Mortgage Resolution
PARTNERS

September 7, 2012

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

**VIA EMAIL: eminentdomainOGC@fhfa.gov AND**
**VIA FAX 202-649-1071**

Comment letter on Federal Register Notice No. 2012-N-11 ("Use of Eminent Domain to Restructure Performing Loans")

Dear Mr. Pollard,

Mortgage Resolution Partners LLC ("MRP") appreciates the opportunity to comment on Federal Register Notice No. 2012-N-11 (the "Notice"). MRP is a community advisory firm that assists local governments around the nation in acquiring underwater mortgage loans (including through eminent domain) and refinancing them at sustainable, reduced principal balances with the goal of keeping American families in their homes.

Summary:

MRP strongly recommends that FHFA cooperate with state and local governments that use eminent domain to acquire mortgage loans from PLS trusts, and not take any action to impede their efforts.

Eminent domain is an important and long-established constitutional mechanism that permits local governments to mitigate damage to their jurisdictions from loan defaults, particularly within the predominately working class and middle class cities and counties that have been hardest hit by the mortgage crisis (many of which have substantial Latino and African American populations). Any actions by Fannie Mae or Freddie Mac (the "GSEs") to retaliate against these jurisdictions (as suggested by certain Wall Street special interest groups) would create significant liability for geographic redlining and must be avoided.

Eminent domain is also an important method for mitigating losses to investors, including investors in private label securitizations ("PLS") including the GSEs, and lenders holding PLS securities or whole loans as collateral like the Federal Home Loan Banks (the "Banks"). Experts agree that properly executed eminent domain actions can increase realized value for PLS investors. Therefore FHFA's regulatory and conservatorship mandate requires cooperating with these actions to increase value for the GSEs and minimize eventual and inevitable losses for American taxpayers. Impeding the actions would be contrary to the FHFA's regulatory and conservatorship mandate.

Governments will pay fair value for all loans acquired by eminent domain, as indeed they are required to do by the courts that oversee all eminent domain proceedings. In determining fair value, moreover, they will use the valuation methodologies that the GSEs themselves use in setting impairment reserves for their investments in the troubled PLS securities they hold and have already taken impairment adjustments for. Therefore the actions will not create any losses for the GSEs or taxpayers.

MRP also observes that the FHFA has no apparent authority or jurisdiction over actions of local governments seeking to exercise the power of eminent domain to acquire PLS loans in accordance with their respective state constitutions, and therefore questions FHFA's assertion in the Notice "that action may be necessary" on its part in this connection.

Importance of using eminent domain:

The mortgage crisis has caused disproportionate harm to the hardest hit cities and counties in the United States. This harm includes reduced property taxes, increased vacancy and crime, and damage to public health. The crisis has also disproportionately affected minority communities, particularly Latinos and African Americans. In the predominately minority San Bernardino County, for example, subprime originations in 2005-2008 were 52% of loan originations by balance, compared to only 37% nationwide.

Loans originated for private label securitization ("PLS") trusts have been especially harmful, with significantly higher rates of subprime loans, loan to value ratios and default rates than loans originated for other purposes. The constitutive documents of most of these trusts, moreover, tend disproportionately to impede loan-sales and -restructurings that benefit bondholders as much as homeowners and their municipalities. Experts at Amherst Securities have concluded that PLS trusts create significant impediments to resolving underwater loans, particularly ones that are current but highly likely to default, and that properly executed

eminent domain programs can increase realized value for PLS investors.[1] Local governments are accordingly now considering acting to protect their communities by purchasing these PLS loans for fair value and refinancing them in order to prevent the costs to the communities of defaults and foreclosures.

FHFA's conservatorship mandate requires reducing losses to the GSEs and American taxpayers. This requires cooperation with local governments to execute eminent domain programs properly in order to increase the value that the GSEs realize from their PLS investments. It also forbids the GSEs to take actions to retaliate against local governments that implement these programs by redlining them, as suggested by some Wall Street special interests. Such geographic redlining would violate consumer protection laws and subject the GSEs to significant legal liabilities.

