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Richmond: Take My Mortgage, Please!

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RICHMOND: TAKE MY MORTGAGE, PLEASE!

The burst of the housing bubble brought challenges for many homeowners, as the value of their homes spiraled downward and many were forced into foreclosure. This, in turn, has caused difficulties for cities, as the vacant and abandoned neighborhoods have become a hub for blight and transience, and the tax base has steadily declined. In an effort to combat these issues, Richmond, California's mayor, Gayle McLaughlin, has teamed up with Mortgage Resolution Partners, LLC. The pair plans to use Richmond's power of eminent domain to "take" underwater mortgages and then refinance them, selling the new mortgages to investors. The plan, however, has met staunch resistance from many, including banks, which represent the current mortgage holders, as well as the Federal Housing Finance Agency, which challenges the wisdom and legality of such a plan. In the battle that has ensued, both sides are standing strong. The opponents are especially worried that a victory for McLaughlin could spur other cities into action, resulting in huge losses for investors. This article posits that while Richmond's plan is bold and likely has legitimate intentions, its constitutionality is questionable and its implementation could bring about catastrophic results.

I. INTRODUCTION

On Homer Avenue on the east side of Cleveland, Ohio, vacant homes litter the landscape. Although fewer than twenty houses line the street, seven of them sit empty and only two of those have been boarded and secured by the city. The vacant homes are in various states of disrepair. Their yards fill the weeds in the summer and a multiplicity of insects breed in the grass. Most of the houses have broken windows, chipped paint, and dislodged gutters. One house draws a number of people who engage in illicit activities during the evening hours. In addition to the empty houses, three once-vibrant commercial buildings sit empty as well. The factory at the end of the street provides one function for the neighborhood; teenagers amuse themselves from time to time by breaking the factory windows with rocks, leaving shattered glass strewn about the street. Two boarded school buildings dominate the other end of the street. Loose bricks occasionally cascade from the second stories, crashing to the street below. Although the current owner removed the rickety and rusty fire escapes that children previously climbed, poison oak plants still run the length of the building.¹

This scene is not an unfamiliar one for residents of cities across the country. Spurred by the burst of the housing bubble and the great recession, vacancy and abandonment continue to cause significant problems for cities.² The problem is multifaceted. The abandoned homes mark the deterioration of a neighborhood, inviting blight, crime, and transience. Even one dilapidated property signals to homeowners and potential buyers alike that the neighborhood is not a good investment.³ Malcolm Gladwell discusses this in his book, *The Tipping Point*:

If a window is broken and left unrepaired, people will conclude that no one cares and no one is in charge. Soon, more windows will be broken and the sense of anarchy will spread from the building to the street on which it faces, sending a signal that anything goes.⁴

1. This hypothetical comes from the experience of Matthew J. Samsa. Matthew J. Samsa, *Reclaiming Abandoned Properties: Using Public Nuisance Suits and Land Banks to Pursue Economic Redevelopment*, 56 CLEV. ST. L. REV. 189, 190 (2008).

2. Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 355 (2006).

3. James J. Kelly, *Refreshing the Heart of the City: Vacant Building Receivership as a Tool for Neighborhood Revitalization and Community Empowerment*, 13 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 210, 212 (2004).

4. This summary of Broken Windows Theory, from the journalist and author Malcolm Gladwell's book, *The Tipping Point*, demonstrates how behavior is shaped by our environment—even by details that may at first seem small. *Id.* (quoting MALCOLM GLADWELL, *THE TIPPING POINT* 141 (2000)).

These visible environmental details shape behavior.⁵ Just as one would expect that if a mugging occurs, it does so in a graffiti-filled subway tunnel or similar locale, one would expect that when crime occurs, it does so in a depressed neighborhood full of vacant, dilapidated houses.⁶ Not only is such a neighborhood a convenient site for hosting criminal activity, but the vacant houses also tell everyone that the neighborhood is the type of place where criminal activity is expected.⁷ As people in a neighborhood see that dilapidation and crime are expected, neighborhoods decline in a vicious cycle.⁸ This problem is compounded by the reduction of the tax base that necessarily follows when homeowners are forced out of their homes.⁹ Cities face a two-pronged attack—they have more problems to solve and less money with which to solve them.

In its exploration of Richmond, California's plan to use eminent domain to take mortgages that are underwater (the "Richmond Plan"), this article discusses the factors leading to, and the potential consequences following, the Richmond Plan.¹⁰ Following this introduction, Part II gives a brief background of eminent domain. Part III of this article discusses the factors leading to the burst of the housing bubble and examines the way in which it contributed to large numbers of foreclosures across the country, especially in Richmond. Part IV of this article will outline Richmond's plan to combat blight by working with Mortgage Resolution Partners, LLC (MRP) to use its eminent domain power to take approximately 600 houses that are underwater. In Part V, this article outlines the current status of the Richmond Plan. Next, Section VI analyzes the constitutionality of the Richmond Plan, focusing specifically on the Takings Clause of the Fifth Amendment. While this article briefly touches upon other potential constitutional challenges to the plan, the article's main focus is the Takings Clause. This article posits that despite the Supreme Court's deference to the legislature, the Richmond Plan may have some real

5. *Id.* (citing MALCOLM GLADWELL, *THE TIPPING POINT* 142–50 (2000)).

6. *Id.* at 212–13.

7. *Id.*

8. *See id.*

9. Samsa, *supra* note 1, at 191; *see also* MORTG. RESOLUTION PARTNERS, HOMEOWNERSHIP PROTECTION PROGRAM: A SOLUTION TO A CRITICAL PROBLEM 6 [hereinafter MRP] ("Consider, for example, a home that was purchased for \$400,000 with a \$360,000 mortgage and has a current tax assessment of the purchase price. If that home sells in foreclosure for \$200,000, its tax assessment is reset and can only increase by a small amount each year in many communities.").

10. The city of Richmond, California, led by Mayor Gayle McLaughlin, is still planning to move forward with the use of eminent domain to take mortgages that are currently underwater. At least four other cities that considered using eminent domain to take underwater mortgages have backed down, deciding that it is too risky. Shaila Dewan, *Eminent Domain: A Long Shot Against Blight*, N. Y. TIMES, Jan. 11, 2014, <http://www.nytimes.com/2014/01/12/business/in-richmond-california-a-long-shot-against-blight.html>.

issues with the Takings Clause. In Part VII, this article urges that while the plan is creative and well intentioned, it will ultimately cause more harm than good. Not only is the legality of Richmond's action questionable, but it also threatens to have just the effect it is meant to solve; it will give a significant windfall to a private company and to individual Richmond homeowners who may have taken out too risky of loans, while ultimately hurting the often working-class individuals who have invested in residential mortgage-backed security (RMBS) trusts and the people of Richmond who will likely have a difficult time procuring future financing.¹¹ The Richmond plan could cause a snowball effect, allowing cities to intervene to break any number of private contracts, further hurting private investors and turning the mortgage industry on its head. Especially at a time when the industry is recovering, this simply does not make sense.

II. EMINENT DOMAIN

Before undertaking an analysis of the Richmond Plan, it is necessary to outline the basics of eminent domain. Eminent domain comes from the Takings Clause of the Fifth Amendment¹² and applies to state governments through the Due Process Clause of the Fourteenth Amendment.¹³ An attribute of governmental power or sovereignty, eminent domain is a process whereby the government is allowed to compel a transfer of property rights in return for just compensation.¹⁴ For example, if the government wants to build a highway that must run in a relatively straight line, the government may use eminent domain to take the requisite property from the property owners who are unwilling to sell their land.¹⁵

In order to be constitutional, however, exercises of eminent domain must satisfy both statutory and constitutional requirements.¹⁶ Specifically, eminent

11. In 2008, John McCain suggested using federal bailout money to buy troubled mortgages and write them down. However, this plan failed because the rules governing many of these pools forbade the trustee, or investor's representative, from selling or modifying the mortgages unless they were already in default, *even if* sale or modification would be in the investors' interests. *Id.*

12. U.S. CONST. amend. V (“[N]or shall private property be taken for public use without just compensation.”).

13. *Chicago, Burlington & Quincy R.R. Co. v. Chicago*, 166 U.S. 226, 239 (1897) (“The conclusion of the court on this question is, that since the adoption of the Fourteenth Amendment compensation for private property taken for public use constitutes an essential element in ‘due process of law,’ and that without such compensation the appropriation of private property to public uses, no matter under what form of procedure it is taken, would violate the provisions of the Federal Constitution.”).

14. THOMAS W. MERRILL & HENRY E. SMITH, *PROPERTY: PRINCIPLES AND POLICIES* 1220 (2d ed. 2012).

15. *See id.*

16. *Id.* at 1221.

domain may only be deployed for a “public use,”¹⁷ and the government must pay “just compensation” for the property.¹⁸ However, these terms can be difficult to interpret. Initially, state courts held that “public use” meant that the property had to be taken for “use by the public.”¹⁹ Yet the Supreme Court only requires that the property be used for the public advantage or benefit and has given great deference to the legislature in determining whether a taking satisfies the “public use” requirement.²⁰ Just as the meaning of “public use” is not intuitive, “just compensation”²¹ can be difficult to define.²² Since eminent domain is typically used when negotiations for a market transaction break down, “fair market value” becomes a hypothetical guess about what the property should have received if transfer of the property had been voluntary.²³ However, the formula used by the courts does not take into account factors such as subjective value; as a result, it cannot be an exact figure.²⁴

Having discussed the basics of eminent domain, this article will now explore the factors leading toward Richmond, California’s novel plan to use its eminent domain power to take mortgages that are underwater.

III. CITIES IN DISTRESS

The first step in understanding the Richmond Plan is to explore the factors contributing to the plan’s birth by examining the expansion and burst of the housing bubble, and then by specifically zeroing in on Richmond’s situation.

The vicious cycle of foreclosure and neighborhood decline began in cities across the United States with the burst of the housing bubble²⁵ and the great recession.²⁶ Large numbers of homeowners who invested in houses they could barely afford when the market was at its peak are now underwater on

17. *Id.*

18. *Id.* at 1245.

