaid principal balance of the loan until you reached a maximum of 125% of the original principal balance. This is called "negative amortization". When a mortgage reached the 125% cap, the loan payments were required to be restructured to cover the regular principal and interest payment on the loan for the remaining term so that no new negative amortization would be allowed.

For example if a 30 year loan for a $100,000 had an interest rate of 15%, the borrower may make a mortgage payment based on the same loan but at a 9% interest rate. If the shortfall, when added to the original loan balance, ever reached a total of $125,000 (say, in year 4), the payments would be modified to pay back the new loan amount of $125,000 over 26 years (30 years minus the 4 years that elapsed) at 15%. This allowed people to buy homes when interest rates were unusually high and assisted in jump-starting the economic recovery in the hope that rates would gradually decrease and home prices would rise.

REASON 2. By applying an objective standard such as LTV, every affected homeowner would be treated fairly.

2. Who is going to condemn all these homes?

   ANSWER: The Municipalities, not the State or Federal Government.

   WHY: The cities have the greatest amount to lose by having vacant homes, i.e., blight, increased crime, impact on valuation of the remaining occupied homes and most of all, they are closest to the problem and therefore more competent to quickly implement the solution.

3. Where is all that money going to come from?

   ANSWER: State issued residential housing bonds. The States are going to lend the money to the municipalities to fund their purchases.

WHY: Because legislative authority already exists to permit States to issue residential mortgage revenue bonds so we are not re-inventing the wheel.

4. Why would anyone buy State issued residential housing bonds?

   ANSWER: Because the proposal contemplates having the U.S. Treasury issue a "guarantee" to each State-issued residential mortgage revenue bonds, essentially creating a "federally insured, federal and state income tax exempt" bond.

   WHY: Not all states have the same credit ratings and in some cases the cost of borrowing and issuing residential housing bonds may make it unaffordable for that state to offer this kind of rescue program.

5. Why would the Federal Government guarantee State issued residential mortgage revenue bonds?

   ANSWER: Because they're going to be compensated for issuing the guarantees (50 basis points) to be paid from the revenue received from tenants (see below for further explanation)

   WHY: It's a lot cheaper to guarantee the loans than to bail out the banks especially when the U.S. Treasury is receiving revenue for its guarantee. It's not like these programs don't already exist. Freddie Mac and Ginnie Mae were founded on these principles.

6. So what's the actual plan? What happens to the house once the Municipality has condemned it?

   ANSWER: The Municipality would enter into a 5-year lease with the existing homeowner (now a tenant). The lease would contain an option for the tenant to repurchase the home from the Municipality any time during the 5-year lease period at a price equal to its then current appraised value, but at no less than the price the city paid for it at the time it condemned the property. The monthly lease payment would be equal to the sum of:

   a. 1/12 of the monthly principal and interest if the price paid by the Municipality were financed at an interest rate 200 bps. higher than the current market rate and based on a 40 year amortization (as opposed to a 30 year amortization) PLUS

   b. 1/12 of what the property taxes would be if the house weren't owned by the Municipality (since cities don't receive property tax revenue on city-owned property) PLUS

c. 1/12 of what it would cost to insure the property against fire and casualty if the property were privately owned.

WHY: This would immediately enable the property to remain occupied, decrease the incidence of vandalism, generate revenue for the city, state and federal government as well as the investors and provide the homeowner with an opportunity to stay in his home for an affordable monthly payment and allow the residential housing market to stabilize over the next 5 years.

7. What's in it for the homeowner?

   ANSWER: The homeowner, while losing his home to condemnation, doesn't have to move, can continue living at a more affordable cost and has 5 years within which to repurchase his home. The price will probably be higher than the day it was condemned (at least that's the hope) but the homeowner may have an opportunity to recover some of his/her lost equity at some point in the future. There's one additional ancillary benefit for the homeowner. If the property is taken by condemnation (as opposed to foreclosure) it should not adversely affect the homeowner's FICO score (credit score) because there's no foreclosure on his credit report; just a condemnation loss not caused or created by him the borrower.