General recommendations:

First, FHFA should cooperate with any state or local government that proposes to use eminent domain to acquire PLS loans.

Second, FHFA and the GSEs should not retaliate in any way against jurisdictions that utilize eminent domain to acquire PLS loans.

Third, to the extent FHFA has concerns about the use of eminent domain, it should defer any action until it learns more about actual plans of local governments and actual loan prices determined in eminent domain proceedings. Any action by FHFA at this time to impede local government action is premature and would be based on assumptions and inadequate knowledge as to programs that have not, after all, yet been fully formulated, adopted or implemented.

Fourth, if and when FHFA does take action (other than cooperating with local governments), it should restrict action to communities that seek to use eminent domain to acquire whole loans owned by or pledged to the Federal Home Loan Banks or the GSEs, or owned by trusts the beneficial interests of which are guaranteed by the GSEs ("Federal Loans"). If a government uses eminent domain only to acquire private loans, such as loans held by PLS trusts, the acquisition has no impact on the credit or liquidity of Federal Loans, so no action is justified or

[1] See Amherst Securities Group LP, "Creative Uses of Eminent Domain – Implications for PLS Trusts" (June 28, 2012), page 2.

within the mandate of FHFA. FHFA should not countenance the redlining of jurisdictions and thereby risk increasing credit prices or reducing credit availability to consumers for newly originated Federal Loans simply because a government uses eminent domain to acquire private loans. Furthermore, as the agent of the federal government, the FHFA should not countenance redlining in any guise.

Specific comments on FHFA's concerns:

FHFA's jurisdiction and States' jurisdiction. Eminent domain is an inherent power of sovereign states, which the states have delegated to cities and counties. When cities and counties use eminent domain they act under the power of the state. The use of this power to purchase private loans (not Federal Loans) is entirely within the states' rights and does not affect FHFA's prerogatives over federal loans, the GSEs, or the Banks. Further, because condemning private loans has no effect on credit, liquidity or other features of Federal Loans, any action to alter the GSEs' policies to retaliate against jurisdictions that condemn private loans would be a regulatory action, not a conservatorship action. It would be arbitrary and capricious because condemning private loans has no effect on Federal Loans, and it would be contrary to the GSEs' statutory mandate to support conforming loans. It would be subject to full judicial review.

Terms of investment. Local governments are considering purchasing troubled private loans from private trusts, governed by state (not federal) law, that have issued private securities. The GSEs and Banks hold these private securities like any other investor and are subject to the trusts' contractual limitations. These trusts generally deny voting or management rights to investors and forbid them to use any rights as investors to the detriment of other investors. These are business investments and must be managed as such.

FHFA may not under pretext of safety and soundness concerns override preexisting contractual limitations that apply to trust investors, in violation of the Contract Clause of the federal constitution. Neither may it bootstrap its way to overriding state law on the use of eminent domain. High unemployment and low wages among those who owe money on loans in GSE trusts, for example, pose a threat to the safety and solvency of the GSEs – as they make default likely. But, by way of analogy, that does not confer upon FHFA the power to dictate wage and employment rules for the states, or to force private companies to hire GSE borrowers, or to force anyone to increase wages for GSE borrowers. Similarly, when the Banks take state debt as collateral, they cannot dictate state fiscal policies, raise state taxes, or otherwise override state laws to maximize the value of the collateral.

States and their delegates have the constitutional authority to use eminent domain to purchase troubled private loans. They will – as of course they must – respect the sovereignty of the

federal government over Federal Loans, and we expect that the federal government will respect the states' counterpart sovereignty over private loans. Even if FHFA had the authority to override states' rights in this area, which it does not, the concerns listed in the notice would not support any action.