19. “Use by the public” meant that property could be taken for highways, parks, railroads, etc., that would be used by the public, but not for a private home or factory. *Id.* at 1221 (citing Philip Nichols, Jr., *The Meaning of Public Use in the Law of Eminent Domain*, 20 B.U. L. REV. 615, 633 (1940)).

20. MERRILL & SMITH, *supra* note 14, at 1221–22.

21. See *United States v. Miller*, 317 U.S. 369 (1943), and MERRILL & SMITH, *supra* note 14, at 1250–54, for further discussion of “just compensation.”

22. MERRILL & SMITH, *supra* note 14, at 1245–46.

23. *Id.* at 1250.

24. See *id.* at 1252–53. See generally Brian Angelo Lee, *Just Undercompensation: The Idiosyncratic Premium in Eminent Domain*, 113 COLUM. L. REV. 593 (2013).

25. DEAN BAKER, CTR. FOR ECON. & POLICY RESEARCH, THE HOUSING BUBBLE FACT SHEET 3 (2005), available at http://www.cepr.net/documents/publications/housing_fact_2005_07.pdf.

26. See M. Hampton Foushee, *Eminent Domain, Mortgage Backed Securities, and the Limits of the Takings Clause*, 8 N.Y.U. J.L. & LIBERTY 66, 69–70 (2013).

mortgages,²⁷ meaning that they owe more—sometimes significantly more—than the homes are currently worth.²⁸ Faced with this dilemma, many homeowners will default on their mortgage payments, either out of necessity or because of a cost-benefit analysis.²⁹ These defaults subject the homes to foreclosure or abandonment and have had the effect of decimating neighborhoods.³⁰ The decimation has plagued cities, not only increasing the crime, blight, and transience, but also reducing the tax base, making it more difficult for cities to take action to fix the problem.³¹ In Irvington, New Jersey, for example, the city has spent \$14 million in response to various hazards related to vacant homes, all the while struggling with dropping property values.³² As cities struggle, they have looked high and low for solutions.

One such city is Richmond, California, a city near San Francisco that was hit hard by the burst of the housing bubble.³³ Following the burst, Richmond's mayor, Gayle McLaughlin, began working with MRP on a novel program.³⁴ The city plans to use eminent domain to take mortgages that are underwater and refinance them, hopefully creating more manageable monthly payments. This would allow homeowners to remain in their homes, help to stabilize the community, and lead Richmond out of the great recession, though it has yet to move forward implementing this creative solution.³⁵ This plan has been the subject of harsh criticism and staunch opposition from many, including banks, the Federal Housing Finance Agency (FHFA), the Securities Industry and Financial Markets Association (SIFMA), and even a Richmond realtors'

27. An underwater mortgage is an outstanding mortgage on which the homeowner debtor owes more on the mortgage than the market value of the house. For example, the Smiths might have purchased a home in 2006, when the home was worth \$400,000. The Smiths currently owe \$360,000 on their home; however, due to the burst of the housing bubble, this home is now worth only \$260,000. Thus, the Smiths are \$100,000 underwater on their investment. *See America's Housing Market: Not waving but drowning*, *ECONOMIST*, Jan. 4, 2014, <http://www.economist.com/news/finance-and-economics/21592644-radical-plan-help-underwater-homeowners-makes-comeback-not-waving> [hereinafter *ECONOMIST*].

28. *Id.*

29. Roger Lowenstein, *Walk Away From Your Mortgage!*, *N.Y. TIMES*, Jan. 7, 2010, http://www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html?_r=0.

30. *See Kelly, supra* note 3, at 212–13.

31. Samsa, *supra* note 1, at 191.

32. Joe Tyrrell, *NJ Town Turns to Eminent Domain to Clean Up Blight of Foreclosed Houses*, *NJ SPOTLIGHT*, Nov. 20, 2013, <http://www.njspotlight.com/stories/13/11/19/nj-town-turns-to-eminant-domain-to-clean-up-blight-of-foreclosed-houses/?p=all>.

33. Dewan, *supra* note 10.

34. *Id.*

35. *Id.* Because Richmond has not yet taken action toward seizing mortgages, mortgage-bond trustees have dismissed their lawsuits due to lack of ripeness until or unless Richmond chooses to use its eminent domain power to take mortgages. Sam Forgione, *Investors withdraw appeals against eminent domain plan*, *REUTERS*, May 16, 2014, available at <http://www.reuters.com/article/2014/05/17/us-mortgages-investing-eminantdomain-idUSBREA4G00A20140517>.

association.³⁶ In the legal battle that has ensued, many are left wondering what the implications of this novel plan will be if it succeeds.³⁷

A. *The Housing Bubble Burst*

In order to understand the challenges Richmond is facing, it is vital to consider the burst of the housing bubble. From 1950 to 1995, house prices grew at the same rate as other goods and services after adjusting for inflation—the normal and sustainable pattern for market growth.³⁸ However, after 1996, house prices began rising substantially—growing 45% *after* adjusting for inflation.³⁹ In fact, in 2005, housing construction constituted approximately 5% of GDP,⁴⁰ and each week roughly 140,000 families purchased a home.⁴¹ Some regions saw an increase in home prices of 60%.⁴² Generally, when prices in an industry rise, it is because of growth in population or income, or because of other natural factors.⁴³ Yet during this particular period of growth, there was no substantial rise in either population or in income to explain the huge increase in the market.⁴⁴ Significantly, as the housing market increased, the rental market remained relatively steady, which is unique because home prices and rental prices typically increase or decrease at a similar rate.⁴⁵ The increase in the housing market was especially high on the East and Pacific coasts.⁴⁶ While it is not surprising that houses on the coasts would be more expensive than houses in other regions, there is still a limit to how much people will pay to live in these areas.⁴⁷ In situations such as this, the economies are eventually unable to function until housing prices are reduced to a competitive price.

At the same time house prices were rising, the ratio of home equity to home value plummeted, reaching a near record low in 2005.⁴⁸ In June of 2006, US residential housing prices were at their peak,⁴⁹ and buyers, who had become accustomed to a strong market and the idea of home ownership as an investment, borrowed blindly due to the high equity offered by the homes.⁵⁰

36. Dewan, *supra* note 10.

37. *Id.*

38. Baker, *supra* note 25, at 1.

39. *Id.*

40. *Id.* at 3.

41. *Id.* at 4.

42. *Id.* at 5.

43. *Id.* at 1.

44. Baker, *supra* note 25, at 1.

45. *Id.* at 2.

46. *Id.*

47. *Id.*

48. *Id.* at 3.

49. MRP, *supra* note 9, at 3.

50. *See* Baker, *supra* note 25, at 3.

Yet these buyers bought homes they could barely afford.⁵¹ Unfortunately, this meant that when homes began to lose value, many homeowners owed more on their mortgages than their homes were worth.⁵² The same homeowners were left with either no choice but to default because of the strained economy or a strong incentive to default.⁵³

Defaults ultimately result in large numbers of foreclosures, and the large numbers of foreclosures can result in vacant and abandoned houses.⁵⁴ From 2000 to 2010, the number of vacant housing units increased by 4.5 million, or 44%.⁵⁵ Most of the losses have occurred in older industrial cities that have lost jobs and population over the past several years.⁵⁶ In fact, more than half of the twenty cities that were the largest in 1950 have lost at least one-third of their populations.⁵⁷

Yet these defaults, which have been so hard on homeowners and cities, have been hard on mortgage holders as well.⁵⁸ While banks hold a large amount of mortgage debt, mortgage-backed securities, a market that exceeded \$6 trillion in 2005, hold most of the mortgages.⁵⁹ Mortgage-backed securities include local pension plans, 401(k) plans, college savings plans, insurance companies, mutual funds, university endowments, and government-sponsored enterprises.⁶⁰

B. *The Richmond Problem*

Foreclosures and abandonment hit many cities hard, propelling them to take action. One such city is Richmond, a refinery town with a population of

51. Tamara E. Holmes, *5 Lessons from the Housing-Bubble Bust*, MSN REAL ESTATE, <http://realestate.msn.com/article.aspx?cp-documentid=23468447> (last visited Sept. 21, 2014).

52. Baker, *supra* note 25, at 3.

53. *Id.* at 4.

54. *See* Samsa, *supra* note 1, at 191.

55. ALLAN MALLACH, BROOKINGS METROPOLITAN POLICY PROGRAM, *LAYING THE GROUNDWORK FOR CHANGE: DEMOLITION, URBAN STRATEGY, AND POLICY REFORM 3* (2012).

56. *Id.*

57. Timothy Williams, *Blighted Cities Prefer Razing to Rebuilding*, N.Y. TIMES, Nov. 12, 2013, http://www.nytimes.com/2013/11/12/us/blighted-cities-prefer-razing-to-rebuilding.html?_r=0.

58. Baker, *supra* note 25, at 4.

59. Baker, *supra* note 25, at 4; *see also* Complaint for Declaratory and Injunctive Relief at 26, *Wells Fargo Bank et al. v. City of Richmond, Cal. et al.*, No. C 13-03663 CRB (N.D. Cal. Aug. 7, 2013) [hereinafter *Complaint*] (explaining that many mortgage backed securities are held in RMBS trusts. An RMBS trust is an investment vehicle whereby financial and economic risks are distributed by pooling mortgage loans and issuing securities or certificates for which the mortgages serve as a collateral).

60. *Complaint, supra* note 59, at 9, 16.

approximately 106,000.⁶¹ Though the city was a shipbuilding center during World War II, it now has a poverty rate of 17%—a figure that is 3% higher than the California average.⁶² Roughly 38% of Richmond homeowners—more than 7,000 people—are underwater on their mortgages,⁶³ compared with 19% nationally.⁶⁴ In just three years, 2,000 of Richmond's homes have gone into foreclosure.⁶⁵ The issue, however, is not constrained to Richmond.⁶⁶ Nationwide, 23% of those with home loans owed *at least* 25% more than their property is worth, and 7.1 million homes with mortgages were underwater at the end of the second quarter of 2013.⁶⁷ The consequences of these underwater mortgages become significant when homeowners are unable to continue making payments and the owners default on their loan obligations.⁶⁸

While foreclosure can be devastating to individual homeowners, its costs are shared by the community.⁶⁹ As discussed above, some of the challenges associated with foreclosure and abandonment include neighborhood blight, transience, and an unkempt appearance.⁷⁰ Homeowners will sometimes gut and abandon their homes, leading to squatters and crime.⁷¹ When one home in a city neighborhood becomes dilapidated or vacant, the people living in neighboring homes are left to deal with the consequences of the appearance of the unkempt home and the potential for illegal activity.⁷² With small lot sizes and densely populated city neighborhoods, the value of each home is tied to that of the others in the neighborhood.⁷³ As homes lose value, owners may no longer choose to invest in them because the return on capital improvements is

61. Michael B. Marois, *Richmond, California, May Abandon Plan to Seize Mortgages*, BLOOMBERG, Sept. 7, 2013, <http://www.bloomberg.com/news/2013-09-07/richmond-california-may-abandon-plan-to-seize-mortgages.html>; *see also* U.S. Census Bureau, *Richmond (city), California: State & County QuickFacts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/06/0660620.html> (last revised Dec. 4, 2014).