8. So (i) where do the cash flows go and (ii) who is going to administer this nightmare?

   ANSWER/EXAMPLE:

   (i) Let's assume that in 2006 a home with an **appraised value of $500,000** was refinanced **with a $400,000 loan (an 80% LTV)**. The monthly payment of principal and interest on that loan in 2006 was a 3% "teaser" rate. In 2008, the interest rate reset to 2008 interest rates resulting in an increased interest rate from 3% to a 6%. Therefore the principal and interest payment in 2006 was $1,686 and today it's increased by $712 per month to $2,398. At the time the loan closed, the property taxes were taxed at 1.25% of the appraised value, i.e., $500,000. The property taxes would be $521/month and insurance would be approximately $75/month. Therefore, **in 2006 the total monthly payment** of principal, interest, taxes and insurance **was approximately $2,282 per month**.

   In 2008, assuming no changes in the property taxes and insurance payments, **the monthly payment increased to $2,994** and the property is now valued at $258,000.

   (ii) Today's value of the property is currently at $258,000 (or 51.6% of the original appraised value-a 48.4% decline in value). The

Municipality condemns the property at its current market value ($258,000) and calculates a new lease payment based on a the current market value of $258,000. The new lease payment would be based on a 40-year amortization of a $258,000 loan at an interest rate of 6% (monthly payment is $1,419.55). Assume further that the property tax rate is 1.25% of the property's value ($268.65) and insurance is equal to $100/month. Here's how it would look:

SOURCES: Rent from Borrower totals $1,788.20

USES:

a. Remitted to the Municipality for taxes and insurance and costs of initial implementation: $368.65
b. Retained Servicing Fee for Servicer (50 bps): $129.00
c. Pass-Thru to State for Bond Issuance Guaranty (50 bps): $129.00
d. Pass- Thru to Federal Government for Guaranty Fee (50 bps): $129.00
e. Pass-Thru Principal and Interest to Bondholder (at 4%): $1032.55

(ii) The best party equipped to handle all of this paper work and bookkeeping is the existing mortgage servicer since they can order the appraisals, work with the borrowers, remit monthly payments, handle lease execution, exercise of purchase options and eviction if necessary. They are already doing very similar work now in dealing with the existing defaulted mortgages and can continue more efficiently than anyone else.

9. What happens at the end of 5 years? What happens if the borrower defaults while he's a tenant?

ANSWER: The borrower/tenant can exercise the option to purchase any time during the 5-year period. If the property value increases (hopefully once property values stabilize), the increase in value would be split 50-50 between the bondholders and the Municipality. That will encourage everyone to stay in the deal and work to keep property values stable and increasing.

10. What's supposed to happen to the existing MBS holders?

ANSWER: They will be forced to stop the practice of "extend and pretend" and will be forced to recognize their unrealized losses in the MBS they've been holding for the last 3-5 years everyone knows are clearly "underwater". To induce the MBS holder to accept the "forced loss" on its MBS, the Federal Reserve (in concert with the Comptroller of the Currency) could revive a tool used during the Savings and Loan crisis in the mid-1980s; regulatory accounting procedures (or "RAP" accounting).

Under RAP accounting, the financial regulators would permit the MBS holder who suffers a loss to amortize its actual loss over a 5-7 year accounting period, i.e., amortizing 1/5 (or 1/7) of the loss each year until the loss has been recognized. In the interim, if the homes increase in value, they may still be able to recover some upside (see the next paragraph). In most cases this favorable regulatory accounting treatment could actually prevent financial institutions from collapsing and subject to seizure.

