

# EMINENT DOMAIN: RICHMOND, CALIFORNIA'S ILLUSORY SOLUTION TO THE MORTGAGE CRISIS

Christine J. De Leon\*

## I. INTRODUCTION

By the end of 2007, America was in the thick of the worst economic period since the Great Depression,<sup>1</sup> a period the press called the Great Recession.<sup>2</sup> A steep decline in America's gross domestic product and precipitous uptick in joblessness shook the nation.<sup>3</sup> In 2007, approximately 1.7 million homes entered into foreclosure.<sup>4</sup> In 2008, there were over 2 million foreclosure filings.<sup>5</sup> During the next four years, that number continued to grow,<sup>6</sup> and one in five U.S. mortgages remained underwater into 2013.<sup>7</sup> California holds the dubious honor of housing multiple metropolitan areas hard-hit by the foreclosure crisis.<sup>8</sup> In 2012, Riverside, California had the fifth most foreclosures and the second largest decline in home prices in the country, while home prices in Sacramento, California dropped more than fifty percent.<sup>9</sup> Further exacerbating the foreclosure and home value problem, private bondholders holding the mortgages were either unwilling or unable to renegotiate the terms of the loans with the homeowners,<sup>10</sup> leaving them to slowly but surely dig themselves into deeper and deeper holes of debt.

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\* Christine J. De Leon

1. E.g., Bob Willis, *U.S. Recession Worst Since Great Depression, Revised Data Show*, BLOOMBERG (Aug. 1, 2009, 12:00 AM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aNivTjr852TI>.

2. See Catherine Rampell, *'Great Recession': A Brief Etymology*, N.Y. TIMES ECONOMIX BLOG (Mar. 11 2009, 5:39 PM), <http://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology/>.

3. *Id.*; see generally FINANCIAL CRISIS INQUIRY COMMISSION, FINANCIAL CRISIS INQUIRY REPORT (2011) available at [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

4. *Mortgage Loss Mitigation Statistics: Industry Extrapolations*, HOPE NOW (2009) (Quarterly for 2007 and 2008), available at <http://www.hopenow.com/industry-data/HOPE%20NOW%20National%20Data%20July07%20to%20Jun09%20v2.pdf>.

5. *Id.*

6. See *Home Foreclosure Statistics*, STATISTIC BRAIN (Oct. 15, 2012), <http://www.statisticbrain.com/home-foreclosure-statistics/>.

7. Tim Reid, *California city becomes first to adopt eminent domain plan*, CNBC (Jul. 30, 2013), <http://www.cnbc.com/id/100926221>.

8. Isaac Brekken, *Cities with the Most Homes in Foreclosure*, NBC NEWS (May 26, 2012), <http://www.nbcnews.com/business/cities-most-homes-foreclosure-794509> (Sacramento, California was 12th in home foreclosures and 5th in home price decline, while Riverside, California was 5th in home foreclosures and 2nd in home price decline).

9. *Id.*

10. Amir Sufi, *Seizures May be Cities' Last Hope in Mortgage Crisis*, BLOOMBERG (Jul. 18, 2012), <http://www.bloomberg.com/news/print/2012-07-18/seizures-may-be-cities-last-hope-in-mortgage-crisis.html>; see also, David A. Dana, *The Foreclosure Crisis and the Antifragmentation Principal in State Property Law*, 77 U. CHI. L. REV. 97, 98 (2010).

Foreclosures can dramatically decrease the value of a home, and serve as a dependable forewarning of a housing crisis.<sup>11</sup> Decreases in home values combined with increasing mortgage debt leads to near-negative or negative equity.<sup>12</sup> Negative equity, also known as an underwater mortgage, is when the homeowner owes more money on his mortgage than the home is worth.<sup>13</sup> Reduction in home value reflects factors such as the home's disrepair, the lenders' attempt to sell the home as quickly as possible, and especially in situations such as foreclosure crises, the excess supply of homes.<sup>14</sup> Further, the foreclosures themselves reduce a home's value by a larger margin than other type of forced sales.<sup>15</sup>

Although rising foreclosure rates have affected the entire nation, some states have been particularly affected. Whilst California has reduced the annual foreclosure filings to its lowest rate since 2007,<sup>16</sup> its volume of foreclosures has remained among the highest nationwide.<sup>17</sup> And although the national foreclosure rate is "more than halfway back to normal,"<sup>18</sup> the seven American cities with the highest foreclosure rates in September 2012 are within California's borders.<sup>19</sup>

The housing crisis remains, despite of improvements in foreclosure rates. In September 2012, the nation reached its lowest foreclosure numbers since July 2007.<sup>20</sup> In the first quarter of 2012, 11.4 million mortgages were underwater, down over two percent from the previous year.<sup>21</sup> Those numbers have continued to decline; and as of 2013, 10.4 million homeowners were underwater on their mortgages,<sup>22</sup> and foreclosures in California were down twenty-nine percent in 2012 from the previous

11. Daniel Hartley, *The Impact of Foreclosures on the Housing Market*, FEDERAL RESERVE BANK OF CLEVELAND (Oct. 27, 2010), <http://www.clevelandfed.org/research/commentary/2010/2010-15.cfm>.

12. See *CoreLogic Reports Negative Equity Decreases in First Quarter of 2012*, CORELOGIC (July 12, 2012), <http://www.corelogic.com/about-us/news/corelogic-reports-negative-equity-decreases-in-first-quarter-of-2012.aspx> [hereinafter CORELOGIC, *Negative Equity Decreases*].