62. Alison Vekshin, *Richmond, California, Advances Mortgage Reduction Plan*, BLOOMBERG, Sept. 11, 2013, <http://www.bloomberg.com/news/2013-09-11/richmond-california-advances-mortgage-reduction-plan.html>.

63. *Id.*

64. Dewan, *supra* note 10.

65. Lydia Depillis, *Richmond's Rules: Why One California Town is Keeping Wall Street Up at Night*, WASH. POST, Oct. 5, 2013, <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/10/05/richmonds-rules-why-one-california-town-is-keeping-wall-street-up-at-night/>.

66. *See* Vekshin, *supra* note 62.

67. Vekshin, *supra* note 62.

68. MRP, *supra* note 9, at 5.

69. *See* Samsa, *supra* note 1, at 191.

70. MRP, *supra* note 9, at 5.

71. Simeone Foxman, *Eminent Domain: This City's Plan to Expropriate Mortgages Aims to Make Wall St Pay for the Housing Bubble*, QUARTZ, Aug. 8 2013, <http://qz.com/113250/this-citys-plan-to-expropriate-mortgages-could-make-wall-st-pay-for-the-housing-bubble/>.

72. Kelly, *supra* note 3, at 212.

73. *Id.*

too low.⁷⁴ As the neighborhoods decline, investors may forego making investments in the area.⁷⁵ It becomes a vicious cycle. Though banks, which often become owners of properties after foreclosure, are required to take care of the homes and keep them up to code, they have not always followed through, as is apparent in Richmond.⁷⁶ With so many homes in foreclosure, Richmond began fining banks \$1,000 a day if they failed to maintain the properties.⁷⁷ To date, the city has collected approximately \$1.5 million from the banks.⁷⁸ Further, a city's tax base moves out with the homeowners, draining municipal resources and making it more difficult to care for the newly dilapidated neighborhoods.⁷⁹ When this snowball begins to roll, it becomes difficult for cities to redevelop these neighborhoods.⁸⁰ Richmond believes that nearly half of the private mortgages in Richmond will go into foreclosure.⁸¹ This could cost Richmond \$25 million.⁸²

Banks have given some mortgage relief, but according to McLaughlin, most of this relief has come in the form of short sales, which means that families are still losing homes and neighborhoods are losing stability.⁸³ Banks are limited in the relief they can give because the mortgages are generally sold to investors as mortgage-backed securities or RMBS trusts. McLaughlin claims that even when the banks have modified loans, the modifications are not enough to solve the problem.⁸⁴

While lenders must attempt to negotiate modifications before foreclosing on homeowners under California law,⁸⁵ these modifications may not always happen. In a letter to Bank of America, California representative George Miller wrote that more than 568,000 of borrowers who had been foreclosed upon had

74. *Id.*

75. *See id.*

76. *See* Dewan, *supra* note 10.

77. *Id.*

78. *Id.*

79. Samsa, *supra* note 1, at 191; *See also* MALCOM GLADWELL, *THE TIPPING POINT* 141 (1st ed. 2002) ("If a window is broken and left unrepaired, people will conclude that no one cares and no one is in charge. Soon, more windows will be broken and the sense of anarchy will spread from the building to the street on which it faces, sending a signal that anything goes."). Gladwell goes on to illustrate how superficial, but highly visible details in our everyday environment shape our behavior. In a subway system overwhelmed by graffiti, muggings just seem natural; somehow both the perpetrator and the victim know this and act accordingly." Kelly, *supra* note 3, at 212.

80. Samsa, *supra* note 1, at 191.

81. Complaint, *supra* note 59, at 11.

82. *Id.* at 24.

83. Laura Flanders, *Meet the Mayor Who's Using Eminent Domain to Fight Foreclosure*, *NATION*, Nov. 20, 2013, <http://www.thenation.com/article/177296/meet-mayor-whos-using-eminent-domain-fight-foreclosure>.

84. *Id.*

85. Complaint, *supra* note 59, at 24.

not been contacted by their mortgage servicer to modify their loans.⁸⁶ In fact, there have been multiple lawsuits threatened and/or filed over banks' failure to modify loans.⁸⁷ For example, a prominent New York prosecutor plans to file a lawsuit against Wells Fargo over alleged violations of a \$25 billion mortgage settlement.⁸⁸ Similarly, the New York attorney general has threatened suit against both Bank of America and Wells Fargo, alleging that the banks have not lived up to a mortgage pact that required them to improve their interactions with borrowers needing loan modification.⁸⁹

Part of the difficulty with loan modification, however, occurs due to the structure of the trusts. Since the RMBS trusts are owned by many different investors, they became much more difficult to modify because any change required the signature of so many parties.⁹⁰ While nearly one hundred of the targeted homes had received loan modification that included debt forgiveness as of January 2014, these modifications are not always sustainable.⁹¹

All of these problems have forced Richmond's city officials to take action "to stabilize neighborhoods, to fight blight, [and] to keep homeowners in their homes."⁹² The city's plan for action, however, has been controversial to say the least.

IV. THE PLAN

In response to the prevalence of blight and foreclosures, Richmond has created the "Richmond CARES Program"⁹³ and enlisted the help of the private financing company MRP.⁹⁴ MRP is currently a privately owned, for-profit investment firm based in San Francisco.⁹⁵ For its part, MRP will raise funds to finance the Richmond Plan, identify the mortgage loans to be acquired through eminent domain, and arrange for the refinancing of seized loans.⁹⁶ It is worth noting that MRP has filed with the Securities and Exchange Commission and

86. Letter from George Miller to Mr. Brian Moynihan, President and Chief Exec. Officer, Bank of America Corp. (Sept. 10, 2013) (on file with author).

87. See Andrew R. Johnson, *New York Plans Action on Alleged Mortgage Violations*, WALL ST. J., Oct. 1, 2013, <http://online.wsj.com/news/articles/SB10001424052702303643304579109830928878264>.

88. *Id.*

89. *Id.*

90. Depillis, *supra* note 65.

91. Dewan, *supra* note 10.

92. Carolyn Said, *Richmond Pushes Forward with Eminent Domain Plan*, SFGATE, Dec. 18, 2013, <http://www.sfgate.com/realestate/article/Richmond-pushes-forward-with-eminent-domain-plan-5073950.php> (quoting Gayle McLaughlin).

93. Flanders, *supra* note 83.

94. Dewan, *supra* note 10.

95. Complaint, *supra* note 59, at 16.

96. *Id.* at 9.

plans to become publicly owned.⁹⁷ MRP has entered into discussion with multiple local governments about using eminent domain to seize residential mortgages, but Richmond is the first city that has decided to implement the plan, though it has not yet taken action.⁹⁸ Eminent domain theoretically solves the problem caused by RMBS trusts' joint-ownership of loans—the struggle to coordinate effectively to take action⁹⁹—because the government action can facilitate the exchange without having to gather signatures from all trust owners.¹⁰⁰

Richmond and MRP plan to either purchase or use Richmond's eminent domain power to seize approximately 624 homes that are underwater¹⁰¹ so they can “retake control over the welfare of their neighborhoods and their fiscal solvency.”¹⁰² Once an underwater loan is chosen, Richmond will purchase or seize the loan for roughly 80% of the home's current value.¹⁰³ The city will pay for this with money from MRP, which will then own the mortgage.¹⁰⁴ After securing the loan, Richmond will refinance the old loan and replace it with a new loan worth approximately 95% of the underlying home value,¹⁰⁵ an amount that will be more manageable for homeowners.¹⁰⁶ For example, if the Smiths are underwater on a home worth \$200,000, Richmond will seize the mortgage using eminent domain, paying \$160,000 to the trust, which is 80% of the value of the home.¹⁰⁷ Richmond will then refinance the loan for \$190,000, leaving a difference of \$30,000.¹⁰⁸ Richmond will receive 5% of this spread (in this case, \$9,500).¹⁰⁹ MRP will receive a flat fee of \$4,500 for each seizure, and may receive further compensation if they arrange the refinancing of the mortgage.¹¹⁰ Investors of MRP will receive any money left over from the taking.¹¹¹ Notably, Richmond and MRP are targeting loans that are current or

97. Mailing from West Contra Costa Association of REALTORS, Don't Let Wall Street Take Another Bite Out of Richmond Homes [hereinafter Realtor Mailing] (on file with author).

98. Complaint, *supra* note 59, at 17.

99. Dewan, *supra* note 10.

100. Depillis, *supra* note 65.

101. During the summer of 2013, underwater homeowners owed an average of 45% more than the value of their homes. Dewan, *supra* note 10.

102. MRP, *supra* note 9, at 4.

103. Complaint, *supra* note 59, at 21.

104. Depillis, *supra* note 65.

105. Complaint, *supra* note 59, at 21.

106. Depillis, *supra* note 65.

107. *See* Complaint, *supra* note 59, at 21.

108. *Id.*

109. *Id.* at 22.