Interestingly, it is these existing MBS holders who are the best candidates to swap their existing underwater MBS for the newly-issued State, federally guaranteed mortgage revenue bonds because: (a) they still retain the possibility of recovering some of their previously-recognized loss if the property values increase and the borrower exercises his repurchase option within the 5 year lease term, i.e., they would receive 50% of the increased value as an "equity kicker"; (b) the bonds, as federally insured instruments, should qualify as part of Tier 1 Capital for regulatory capital purposes for financial institutions; (c) some of their gains from bond revenue and future income may not be taxable under "loss carry forward" accounting rules and may offset part of the loss recognized when the property was condemned, and (d) the Mortgage Revenue Bonds, as a 5-year, federally guaranteed instrument yielding almost 350 bps higher than a comparable 5-year US Treasury Note, make it an attractive short term investment.

11. Who's going to decide how much the property is worth when the Municipality condemns it?

    ANSWER: Allow the current servicer order at least 2 appraisals and have them forwarded to the City Attorney's office or its designee to handle the valuation.

Conclusion

While there is no perfect solution, eminent domain is a step in the right direction, a step that better serves the public need for a public purpose. Some professional economists have suggested that the average LTV in certain California communities is 167% and the average unemployment rate is 25%. The problem is not unique to California. Other states and cities are confronted with this issue and the list keeps growing every day. The Wall Street Journal reports that while housing prices seem to have stabilized, there hasn't been an increase in owner occupancy. That means that private investor groups are going to profit from the purchase of a massive number of homes and rent them out themselves.

Private investment in residential housing is a good first step but it can't solve the long term housing crisis and the bankruptcy problem confronting more and more of our cities on a daily basis. At some point in the very near future, the mortgage servicers, who are advancing property taxes and insurance premiums for delinquent homeowners utilizing their lines of credit, are going to run out of credit facilities themselves. Mortgage servicer's "accounts receivable" financial resources, even if 100% of their

advances are reimbursed on liquidation of the property, aren't infinite. That would leave private investors to buy delinquent tax liens at a discount to earn a 12%+ return on a "super lien" in order to preserve cash flow for our cities.

When the Federal Reserve permitted private banks and investment banks to implement the "pretend and extend" policy on its "mark to market" rules, it not only extended the housing crisis, it exacerbated it. The judicious use of eminent domain, when properly structured, can and will

1. relieve the financial stress on the housing market,
2. generate property tax revenues for municipalities while reducing the costs of managing blight,
3. generate income to the State by way of guaranty fees while mitigating the losses incurred in losing its tax base as its citizens relocate,
4. generate income for the Federal government for its guaranty and may reduce the costs to taxpayers of another bail out,
5. encourage homeowners not to abandon their homes because the payments are more affordable and to maintain them because of the possibility of recovering some of their lost "equity" if the market returns,
6. provide upside to municipalities and investors by providing them with an "equity kicker" opportunity if the tenant exercises the purchase option at a time when home prices had bottomed out and are beginning to rise,
7. provide an opportunity for existing investors to trade an underwater, uninsured asset for a federally insured, state issued, piece of short term paper yielding 3.50% more than a comparable US Treasury Note with the possibility of recovering some of the loss recognized when the unrealized losses were recognized, and
8. would provide a realistic alternative by which Wall Street can craft a financially viable solution to a problem it was instrumental in creating.

That sounds like a good trade-off when viewed in light of existing proposals being considered today. Desperate times call for desperate measures. Time is quickly running out for us to implement an "out of the box" solution. That time is now.

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Washington's highest court rules MERS cannot foreclose on homeowners

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By **Brent Hunsberger, The Oregonian**

The Washington Supreme Court ruled unanimously today that the mortgage industry's controversial document-recording system lacked authority to start out-of-court foreclosures and might have violated state consumer protection laws.

The Associated Press

Washington Supreme Court Justice Tom Chambers, pictured here in 2006, wrote the opinion holding that lenders in the state could not foreclose on homeowners in the name of the Mortgage Electronic Registration Systems Inc.