Pricing generally. Eminent domain requires good faith negotiations over the price of property subject to condemnation. No government has adopted any eminent domain program, let alone begun to negotiate price. Any action based on concerns about the price that a PLS trust *might* ultimately receive would be speculative and premature. The reason, again, is that eminent domain law, overseen by the courts in all eminent domain proceedings, *mandates* payment of fair value; there simply is no ability under the law to purchase loans for a lower price. FHFA must also respect the constitutional rights of state courts in this connection as well as the separation of judicial powers from those of the executive branches of government, as a general matter.

Effect on value of GSE and Bank investments. Local governments must pay fair value for all mortgage loans and therefore will not cause any losses. All losses have in fact already occurred because of the disastrous collapse of housing prices in affected communities. The GSEs take reserves against their PLS investments based on a loan by loan analysis of the underlying loans within the trusts. MRP is committed to working with governments that will pay the full value of each acquired loan net of the actual related reserves that the GSEs hold against the trust investments with respect to the loan, so that neither the GSEs nor the taxpayers can suffer any loss.

In addition, after discussions with local governments across the country, MRP will expand the services it provides to cover *all* PLS loans, not just those that are current. This will enable local governments to acquire and resolve the greatest number of loans, helping the greatest number of homeowners. In addition, it will provide additional benefits for PLS investors like the GSEs and Banks, who currently suffer significant losses from defaulted loans. FHFA's conservatorship mandate requires cooperation with such loss mitigation in order to minimize losses to the GSEs and to American taxpayers.

Safe and sound operations. Even if eminent domain actions could harm the value of PLS investments that the GSEs and Banks hold, they would not have any impact on safety and soundness. As of March 31, 2012, the fair value of PLS holdings on the books of the GSEs already includes reserves for losses equal to nearly 25% of the unpaid principal balances on the underlying PLS loans, and represents less than 1.3% of GSE assets. No conceivable eminent domain action, supervised by courts and based on expert appraisals, could result in a valuation sufficiently lower than the existing 25% loss reserves to create any safety or soundness issue for the GSEs. This point cannot be emphasized too much.

Valuation by local governments of complex financial instruments traded on national and international markets. This concern is misplaced for three reasons. First, as even a noted opponent of eminent domain recognizes, governments do not fix the compensation for condemned property -- the parties utilize appraisers, and a jury generally determines fair value, whether the condemnor is a local government or the federal government.[2] Our federal system respects local governments as much as the federal government, and it respects the decisions of citizen-jurors whether they are hearing a federal or local condemnation action.

Second, governments will *not* purchase complex internationally traded financial instruments. They will purchase individual mortgage *loans*, which are not at all complex. Wall Street prices individual mortgage loans every day, and many public companies (including banks) carry mortgage loans at fair value in audited financial statements that corporate officers certify at risk of sanctions.

Third, other forms of intangible property are frequently subject to taxation at fair value, and there is no reason to believe that there is any lesser ability to value intangible property for condemnation purposes than for tax purposes.

The use of eminent domain to revise existing financial contracts. This concern reveals a fundamental misunderstanding of the proposals to use eminent domain to acquire mortgage loans. No government will use the power of eminent domain to revise any contracts. Governments will use the power to *purchase* contracts, which the U.S. Supreme Court has long held is within the sovereign power of eminent domain, to which the Contract Clause of the U.S. constitution does not apply.[3] Thereafter, the government may accept a short refinance or otherwise reduce principal, but purely in its capacity as owner of the loan, like any other owner who accepts a HAMP modification, an FHA short refinance, or other resolution to maximize the value of the asset.

Effects on other performing loans. Concerns about the effect of eminent domain on other performing loans are unjustifiable. There have been many instances of principal reductions on performing loans that have had no effect on other loans (particularly GSE loans), and for which FHFA has not proposed to take any action. For example, Bank of America and JPMorgan Chase have unilaterally reduced principal on portfolio loans in order to maximize the net present value of the loans by preventing default with its

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[2] See Gideon Kanner, http://gideonstrumpet.info/?p=3838.