110. *Id.*

111. *Id.*

from borrowers who appear likely to repay their loans.¹¹² This plan is the brainchild of three different professors—Robert Hockett of Cornell Law,¹¹³ Lauren Willis of Loyola University, and Howell Jackson of Harvard—who came up with the plan simultaneously but independently.¹¹⁴

MRP's program is a response to real problems.¹¹⁵ The Federal Reserve Board cites three key forces at the root of these problems, resulting from within the housing market.¹¹⁶ First, there is a persistent excess supply of vacant homes on the market, several stemming from foreclosures.¹¹⁷ Second, there has been a significant downshift in the availability of mortgage credit, and there is no telling when this will turn around.¹¹⁸ Finally, foreclosure procedures are inefficient and impose great costs on homeowners, lenders, and communities.¹¹⁹ Richmond and MRP's plan seeks to benefit both individual homeowners and the community as a whole.¹²⁰ On the individual level, the partners seek to save homeowners money and preserve home ownership equity, allowing homeowners to remain in their homes.¹²¹ This will stabilize the broader community by reducing and preventing blight.¹²² Further, homeowners with reduced mortgage payments will be able to spend that money on local businesses, adding money to the local economy and stimulating community wealth.¹²³ However, as already noted, the plan has been met with staunch resistance from several sources, including but not limited to mortgage holders, the FHFA, and a group of Richmond realtors.¹²⁴

112. Under the MRP business model, a loan seizure will not be profitable unless the seized loan can be refinanced or the amount paid to compensate the RMBS trusts would be unreimbursed. Unless it targets performing homeowners with good credit ratings, MRP could have a difficult time selling the new loan to investors. MRP, *supra* note 9, at 19–20.

113. See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 149–57 (2012), for a more detailed discussion of the Richmond Plan.

114. Depillis, *supra* note 65.

115. Kelly F. Heudepohl, Comment, *A Life Raft for Underwater Mortgages? Whether the Federal Constitution Permits State and Local Governments to Condemn Home Mortgage Contracts to Solve the Housing Crisis*, 49 WILLAMETTE L. REV. 275, 281 (2012).

116. Jennifer Burnett, *CSG Staff Speaks to KY Task Force on Foreclosures*, CSG KNOWLEDGE CENTER, Dec. 6, 2012, <http://knowledgecenter.csg.org/kc/content/csg-staff-speaks-ky-task-force-foreclosures>.

117. *Id.*

118. *Id.*

119. *Id.*

120. See Complaint, *supra* note 59, at 54.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

V. THE LAWSUIT

This resistance culminated in two lawsuits: one headed by Wells Fargo Bank and Deutsche Bank National Trust Company as trustees for hundreds of residential mortgage-backed trusts that hold the targeted mortgage loans,¹²⁵ and the other by Bank of New York Mellon, U.S. Bank, and Wilmington Trust Co.¹²⁶ Though the district court in the former lawsuit dismissed the banks' motion for a preliminary injunction,¹²⁷ the banks have said they will continue their resistance against the city and MRP's plan if eminent domain action is taken.¹²⁸ Until and unless such action is taken, however, the banks have dismissed their lawsuit.¹²⁹

On September 16, 2013, United States District Judge for the Northern District of California Charles R. Breyer dismissed the banks' claims because the claims were not yet ripe.¹³⁰ Judge Breyer held that because the claims do not rest on contingent future events *certain* to occur, but rather rest on future events that *may never* occur, the plaintiffs did not have standing to bring suit.¹³¹ Until Richmond actually takes action and uses its eminent domain power to seize mortgages, it would appear that the courts will not step in.¹³²

Even within the city, there seems to be a lot of disagreement about whether the plan is the best course of action. At its first vote on the Richmond Plan in April of 2013, the city council voted unanimously in its favor.¹³³ However, when McLaughlin attempted to move forward with the plan in September of 2013, the Richmond Plan passed with just four of seven votes.¹³⁴ According to Richmond realtor Jess Wright, "the underwater mortgage bailout program is on life support."¹³⁵ This internal dissent could explain why Richmond has not yet taken action and may signal that the banks will not need to file another lawsuit.

125. *Id.*

126. Phyllis Skupien, *Quick Ruling Denied in Dispute over California Town's Mortgage Seizure Plan*, THOMSON REUTERS, Oct. 16, 2013, available at <http://blog.thomsonreuters.com/index.php/quick-ruling-denied-in-dispute-over-california-towns-mortgage-seizure-plan/>.

127. Depillis, *supra* note 65.

128. *Id.*

129. Forgione, *supra* note 35.

130. Dan Levine, *Judge Dismisses Lawsuit Against Richmond, California Mortgage Plan*, THOMSON REUTERS, Sept. 16, 2013, available at <http://www.reuters.com/article/2013/09/16/usa-mortgages-ruling-idUSBRE98F12M20130916>.

131. *Id.*

132. *Id.*

133. Dewan, *supra* note 10.

134. *Id.*

135. *Id.*

A. *The Stakes*

The stakes are high on both sides. If Richmond and MRP take eminent domain action and lose in court, the city could find itself in serious debt because it was unable to get insurance to shield itself from such a loss.¹³⁶ This is especially pertinent because the city attempted to pass a \$34 million bond issuance to refinance some of its earlier debt, but could not find investors for the bonds.¹³⁷ MRP has already spent more than \$7 million to promote its plan and pay legal fees.¹³⁸ Yet the opponents' stakes are also very high, especially because a victory for the Richmond Plan could encourage numerous other municipalities to follow suit, taking underwater mortgages even when they are performing.¹³⁹ This could cost RMBS trusts billions of dollars.¹⁴⁰

B. *Current Status*

Richmond has not taken action yet, likely due in part to a divide of opinion within the city council.¹⁴¹ Though three council members back McLaughlin, the vice mayor and two council members, who are concerned that the plan will subject Richmond to crushing legal liabilities that may not be covered by MRP, have met McLaughlin with opposition.¹⁴² In a letter, Councilman Nat Bates has called the plan "ill advised," asserting that if the plan continues to move forward, he will push to take the issue to voters.¹⁴³

However, in a 4–2 vote on December 17, 2013, the Richmond City Council voted to set guidelines for using eminent domains to take mortgages in an effort to prevent foreclosures.¹⁴⁴ While the council would currently need a five-vote supermajority to take action, Richmond does have the power to, with a majority vote, set up a joint powers authority that could unilaterally authorize eminent domain with its own supermajority vote.¹⁴⁵ If the plan does move forward, council members have agreed to prioritize target locations by beginning the eminent domain plan in the neighborhoods that were hit hardest by the foreclosure crisis.¹⁴⁶ If Richmond takes eminent domain action, the banks have pledged that their lawsuit will be "immediately re-filed."¹⁴⁷

136. Depillis, *supra* note 65.

137. *Id.*

138. *See infra* Part VII.C.

139. *See infra* Part VII.C.

140. *See infra* Part VII.C.

141. Said, *supra* note 92.

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. Forgione, *supra* note 35.

VI. CONSTITUTIONALITY

There has been much debate regarding whether Richmond's proposed action is constitutional.¹⁴⁸ This article focuses primarily on the Takings Clause, but gives a brief overview of some of the other constitutional arguments. The Supreme Court has set a precedent for the use of eminent domain under the Takings Clause in decisions such as *Berman v. Parker*,¹⁴⁹ *Hawaii Housing Authority v. Midkiff*,¹⁵⁰ and *Kelo v. City of New London*.¹⁵¹ Yet while *Berman*, *Midkiff*, and *Kelo* showed great deference to legislative judgment,¹⁵² forty-two states responded to the *Kelo* decision by enacting legislation or passing ballot measures to limit the circumstances under which the government could use its eminent domain power to take property when using economic development as a legitimate public purpose.¹⁵³ Further, while Supreme Court precedents allow an expansive definition of "public use," several lower court decisions in the twenty-first century invalidated the use of eminent domain as a means of acquiring real estate for particular entities.¹⁵⁴

It is important to note that though *Berman*, *Midkiff*, and *Kelo* dealt with the transfer of real property, courts have consistently permitted the seizure of intangible property under the Fifth Amendment's Takings Clause.¹⁵⁵ In fact, in

148. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 6, 2012). See generally Complaint, *supra* note 59.

149. *Berman v. Parker*, 348 U.S. 26 (1954).

150. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229 (1984).

151. *Kelo v. City of New London*, 545 U.S. 469 (2005).

152. *Id.* at 487–88.

153. Nat'l Conference of State Legislatures, *Eminent Domain Overview*, NCSL, <http://www.ncsl.org/research/environment-and-natural-resources/eminent-domain-overview.aspx> (last visited Dec. 1, 2014) (explaining that between 2005 and 2011, forty-two states enacted legislation or passed ballot measures in response to *Kelo*; these measures either restricted the use of eminent domain for economic development, defined "public use," established additional criteria for designating blighted areas subject to eminent domain, strengthened public notice, public hearing, and landowner negotiation criteria, or required compensation at greater than fair market value).

154. MERRILL & SMITH, *supra* note 14, at 1222–23 (citing Sw. Ill. Dev. Auth. v. Nat'l City Envtl., L.L.C., 768 N.E.2d 1 (Ill. 2002) (invalidating condemnation of recycling center for retransfer to auto race track for use as a parking lot); 99 Cents Only Stores v. Lancaster Redevelopment Agency, 237 F. Supp. 2d 1123 (C.D. Cal. 2001), *appeal dismissed as moot*, 60 Fed. App'x 123 (9th Cir. 2003) (invalidating condemnation of lease in shopping center for retransfer to another store for expansion); Casino Reinvestment Dev. Auth. v. Banin, 727 A.2d 102 (N.J. Super. 1998) (invalidating condemnation of land for future expansion of a commercial casino); Wayne Cnty. v. Hathcock, 684 N.W.2d 765 (Mich. 2004) (holding that property cannot be condemned and retransferred to a commercial entity when the sole rationale is economic development)).