The state's highest court **ruled** that lenders could not foreclose on homeowners in the name of the Mortgage Electronic Registration Systems Inc. It found that **MERS** did not meet Washington's definition of a beneficiary and could not foreclose on behalf of a lender that holds the mortgage note.

"Simply put, if MERS does not hold the note, it is not a lawful beneficiary," the court wrote in an opinion written by Justice Tom Chambers and released today.

The Oregon Supreme Court also **is considering whether** MERS can be a beneficiary under Oregon law, said Rick Fernandez, an attorney in Lake Oswego whose cases are before the court.

In July, the Oregon Court of Appeals ruled that lenders could not use MERS to skirt state law requiring that all mortgage sales be recorded in county offices before launching out-of-court foreclosures.

Washington's court today also found that MERS's involvement in robo-signing mortgage documents, among other behaviors, appeared to violate Washington's Consumer Protection Act. But consumers must try such claims on a case-by-case basis, the court said

MERS was created by the mortgage industry to bundle and sell loans to investors without having to record every assignment with county clerks. It is involved in most mortgages across the country, but does not take payments

from borrowers or negotiate on behalf of lenders.

MERS spokeswoman Janis Smith noted that Thursday's decision applies only to non-judicial foreclosures done outside a courtroom, the process lenders typically use. MERS voluntarily changed its rules in July 2011 to stop foreclosures in its name, she said.

Melissa Huelsman, a Seattle attorney, represented homeowner Kristin Bain in one of the cases against the court. Bain had sued Metropolitan Mortgage Group, Indymac Bank, Fidelity National Title and MERS.

Huelsman said the ruling cleared the path for homeowners to recover damages and attorneys fees from lenders found to have wrongfully foreclosed. She called the decision a victory for the rule of law.

"Too often we've seen courts twisting themselves into knots to get to a decision that's inconsistent with the statute," Huelsman said.

Attorneys said they were still evaluating how the decision impacts existing cases and already completed foreclosures.

"I would guess that lenders will approach out-of-court foreclosures involving MERS much more cautiously," Fernandez said.

Washington Attorney General Rob McKenna and the National Consumer Law Center had submitted briefs supporting the cases of Bain and homeowner Kevin Selkowitz. The Washington Bankers Association had supported MERS.

In its ruling, the court noted the confusion MERS had caused distressed homeowners who were trying to identify and negotiate modifications with the true owner of their mortgage.

"While not before us, we note that this is the nub of this and similar litigation and has caused great concern about possible errors in foreclosures, misrepresentation, and fraud," the opinion said.

"Under the MERS system, questions of authority and accountability arise, and determining who has authority to negotiate loan modifications and who is accountable for misrepresentation and fraud becomes extraordinarily difficult."

It called the debate over whether MERS could foreclose without owning the mortgage as "a simple question" under Washington law: "... if MERS never 'held the promissory note' then it is not a 'lawful beneficiary.'"

The court cited previous federal court rulings in Washington in favor of MERS as "not well taken."

The cjustices declined to evaluate the legal impact of their ruling, as U.S. District Court Judge John C. Coughenour **asked them to** last year when he sought their opinion.

Under the state's Consumer Protection Act, MERS's characterization of itself on deeds of trust as a beneficiary could be considered an unlawful deceptive practice, the court said.

"The fact that MERS claims to be a beneficiary, when under a plain reading of the statute it was not, presumptively meets the deception element of a CPA action," the court said.

So could MERS's participation in robo-signing mortgage documents, the court said.

"MERS's officers often issue assignments without verifying the underlying information, which has resulted in incorrect or fraudulent transfers," the court said. "Actions like those could well be the basis of a meritorious CPA claim."

The court also said MERS could not show that it acted as an agent for parties who owned Bain and Selkowitz's loans, which are often sold repeatedly to other investors. MERS also failed to identify the parties that control and are accountable for its actions, the court said.

MERS spokesman Jason Lobo said it will be able to show a trial court which lenders it represented in those cases.

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