[3] *See, e.g., Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). For more information on this topic, see this link: http://mortgageresolutionpartners.com/fact-or-fiction.

related costs.[4] In addition, the FDIC has frequently used its governmental powers to acquire performing loans and transfer them to a public/private partnership to work them out to prevent default.[5] The federal government has made principal reduction an important policy goal through the FHA short refinance program and HAMP, which are not restricted to defaulted loans.

Potential chilling effects. American governments have used eminent domain to condemn bondholder rights, residential rental real estate,[6] corporate stock,[7] and a myriad of other assets without chilling lending, rental investments, or stock investments. In particular, Connecticut has condemned tax-exemption covenants in some $4 billion of its own state debt, retroactively subjecting the bonds to tax, without chilling lending to the state.[8] New York law authorizes the Long Island Power Authority to condemn debt issued by local utilities, and this has not chilled lending to New York utilities.[9]

Proponents have advocated using eminent domain to purchase mortgage loans (including securitized loans) since 2008.[10] The use is constitutional and was in fact prescribed by the U.S. Supreme Court,

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[4] See "Big Banks Easing Terms on Loans Deemed as Risks," New York Times (July 2, 2011): http://www.nytimes.com/2011/07/03/business/03loans.html?_r=2.

[5] See, e.g., FDIC taking over a failed bank and transferring a portfolio consisting of 70% performing loans to a public/private workout entity: "Legacy Loans Program -- Winning Bidder Announced in Portfolio Sale," http://www.fdic.gov/news/news/press/2009/pr09172.html.

[6] See *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984).

[7] See, e.g., *Offield v. New York, New Haven & Hartford R.R. Co.*, 203 U.S. 372 (1906).

[8] For a description of the use of eminent domain on Connecticut state debt, see "Billions in Tax Revenue Stays in State, Thanks to Squire Sanders," http://www.squiresanders.com/de/experience/casestudies/CaseStudyDetail.aspx?StudyID=493; for Connecticut legislation, see: http://www.cga.ct.gov/2011/pub/chap208b.htm.

[9] See New York State Public Authorities Law, art. 5, tit. 1-A, sec. 1020-f(e).

[10] See Howell Jackson, "Build a Better Bailout," http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html. For other suggestions to use state eminent domain authority to purchase loans or homes to resolve the mortgage crisis, see "Builder: Eminent Domain Could Calm Foreclosure Chaos," Las Vegas Sun, http://www.lasvegassun.com/news/2009/feb/13/builder-eminent-domain-could-calm-foreclosure-chao/, and Lauren Willis, "Stabilize Home Mortgage Borrowers, and the Financial System Will Follow," http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1273268.

which explicitly instructed in 1935 that where "the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain . . ."[11] Even lenders who were unaware of the law before this crisis are now fully aware of the legality of loan condemnation. Lenders will price this risk into future loans whether or not any local government actually exercises the power now, so there is no reason to impede the use of the sovereign power of eminent domain to mitigate losses now.

Constitutionality. In our system of checks and balances, the *courts*, not executive agencies, determine the constitutionality of condemnations. A federal agency should not interfere with judicial determinations of the law. The use of eminent domain to purchase mortgage loans from private label securitization trusts is constitutional, and courts will so determine in eminent domain actions.

Fees and costs of the action. These are matters for the local government to evaluate. Under our federal system, they are not for a federal agency to evaluate.

Role of courts and use of judicial resources. These are also matters for the local government to evaluate, not a federal agency. California has already considered the issues and enacted legislation giving eminent domain actions priority over all other civil actions in court. Courts will expeditiously hear these actions because California has already acknowledged their importance.

The application of consumer protection laws. We are confident that local governments will comply with all applicable consumer protection laws. We applaud FHFA's concerns about these laws and hope that it will ensure that all other market participants, including Fannie Mae, Freddie Mac, and members of SIFMA and the ASF, comply with these laws and do not redline any communities that use their authority to mitigate the mortgage crisis in their communities.

Sincerely,

Graham Williams
Chief Executive Officer

[11] *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 602 (1935).