155. Foushee, *supra* note 25, at 77; see, e.g., *Liggett & Myers Tobacco Co. v. United States*, 274 U.S. 215, 220 (1927) (tobacco contracts); *In re Fifth Ave. Coach Lines, Inc.*, 18 N.Y.2d 212, 221 (1966) (bus operating routes and schedules); *City of Oakland v. Oakland Raiders*, 31 Cal. 3d

its *City of Oakland v. Oakland Raiders* decision, the California Supreme Court held that the right of eminent domain encompasses property of every kind.¹⁵⁶

A. *The Takings Clause*

As noted above, one of the major criticisms of the Richmond Plan is that it violates the Takings Clause of the United States Constitution.¹⁵⁷ Implicated by the Takings Clause are the requirements that for a municipality or governmental body to take private property, the taking must be “rationally related to a conceivable public purpose”¹⁵⁸ and the government must pay “just compensation” for the property.¹⁵⁹

1. Public Purpose

In order to analyze the Richmond Plan in terms of “public purpose,” it is important to look at the relevant United States Supreme Court precedents, the first of which is *Berman v. Parker*. In *Berman*, the Supreme Court upheld the use of eminent domain where the District of Columbia attempted to take all rights to the land located in a particular area for the purpose of redeveloping a blighted area.¹⁶⁰ Though not all of the property taken by the District of Columbia was blighted¹⁶¹ and some of the property taken was given to private parties,¹⁶² the use of eminent domain was held to be lawful. First, the Court stated that the police power is broad and the role of the judiciary in determining whether that power is being properly used is extremely narrow.¹⁶³ Next, the Court held that “public purpose” is a broad concept and the revitalization of blighted communities is a recognized public purpose.¹⁶⁴ The

656, 668 (1982) (a sports franchise); *Porter v. United States*, 473 F.2d 1329, 1333–35 (5th Cir. 1973) (the right to exploit the collector’s value of Lee Harvey Oswald’s personal effects).

156. *City of Oakland v. Oakland Raiders*, 31 Cal. 3d. 656 (1982).

157. U.S. CONST. amend. V (“nor shall private property be taken for public use, without just compensation”); CAL. CONST. art. I, § 19 (providing that private property may be taken only for a “public use”).

158. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241 (1984).

159. *Id.*

160. *Berman v. Parker*, 348 U.S. 26, 28 (1954).

161. The appellants in *Berman* owned a department store and claimed that their property could not be taken because it was commercial, was itself blighted, and would be given to a private rather than public agency for redevelopment to serve a private rather than public use. *Id.* at 31.

162. *Id.*

163. *Id.* at 32 (“An attempt to define its reach or trace its outer limits is fruitless, for each case must turn on its own facts Subject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive.”).

164. *Id.* at 33 (“The concept of public welfare is broad and inclusive The values it represents are spiritual as well as physical, aesthetic as well as monetary If those who govern the District of Columbia decide that the Nation’s Capital should be beautiful as well as sanitary, there is nothing in the fifth amendment that stands in the way.”).

Court made clear that as soon as a public purpose is established, eminent domain is a means to an end and allows transfer of property from one private party to other private parties as part of a comprehensive redevelopment plan.¹⁶⁵ After all, the public end may be equally as or better served by a private enterprise than a public agency, and the legislature is in a better position than the court to make this determination.¹⁶⁶ Finally, the Court held that eminent domain need not be used on a structure-by-structure basis, but instead may be used on an entire area, even when not all of the buildings are blighted.¹⁶⁷

Thirty years later, the Supreme Court again analyzed “public purpose” in the landmark case *Hawaii Housing Authority v. Midkiff*. In *Midkiff*, the Court was asked to determine whether the Hawaii Housing Authority could exercise eminent domain to take property from large private landholders and distribute it among private parties in order to break up a land oligopoly, which began when Hawaii was first settled.¹⁶⁸ Again deferring to the legislature, the Court held that where the exercise of eminent domain power is rationally related to a conceivable public purpose, eminent domain is allowed even if it ultimately results in transfer of property from one private party to another.¹⁶⁹ Condemned property need not be put into use for the general public, and the mere fact that property taken by eminent domain is transferred immediately to private beneficiaries does not mean that the taking has only a private purpose.¹⁷⁰ The Court, stating that regulating an oligopoly and the evils associated with it is a classic exercise of a state’s police power, held that Hawaii’s approach was comprehensive and rational.¹⁷¹ Finally, the Court held that whether the provision actually accomplished the objectives it sought to achieve was

165. *Id.* (“For the power of eminent domain is merely the means to the end.”).

166. *Berman*, 348 U.S. at 33–34 (“But the means of executing the project are for Congress and Congress alone to determine, once the public purpose has been established We cannot say that public ownership is the sole method of promoting the public purposes of community redevelopment projects.”).

167. *Id.* at 34.

168. When Polynesian immigrants settled the Hawaiian Islands, the settlers developed a feudal land tenure system where the island high chief controlled all land and assigned it to subchiefs for development. All land was eventually returned to the trust of the high chief; thus there was no private ownership of land. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 231 (1984).

169. *Id.* at 241.

170. *Id.* at 243–44.

171. *Id.* at 241–42 (“The people of Hawaii have attempted, much as the settlers of the original 13 Colonies did, to reduce the perceived social and economic evils of a land oligopoly [That has] created artificial deterrents to the normal functioning of the State’s residential land market and forced thousands of individual homeowners to lease, rather than buy, the land underneath their homes.”).

irrelevant.¹⁷² In order to meet constitutional requirements, the legislature simply must rationally believe that the act would promote its objective.¹⁷³

The final case discussed in this section is *Kelo v. City of New London*, a 5–4 Supreme Court decision involving a development plan that was projected to create jobs, increase tax and other revenues, and revitalize an economically distressed city.¹⁷⁴ Though none of the petitioners’ properties were in a blighted or poor condition,¹⁷⁵ the city’s use of eminent domain satisfied the “public use” requirement of the Fifth Amendment as part of a comprehensive economic development plan.¹⁷⁶ Citing *Berman* and *Midkiff* heavily,¹⁷⁷ the Court, not surprisingly, deferred to the legislature,¹⁷⁸ noting the comprehensive character of the plan, the thorough deliberation that preceded its adoption, the limited scope of the court’s review, and the broad understanding of public purpose.¹⁷⁹ Further, the Court rejected the contention that this was a one-to-one transfer of property from citizen A to citizen B outside the confines of an integrated plan.¹⁸⁰ The pursuit of a public purpose may benefit individual private parties, and this is allowed as long as it is part of a comprehensive economic development plan.¹⁸¹ Finally, the Court rejected the argument that takings for purely economic purposes should require “reasonable certainty” that the expected public benefits would actually accrue.¹⁸² When the legislature’s purpose is legitimate and its means are not irrational, the wisdom of such takings is not to be debated.¹⁸³

Kelo and other precedents provide strong support that eminent domain may be properly used for economic development, increasing the tax base, and

172. *Id.* at 242.

173. *Id.*

174. The city of New London, which had an unemployment rate nearly double that of the state and a population at its lowest since 1920, was considered a “distressed municipality” by a state agency. *Kelo v. City of New London*, 545 U.S. 469, 472 (2005). The development plan sought to build commercial buildings, a pedestrian riverwalk, residences, a public walkway, a museum, a state park, and office space, among other things. *Id.* at 474.

175. *Id.* at 475.

176. *See id.* at 469.

177. The Court also cited *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984), a case dealing with provisions of the Federal Insecticide, Fungicide, and Rodenticide Act under which the Environmental Protection Agency could consider data (including trade secrets) submitted by a prior pesticide applicant in evaluating a subsequent application so long as the second applicant paid just compensation for the data. *See Kelo*, 545 U.S. at 469.

178. *See Kelo*, 545 U.S. at 482 (“Our earliest cases in particular embodied a strong theme of federalism, emphasizing the ‘great respect’ that we owe to state legislatures and state courts in discerning local public needs.”).

179. *Id.* at 484.

180. *Id.* at 487.

181. *Id.* at 485.

182. *Id.* at 487–88.

183. *Id.* at 488.

combating blight—the very ends the Richmond Plan is designed to achieve.¹⁸⁴ Further, simply because a private party benefits from the government’s pursuit of a public purpose does not mean that a transfer is improper.¹⁸⁵ The reasoning behind this is that public ownership is not necessarily the only, nor the best, way to serve a public end.¹⁸⁶ Yet it is important to note that the circumstances surrounding *Kelo* and the Richmond Plan are different. In *Kelo*, the City of New London planned a comprehensive redevelopment project, which included a number of new buildings and parks aimed at improving the city’s economic condition, recreational space, and aesthetic appeal.¹⁸⁷ In contrast, the Richmond Plan aims solely to transfer mortgages from one group of investors to another, leaving homeowners in place and casting doubt as to whether this can truly constitute a “comprehensive redevelopment project” aimed at serving a public purpose.¹⁸⁸ The Richmond Plan, then, may better be likened to *Midkiff*, where the Hawaii Housing Authority took large plots of land from private parties and distributed those plots among other private parties in order to break up a land oligopoly, which began when Hawaii was first settled¹⁸⁹ and “created artificial deterrents to the normal functioning of the State’s residential land market.”¹⁹⁰ Richmond, then, may be able to make a plausible argument that the purpose of the Richmond Plan is to take and redistribute unjust mortgages that deter the normal functioning of Richmond’s residential land market.¹⁹¹ If the court is able to see a parallel between these “public use” arguments, Richmond will succeed on this point. Still, where the police power is difficult to define and each case must turn on its own facts, it is difficult to determine how a court will rule.¹⁹²

While combating blight seems to clearly be a “public purpose,” Richmond may have a difficult time explaining that its action is “reasonably related” to such public purpose. This is because loan modifications are not necessarily correlated to the likelihood that a homeowner will default,¹⁹³ meaning that the Richmond Plan may not actually do anything to prevent blight, crime,

184. See *Kelo*, 545 U.S. at 483–84.

185. *Id.* at 485.

186. *Id.* at 486 (“The public end may be as well or better served through an agency of private enterprise than through a department government—or so the Congress might conclude.”).

187. See Foushee, *supra* note 26, at 93–94 (explaining that the comprehensive redevelopment project included a waterfront conference hotel, marinas, a pedestrian riverwalk, a Coast Guard museum, a state park, and 90,000 square feet of office space).

188. See *id.* at 94.

189. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 231 (1984).

190. *Id.* at 242.

191. See *id.*

192. *Berman v. Parker*, 348 U.S. 26, 32 (1954) (“The definition [of police power] is essentially the product of legislative determinations addressed to the purposes of government, purposes neither abstractly nor historically capable of complete definition.”).

193. Foushee, *supra* note 26, at 85.

transience, or the reduction of the tax base. In its 2012 *Review of Options Available for Underwater Borrowers and Principal Forgiveness*, the FHFA found that a borrower's post-modification loan-to-value ratio has little effect on whether the borrower will continue to perform on the loan.¹⁹⁴ Among homeowners who received loan modifications, those with a post-modification loan-to-value ratio of 80% were only 2% more likely to stay current and perform on their loan than homeowners with a post-modification loan-to-value ratio of 190%.¹⁹⁵ It follows, then, that even if MRP is able to refinance the mortgages, the loan modification may not have much effect on halting foreclosure. However, the *Kelo* majority rejected the requirement that there be "reasonable certainty" that the expected public benefits would actually accrue, instead holding that "if a legislature's purpose is legitimate and its means are not irrational," courts should not delve into the wisdom of takings.¹⁹⁶

Even if one does not consider the wisdom of the Richmond Plan, *Kelo* makes clear that a city may not take property under the pretext of a public purpose when its actual goal is to confer a private benefit, nor may a city adopt a development plan in order to benefit a particular class of identifiable individuals.¹⁹⁷ The Court in *Kelo* asserts that a one-to-one transfer of property, executed outside the confines of an integrated development plan, "would certainly raise a suspicion that a private purpose was afoot."¹⁹⁸ Justice Kennedy's concurring opinion in *Kelo* discusses factors that should be considered in determining whether there is a plausible accusation of impermissible favoritism to private parties.¹⁹⁹ Though at least one of these

194. *Id.* (citing FED. HOUS. FIN. AGENCY, REVIEW OF OPTIONS AVAILABLE FOR UNDERWATER BORROWERS AND PRINCIPAL FORGIVENESS (July 31, 2012), available at <http://www.fhfa.gov/PolicyProgramsResearch/Research/Pages/Review-of-Options-Available-for-Underwater-Borrowers-and-Principal-Forgiveness.aspx>).

195. Foushee, *supra* note 26, at 85 ("A homeowner with a post-modification LTV of 80 percent or less had a 72 percent likelihood of remaining current and performing on his loans for the first 12 months after modification, while a homeowner with a post-modification LTV of 190 percent or higher had a 70 percent likelihood of staying current and performing during that same period.").

196. *Kelo v. City of New London*, 545 U.S. 469, 488 (2005).

197. *Id.* at 478 ("Nor would the City be allowed to take property under the mere pretext of a public purpose, when its actual purpose was to bestow a private benefit. The takings before us, however, would be executed pursuant to a 'carefully considered' development plan Therefore, as was true of the statute challenged in *Midkiff*, the City's development plan was not adopted 'to benefit a particular class of identifiable individual.'").

198. *Id.* at 487.

199. *Id.* at 491–92 (Kennedy, J., concurring) (highlighting, in the specific *Kelo* context, (1) that New London had a depressed economic condition and that there was evidence corroborating its validity, (2) that there was a substantial commitment of public funds by the state to the development project *before* most of the private beneficiaries were known, (3) that the city reviewed a variety of development plans before choosing a private developer, (4) that the city

factors was met—Richmond is facing depressed economic conditions, and this can be corroborated with evidence²⁰⁰—others are called into question. For example, did Richmond commit substantial public funds before the private beneficiaries were known?²⁰¹ Did the city review a variety of development plans?²⁰² Was MRP chosen from a group of applicants before Richmond decided upon using eminent domain?²⁰³ While the answers to these questions are somewhat unclear, it is likely MRP and Richmond worked on the plan together.²⁰⁴ In fact, McLaughlin began considering the idea after hearing about it from MRP and the Alliance of Californians for Community Empowerment.²⁰⁵ Further, unlike in *Kelo*, where several projects benefitting several private parties were part of the economic development plan,²⁰⁶ the Richmond Plan will solely benefit MRP and the homeowners whose mortgages are refinanced.²⁰⁷ In their complaint, the banks went so far as to say that the Richmond Plan is a seizure of property from one private party to another private party, with “Richmond receiving a small cut of the profits as its fee for renting out its eminent domain powers.”²⁰⁸ Finally, Richmond’s plan specifically targets mortgages held by private-label RMBS trusts as opposed to those held by trusts sponsored and guaranteed by Fannie Mae and Freddie Mac, or those held directly by banks.²⁰⁹ One must wonder why, if the Richmond Plan’s true purpose is keeping Richmond citizens in their homes in order to prevent crime, blight, transience, and so forth, the plan does not target *all* underwater mortgages.²¹⁰ However, it may be that instead, Richmond is targeting loans held by RMBS trusts because they are particularly difficult to modify²¹¹ and thus require eminent domain. This argument directs our

chose from a group of applicants rather than picking out a particular transferee beforehand, and (5) that other private beneficiaries of the project are still unknown).

200. *Id.* at 491.

201. *Id.* at 492.

202. *Kelo*, 545 U.S. at 492.

203. *Id.*

204. Nick Timiraos, *Investor Group Sues Richmond, Calif., over Eminent Domain Plan*, WALL ST. J., Aug. 7, 2013, <http://online.wsj.com/article/SB10001424127887324522504578654690187664354.html> (“The city is teaming up with Mortgage Resolution Partners, a private investment firm based in San Francisco.”).

205. Dewan, *supra* note 10.

206. *See Kelo*, 545 U.S. at 474.

207. Foushee, *supra* note 26, at 94.

208. Complaint, *supra* note 59, at 19.

209. *Id.* at 20.

210. Wells Fargo et al. posit that RMBS loans are targeted because they and their certificateholders are too dispersed to coordinate meaningful resistance. *Id.*

211. Richmond and MRP claim that private-label RMBS trusts are inefficient because some of their governing documents prohibit loan servicers from permanently reducing a borrower’s principal balance. *Id.*

attention back to the *Midkiff* analysis. In *Midkiff*, the public purpose was reducing the perceived social and economic evils of a land oligopoly, which created artificial deterrents to the normal functioning of the state's residential land market.²¹² In Richmond, the public purpose may be reducing the perceived social and economic evils of unjust mortgage rates, which do not allow homeowners to remain in their homes and thus decimate neighborhoods.

2. Just Compensation

Beyond issues with the public use requirement, there are some major concerns about whether Richmond will provide homeowners with “just compensation” for the takings. The Fifth Amendment’s “just compensation” requirement means that in order to be a constitutional taking, cities must pay an amount equal to the property’s fair market value, or the price that would be agreed upon by a willing seller and a willing buyer.²¹³ The Supreme Court defined “just compensation” as the “full and perfect equivalent in money of the property taken” when the property is seized.²¹⁴ However, this is an issue of first impression—courts have never determined what just compensation means in relation to the seizure of mortgages.²¹⁵

While courts have not considered mortgage seizures specifically, courts have considered the rights of secured creditors in other settings. In *Louisville Joint Stock Land Bank v. Radford*, the Supreme Court examined the constitutionality of the Frazier-Lemke Amendment (the “Amendment”) to the Bankruptcy Act, which prevented distribution of a person’s property despite default.²¹⁶ According to the Amendment, a debtor who filed for bankruptcy was entitled to a stay of all proceedings for five years while retaining possession of the property in question, as long as the debtor paid rent annually.²¹⁷ The debtor had the right, at any time during or at the end of the five years, to request reappraisal of the real estate and pay the reappraised price.²¹⁸ The Court held that a statute enacted for the relief of a mortgagor, when applied to a preexisting mortgage, would only be constitutional if it allowed the mortgagee to obtain substantial payment of the indebtedness.²¹⁹ If

212. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241–42 (1984).

213. *Lee*, *supra* note 24, at 593.

214. *United States v. Miller*, 317 U.S. 369, 373–74 (1943).

215. A mortgage note is intangible property, defined by *Black’s Law Dictionary* as a “lien against property that is granted to secure an obligation.” BLACK’S LAW DICTIONARY 313 (9th ed. 2009); *see also Foushee*, *supra* note 26, at 97.

216. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

217. *Id.* at 575–76.

218. *Id.* at 576.

219. *Id.* at 581 (“Statutes for the relief of mortgagors, when applied to preexisting mortgages, have given rise, from time to time, to serious constitutional questions. The statutes were sustained by this Court when . . . they were found to preserve substantially the right of the mortgagee to

the right of the mortgagee is substantially abridged, the law must be stricken down.²²⁰ A modified version of the Amendment was addressed and ultimately upheld by the Supreme Court two years later in *Wright v. Vinton Branch of the Mountain Trust Bank*.²²¹ Since the length of the stay was reduced and new protections were offered to farm creditors, the Court held that the creditor's security interest was not substantially impaired by the act.²²² Finally, in *Wright v. Union Central Life Insurance Co.*, the Supreme Court asserted that a creditor's constitutional rights were protected as long as there were safeguards in place to protect the right of secured creditors "to the extent of the value of the property."²²³ As these cases show, a secured creditor has a constitutional right to seek the value of his or her property or collateral.²²⁴

In this situation, however, Richmond and MRP do not plan to pay the value of the mortgages, but instead will only be paying 80% of the *value of the home*.²²⁵ MRP's president, Steve Gluckstern, argues that the amount the company would pay for the mortgages is fair market value because it is equal to the value Fannie Mae assigned to its securities in financial filing disclosures, based on the amount of loans expected to default.²²⁶ Further, since creditors typically do not gain the full value of a home when a house is sold through foreclosure, MRP argues that the appraised value of the home is higher than the creditor could expect to recover.²²⁷ Notably, the difference between the amount paid by MRP and the current value of the mortgages could result in a return of up to 30% for MRP's investors.²²⁸

In order to accept MRP's position, one would have to accept the assumption that each of the underwater homes would actually default on its loan and fall into foreclosure.²²⁹ However, this is highly unlikely. Richmond's plan targets loans that are currently performing and have a low risk of default—it is the only way MRP's plan will be financially feasible.²³⁰ In

obtain, through the application of security, payment of the indebtedness. They were stricken down . . . when it appeared that this substantive right was substantially abridged.").

220. *Id.*

221. *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 440, 470 (1937).

222. Foushee, *supra* note 26, at 99–100.

223. *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278 (1940).

224. Foushee, *supra* note 26, at 100.

225. *Id.* at 96.

226. Jon Prior, *Still No Partner for Radical Mortgage Resolution*, POLITICO, Jan. 16, 2013, <http://www.politico.com/story/2013/01/still-no-partner-for-radical-mortgage-resolution-86233.html>.

227. *See* Foushee, *supra* note 26, at 101.

228. Prior, *supra* note 226.

229. Foushee, *supra* note 26, at 102.

230. There are somewhere between 1,000 and 2,000 mortgage loans, in Richmond alone, that meet the MRP profile. The seizure of these mortgages could cause tens of millions of dollars in losses to the RMBS trusts and their beneficiaries. Complaint, *supra* note 59, at 13.

Richmond, approximately 70% of the homes targeted are current on their payments,²³¹ and simply because a home has lost value due to the downturn of the housing market does not mean that its owners will stop payments on the home.²³² Further, the Richmond Plan disregards the money generated by the interest payments coming from performing mortgages.²³³ When a mortgage lender extends a loan of \$125,000 at a 3.5% interest rate over a thirty-year period, the lender may expect that the loan will generate \$77,070.10 in interest income during the period of the loan.²³⁴ This loss is not accounted for by MRP's valuation. Thus, the loss to the holders of the RMBS trusts are twofold; they are paid 20% less than the value of the home and are immediately cut off from the cash flow generated by principal and interest repayments.²³⁵

The Richmond Plan will have a difficult time surviving a Takings Clause challenge. Though *Kelo* and other precedent gave significant deference to the legislative branch in determining what constitutes public purpose, MRP and Richmond will have to overcome the argument that the Richmond Plan is intended to favor MRP with only incidental public benefits.²³⁶ Even if the Richmond Plan succeeds, it will have a difficult time constituting "just compensation," as MRP will pay only 85% of the underlying value of the home though approximately 70% of the loans targeted are at low risk of default and the Richmond Plan fails to account for losses in interest payments.²³⁷

B. Other Constitutional Arguments

Beyond the Takings Clause, critics of the plan have made other constitutional arguments. The banks argue that in allowing citizens who do not live in Richmond to seize notes that are held outside of Richmond, the city's use of eminent domain would violate California's statutory prohibitions against extraterritorial seizures.²³⁸ Moreover, the banks believe that Richmond's action would violate both the Contracts Clause, which prevents a local government

231. Timiraos, *supra* note 204.

232. Foushee, *supra* note 26, at 101.

233. *Id.* at 105–06.

234. *Id.* at 106.

235. *Id.*

236. *Kelo v. City of New London*, 545 U.S. 469, 490 (2005) (Kennedy, J., concurring) ("The determination that a rational-basis standard of review is appropriate does not, however, alter the fact that transfers intended to confer benefits on particular, favored private entities, and with only incidental or pretextual public benefits, are forbidden by the Public Use Clause.").

237. *See supra* Part VI.A.2.

238. CAL. CONST. art. I, § 1 (prohibiting local governments from seizing extraterritorial property); Complaint, *supra* note 59, at 34 ("The Fifth amendment to the U.S. Constitution prohibits a local government from extraterritorially seizing property pursuant to eminent domain powers.").

from abrogating debts of local residents held by creditors,²³⁹ and the dormant commerce clause doctrine, which prevents local governments from discriminating against out-of-state investors or erecting barriers to interstate commerce that benefit the state's economy.²⁴⁰ The banks argue that in benefiting its local economy, Richmond's action would come at the expense of an important sector of interstate commerce—the interstate market for mortgage-backed securities.²⁴¹ This, in turn, will affect numerous Americans because this portion of the home loan industry enables people to buy homes.²⁴² The banks' final constitutional argument is that Richmond's action would violate the Equal Protection Clause because the proposed plan discriminates against both the mortgage holders and certain classes of Richmond homeowners without any legitimate purpose.²⁴³

Like the banks, the FHFA cited the constitutionality of the use and the application of state and federal consumer laws as reasons for its opposition to the plan, as well as concerns about Richmond and other local governments' valuations of complex contractual arrangements traded in both national and international markets.²⁴⁴ Jeff Wright, spokesman for a group of Richmond realtors speaking out against the plan, shares this concern about the government's interference in private contracts.²⁴⁵ Wright does not want the government to break up a contract between a lender and homeowner to help someone who either should not have taken out a loan in the first place or who, though underwater on his or her mortgage, can and would continue performing.²⁴⁶ This, he argues, is part of the risk inherent in any investment.²⁴⁷ Finally, the plan would impact millions of negotiated and performing mortgage contracts.²⁴⁸ In a city that is nearly two-thirds minority, the FHFA worries that Richmond's plan will constitute redlining, cutting off credit to a disproportionate number of Hispanics and African Americans.²⁴⁹

As is apparent from the discussion in this section, the Richmond Plan is rife with constitutional issues. Like many eminent domain actions, it will be

239. Complaint, *supra* note 59, at 38 (citing U.S. CONST. art. I, § 10 which prohibits states from "impairing the Obligation of Contracts").

240. *See id.* at 36.

241. *Id.* (citing U.S. CONST. art. I, § 8 which gives Congress the power to regulate commerce among the several states).

242. *See id.*

243. *Id.* at 42 (citing U.S. CONST. amend. XIV which provides that no state shall deny any person within its jurisdiction equal protection of its laws).

244. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 6, 2012).

245. Depillis, *supra* note 65.

246. *Id.*

247. *Id.*

248. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652.

249. Depillis, *supra* note 65.

challenged heavily under the Takings Clause. Yet due to its unique nature as targeting intangible property owned by secured creditors across the country, the Richmond Plan is exposed to numerous other constitutional challenges. Even if the Richmond Plan is constitutional, however, it is likely not a good idea for more practical reasons.

VII. MORE HARM THAN GOOD

Despite its creativity and best intentions, the Richmond Plan is simply not the wisest course of action at this point in time. Even if the Richmond Plan was able to survive a constitutional challenge, its implementation could result in significant consequences to the very people the plan aims to help.

A. *Who Owns the Mortgages?*

One of the first hurdles discussed after Richmond decided to move forward with the Richmond Plan was the fact that the mortgages Richmond plans to take through eminent domain are not actually owned by banks or by any one individual entity.²⁵⁰ In its response to Richmond's offer to purchase the underwater mortgages, Wells Fargo's assistant general counsel David Gorsche wrote that the bank's understanding of the law is that even if it did think the plan made sense, the bank "does not have the contractual authority to sell the loans²⁵¹ and is not aware of any other party having the contractual authority to sell the loans or consider [Richmond's] offer."²⁵² This is because the mortgages are held by RMBS trusts.²⁵³ The beneficiaries for these trusts include state and local pension plans, 401(k) plans, college savings plans, insurance companies, mutual funds, university endowments, and government-sponsored enterprises.²⁵⁴ There are a couple of problems with the fragmented ownership of the mortgages.²⁵⁵ If Richmond offers to purchase the mortgages, it will be immensely difficult to track down and negotiate with the specific owner(s) of each individual mortgage.²⁵⁶ If Richmond uses eminent domain to take the mortgages, it risks violating multiple constitutional and statutory provisions, which have already been discussed.²⁵⁷

Beyond its inability to sell the loans, Richmond's plan could cause significant economic harm to the beneficiary entities and individuals, a vast

250. Vekshin, *supra* note 62.

251. Dewan, *supra* note 10.

252. Vekshin, *supra* note 62.

253. Complaint, *supra* note 59, at 13.

254. *Id.*

255. *See* Dewan, *supra* note 10.

256. *Id.*

257. *See supra* Part V.

number of whom are retirees.²⁵⁸ This is because the mortgage loans that are conveyed into RMBS trusts are carefully structured with the expectation that most homeowners will stay in their homes and continue to pay their mortgages.²⁵⁹ Representative John Campbell, a Republican from California, said that “the savers and retirees who own these mortgages, many of them through their pension funds and 401(k) accounts, would be exposed to serious losses” if Richmond goes through with its plan.²⁶⁰

While the Richmond Plan has the potential to harm the holders of the RMBS trusts, the plan will likely benefit a different group of investors.

B. *An Unjust Windfall*

Critics are concerned that Richmond’s plan targets loans that are currently performing and have a low risk of default, which they predict would result in significant losses to the mortgage holders.²⁶¹ After all, simply because a home has lost value due to the downturn of the housing market does not mean that its owners will not continue to make payments on the home.²⁶² In fact, approximately 70% (444 of 624) of the homes targeted are current on their payments.²⁶³ If cities have the power to seize loans—even performing loans—when the market declines, lenders will be forced to change their practices.²⁶⁴ Specifically, lenders will be forced to react by issuing loans with more demanding terms that will exclude some from obtaining loans and purchasing

258. Complaint, *supra* note 59, at 13; *see also* Sec. Indus. & Fin. Mkts. Ass’n, *SIFMA Statement Following Richmond Vote on Eminent Domain*, SIFMA (Sept. 11, 2013), <http://www.sifma.org/newsroom/2013/sifma-statement-following-richmond-vote-on-eminant-domain/> [hereinafter SIFMA Press Release] (“SIFMA AMG notes that the proposed plan is simply an unlawful taking of wealth that would enrich one small group of private investors at the expense of mortgage investors across the U.S., including everyday American savers who are invested in mortgage-backed securities through their retirement plans and other funds.”).

259. The expectation that these mortgage loans will be paid off at full value are based on a careful analysis of historical trends which takes into consideration the cyclical nature of the housing market. Complaint, *supra* note 59, at 14.

260. John Campbell III, *Campbell Introduces The Defending American Taxpayer Abusive Government Takings Act*, VOTE SMART (July 18, 2013), <https://votesmart.org/public-statement/807369/campbell-introduces-the-defending-american-taxpayers-from-abusive-government-takings-act#.UwZ-nxawMOM>.

261. There are somewhere between 1,000 and 2,000 mortgage loans, in Richmond alone, that meet the MRP profile. The seizure of these mortgages could cause tens of millions of dollars in losses to the RMBS trusts and their beneficiaries. Complaint, *supra* note 59, at 13.

262. Foushee, *supra* note 26, at 104.

263. Timiraos, *supra* note 204.

264. Complaint, *supra* note 59, at 29.

homes.²⁶⁵ This will harm housing markets, as lenders will be forced to reduce the available residential loan credit and interest rates will go up.²⁶⁶

Even among homeowners in Richmond, the plan may favor certain loans. Jeff Wright, a Richmond real estate agent who opposes the plan, believes that in reality, the plan will not even affect the majority of mortgages because eminent domain will not be used to help anyone with loans backed by Fannie Mae or Freddie Mac.²⁶⁷ Further, the Richmond Plan does not target loans held by banks.²⁶⁸

Though the Richmond Plan stands to have a large impact on the residents of Richmond and on the investors who happen to own mortgages in the city, its effects could be felt much further if other cities decide to follow suit.

C. A Snowball Effect

Critics worry that if Richmond's plan is successful, other cities will follow in their footsteps, creating a snowball effect.²⁶⁹ Mayor McLaughlin assures that the plan's use of eminent domain would only occur in "exceptional circumstances when large numbers of households are underwater;"²⁷⁰ yet the law does not always work this way. If the banks' lawsuit fails and Richmond is allowed to use eminent domain to break private contracts for the public good, it may be difficult to define "exceptional circumstances" in the future—especially through case law, which is necessarily fact-specific and is often an improper vehicle for creating broad policies. The FHFA further worries that administering a program will drain judicial resources and will be rife with administrative and judicial costs and fees.²⁷¹

Several other cities have already considered the use of eminent domain to take underwater mortgages. MRP's eminent domain proposal has been considered by local governments in California like San Bernardino County, El Monte, La Puente, San Joaquin, and Orange Cove as well as by North Las Vegas, NV, Newark, NJ, Seattle, WA, and others.²⁷² Mayor Wayne Smith of Irvington, New Jersey, has followed Richmond's example and plans to move

265. *Id.*

266. *Id.*

267. Dewan, *supra* note 10.

268. Wells Fargo et al. posit that this is because the RMBS trusts may have a more difficult time coordinating to create meaningful resistance, whereas the banks or the federal government may have a better chance of fighting the plan. Complaint, *supra* note 59, at 20; *see also* Tyrrell, *supra* note 32.

269. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 6, 2012).

270. Said, *supra* note 92.

271. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652.

272. Complaint, *supra* note 59, at 11.

forward with using eminent domain to take underwater homes.²⁷³ Irvington plans to target the approximately 1,000 “private-label” mortgages as opposed to going after Fannie Mae and Freddie Mac.²⁷⁴ Smith thinks that by targeting mortgages held by banks and investors, the city may be able to avoid some of the legal challenges of using eminent domain.²⁷⁵ Unlike Richmond, Irvington has not yet agreed to work with MRP on its eminent domain plan and is seeking investor proposals.²⁷⁶ Irvington asserts that the process will be fair, open, and competitive,²⁷⁷ potentially shielding the city from some of the “public use” challenges faced by Richmond.

Not only is there concern that other cities will follow suit to take mortgages, but there is also concern that eminent domain could be used to acquire different types of loans—for example, underwater car loans, underwater student loans, and credit card debt.²⁷⁸ If other cities follow suit, or if this legal precedent allows cities to take different types of debt for less than its face value, the banks worry that the damages to RMBS trusts would exceed billions of dollars.²⁷⁹

In the face of such staggering potential consequences, opponents are taking the Richmond Plan seriously, combating it both through the legal system and through investment decisions.

D. A Chilling Reality

In an effort to avoid or minimize further losses, many investors have expressed their hesitance in lending to communities like Richmond that plan to use eminent domain to take mortgages. Whether for punishment, self-preservation, or both, the withholding of financing could have great consequences for the citizens of these communities. In a public statement, the FHFA said it “has significant concerns about the use of eminent domain to revise existing financial contracts,” worrying that the resulting losses would “represent a cost ultimately born by taxpayers” and would have “a chilling effect on the extension of credit to borrowers seeking to become homeowners and on investors that support the housing markets.”²⁸⁰ This is because if any mortgage loans, even those that are highest performing, could be seized by local governments at substantial discounts, investors will be wary of

273. Tyrrell, *supra* note 32.

274. *Id.*

275. *Id.*

276. *Id.*

277. *Id.*

278. Depillis, *supra* note 65.

279. Complaint, *supra* note 59, at 11.

280. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 6, 2012).

purchasing the mortgage loans and lending banks will protect themselves by offering loans with onerous terms.²⁸¹

Officials from the Securities Industry and Financial Markets Association (SIFMA) have pointed to history to show the dangers of interfering.²⁸² In 2002, the Georgia mortgage market shrank by roughly 15% when the legislature passed a law intended to prevent lenders from steering consumers to high-interest loans.²⁸³ Though the law was intended to help Georgia consumers, lenders opposed the bill, arguing that it would inhibit their ability to make loans to people with bad credit.²⁸⁴ Some lenders pulled out of the state altogether, and two ratings agencies said that because they could be sued under the law, they would be unable to rate Georgia loans for resale to investors.²⁸⁵ Despite investors' fears, most typical thirty-year mortgages were unaffected, and some believe that had the law remained in place, it would have mitigated the housing crisis.²⁸⁶ Proponents of the Richmond Plan argue that ultimately, any initial chilling will be short-lived because they will offer a good enough deal to entice investors to lend.²⁸⁷

As this article has already touched upon, even a group of realtors from the Richmond community has banded together in opposition of the city's plan.²⁸⁸ The realtors have created a pamphlet entitled *Don't Let Wall Street Take Another Bite Out of Richmond Homes* that they sent to members of the community, and they even launched a website called StopInvestorGreed.com.²⁸⁹ The realtor group's spokesman, Jeff Wright, has been part of Richmond's realty business for thirty years and is the former president of the West Contra Costa Association of REALTORS.²⁹⁰ He worries that the "MRP and Wall Street Investors' plan to seize Richmond's underwater mortgages will backfire and seriously harm the value of homes in Richmond."²⁹¹ Most importantly, the realtor group is concerned that if Richmond's plan is followed, investors will react by refusing to lend to Richmond and its citizens.²⁹²

281. Complaint, *supra* note 59, at 14.

282. Dewan, *supra* note 10; *see also* SIFMA Press Release, *supra* note 258.

283. Dewan, *supra* note 10.

284. *Id.*

285. *Id.*

286. *Id.*

287. Depillis, *supra* note 65.

288. Realtor Mailing, *supra* note 97.

289. *Id.*

290. *Id.*

291. *Id.*; *see also* SIFMA Press Release, *supra* note 258.

292. Depillis, *supra* note 65.

There is some support for this argument, as investors refused to bite at a \$34 million bond issuance that the city tried to pass in July of 2014.²⁹³ Wright likened Richmond's bonds to a "dented can," hypothesizing that investors will refuse to lend in Richmond's jurisdiction if there is a threat of taking and will choose instead to invest in other markets.²⁹⁴ Scott Simon, a former managing director of Pimco, reinforced this sentiment, questioning why a lender would invest in an area willing to say, "I know you lent someone \$100, but we are going to say you only get \$50."²⁹⁵ Jonathan Lieberman, head of residential mortgage investing at Angelo, Gordon & Co., agreed, asserting that investors "cannot invest where [their] money is going to be expropriated—that's a key tenet of investing."²⁹⁶ Yet the Richmond Plan may chill investments at a time when the market is already on the upswing.

E. Too Much and Too Late

Beyond all of the legal and practical consequences of the Richmond Plan looming, many believe the proposed solution is coming too late. Critics of the eminent domain plan believe that the housing market will take care of itself.²⁹⁷ Jeff Wright and his colleagues believe that there is no inherent harm in foreclosure.²⁹⁸ If someone defaults and leaves, Richmond's market is hot enough that another buyer will take his or her place.²⁹⁹ The housing market is on the upturn.³⁰⁰ The realtor group believes that there are better alternatives and that lenders will likely work with homeowners if the homeowners are willing to make payments.³⁰¹

In January 2014, more than half of the 624 homeowners whose mortgages Richmond planned to take through eminent domain were current on their payments.³⁰² Though about 28% of Richmond mortgages are deeply

293. *Id.*

294. *Id.*

295. Timiraos, *supra* note 204.

296. *Id.*

297. Chris George, president of CMG Financial, one of the largest East Bay mortgage bankers, opined that the Richmond Plan seeks to solve a problem that is solving itself, noting that in June, median home prices in Contra Costa County posted a 31.5% year-over-year gain and Richmond home values have increased 22.7% in the last year. Chris George, *Guest Opinion: Richmond Eminent Domain Plan is Dangerous*, CONTRA COSTA TIMES, Sept. 1, 2013, http://www.contracostatimes.com/opinion/ci_23975663/richmond-eminent-domain-plan-is-dangerous.

298. Depillis, *supra* note 65.

299. *Id.*

300. *Id.*

301. Realtor Mailing, *supra* note 97.

302. Dewan, *supra* note 10.

underwater,³⁰³ ninety-one of the targeted loans have received loan modification including debt forgiveness, though not all modifications have been sustainable.³⁰⁴ One-third of the homeowners initially identified are no longer underwater, according to critics of the Richmond Plan, though MRP disputes this figure.³⁰⁵ The mortgage crisis seems to be improving across the United States.³⁰⁶ Nationwide, from the first quarter to the second quarter of 2013, the number of properties with negative equities has gone from 9.6 million (19.7%) residential properties with a mortgage to 7.1 million (14.5%) residential properties with a mortgage.³⁰⁷ Critics of the eminent domain plan believe that the housing market will take care of itself.³⁰⁸

VIII. FINAL THOUGHTS

Richmond and cities like it have been hit hard by the burst of the housing bubble and the great recession, meriting a real solution. However, despite the boldness and creativity of the Richmond Plan, it simply poses too many legal and practical consequences to be practicable at this point in time. Even if the plan is able to overcome the constitutional challenges, its implementation will ultimately come with great costs—costs that will be borne in large part by the private citizens the plan aims to help. Thus, because of its constitutional and practical consequences, the Richmond Plan will bring more harm than good.

EMILY C. CORY*

303. A home is “deeply underwater” when a homeowner owes significantly more than his or her home is worth. Richmond’s 28% figure for deeply underwater homes is higher than the national average, which stood at 19% in January 2014. *Id.*

304. *Id.*

305. *Id.*

306. *Id.*

307. CORELOGIC, EQUITY REPORT: SECOND QUARTER 2013, at 2 (2013), available at <http://www.corelogic.com/research/negative-equity/corelogic-q2-2013-equity-report.pdf>.

308. George, *supra* note 297.

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