13. *Id.*

14. *Id.*; see also Mary Gallagher, *How Foreclosures Affect Housing Prices*, SAN FRANCISCO CHRONICLE, <http://homeguides.sfgate.com/foreclosures-affect-housing-prices-8984.html> (last visited Jan. 19, 2012).

15. Patti Richards, *How Foreclosures Hurt Everyone's Home Values*, MIT MEDIA RELATIONS (July 20, 2010), <http://web.mit.edu/press/2010/housing-prices.html> (foreclosures reduced the value of a home by an average of 27% while other types of forced sales, such as bankruptcy, only reduced the home's value by 3-7%).

16. See, e.g., *California Foreclosure Activity Lowest Since Early 2007*, DQ NEWS (Oct. 17, 2012), <http://www.dqnews.com/Articles/2012/News/California/CA-Foreclosures/RRFor121017.aspx> (low reached in 2012); RealtyTrac Staff, *Foreclosure Activity Drops to a 5-Year Low in September*, REALTYTRAC (Oct. 9, 2012), <http://www.realtytrac.com/content/foreclosure-market-report/september-and-q3-2012-us-foreclosure-market-report-7424> (foreclosure starts in California have decreased by 45% from the previous year, reaching a 69-month low, but still ranked amongst the top three states in the month and quarter)[hereinafter REALTYTRAC, *5-year low*].

17. See e.g., *California Foreclosure Rate Tops In Nation; San Leandro Family's Struggle Typical*, CBS LOCAL: SAN FRANCISCO BAY AREA (July 12, 2012), <http://sanfrancisco.cbslocal.com/2012/07/12/california-foreclosure-rate-tops-in-nation-san-leandro-familys-struggle-typical/>.

18. Susanna Kim, *Top 10 Metro Areas with the Highest Foreclosure Rates*, ABC NEWS (Oct. 25, 2012), <http://abcnews.go.com/Business/top-10-metropolitan-areas-highest-foreclosure-rates/story?id=17556494#ULMgM6WYXUk> (quoting Daren Blomquist, Vice President at RealtyTrac).

19. *Id.* (Stockton, California had the worst rate of one in every 67 homes in foreclosure).

20. REALTYTRAC, *5-year low*, *supra* note 16.

21. CORELOGIC, *Negative Equity Decreases*, *supra* note 12.

22. Matthew Goldstein, *Eminent domain to fix troubled mortgages makes a Calif. comeback*, CNBC (Apr. 16, 2013, 12:39 AM), <http://www.cnbc.com/id/100646504>.

year.<sup>23</sup> Notwithstanding these improvements, high foreclosure rates continue to pose a special problem for local governments. In addition to the lost property tax revenue,<sup>24</sup> foreclosures often lead to abandoned homes and vacant properties.<sup>25</sup> When concentrated, those vacant properties may act as a setting for illicit activity such as drug use and distribution, squatting, prostitution, and theft.<sup>26</sup> Concentrated foreclosures also affect the surrounding area, reducing the property value of neighboring homes not yet in foreclosure.<sup>27</sup> Local governments must also respond by increasing expenditures to secure the newly vacant homes, raise police and fire protection, redevelop blighted areas, and provide social programs meant to address homelessness, job loss, and educational needs due to foreclosure.<sup>28</sup> Furthermore, the costs associated with the legal or administrative systems processing the foreclosures themselves add to the local economy's burden.<sup>29</sup> After recognizing the repercussions of foreclosures, the government has attempted to remedy the housing crisis and mitigate the ominous foreclosure rates through various plans.

One novel proposal requires local governments to use their eminent domain power and has initiated debate in municipalities across the nation. Traditionally, eminent domain has been used to forcibly acquire privately owned real property for public use.<sup>30</sup> In San Bernardino County in California, the local government teamed with a private community advisory firm and proposed using its eminent domain power to help distressed homeowners with their underwater mortgages by seizing those mortgages and restructuring them.<sup>31</sup> With decreased principals on the loans, the homeowners would then make lower mortgage payments while staying in their homes.<sup>32</sup> Other cities experiencing especially troubled housing markets, such as

23. RealtyTrac Staff, *1.8 Million U.S. Properties with Foreclosure Filings in 2012*, REALTYTRAC (Jan. 14, 2013) <http://www.realtytrac.com/content/foreclosure-market-report/2012-year-end-foreclosure-market-report-7547>.

24. See Ellen Schloemer et al., Ctr. for Responsible Lending, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners 24* (2006), available at <http://www.responsiblelending.org/pdfs/FC-paper-12-19-new-cover-1.pdf>.

25. See Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 *Housing Pol'y Debate* 57, 57 (2006).

26. *Id.* at 59.

27. *Id.* at 57. The Fannie Mae Foundation administered a case study on Chicago, Illinois and determined each foreclosure reduces the value of each single-family home within an eighth of a mile by an average of one percent. *Id.* at 58. A second study of Philadelphia, Pennsylvania revealed similar results. Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy 20* (2004), available at <http://comm-org.wisc.edu/paper2004/shlay/shlay.htm>.

28. See William C. Apgar et al., Homeowner Preservation Found., *The Municipal Cost of Foreclosures: A Chicago Case Study 20-29* (2005), [http://www.995hope.org/content/pdf/Apgar\\_Duda\\_Study\\_Full\\_Version.pdf](http://www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf); see also Immergluck & Smith, *supra* note 25, at 58-59.

29. John P. Relman, *Foreclosures, Integration, and the Future of The Fair Housing Act*, 41 *IND. L. REV.* 629, 645 (2008).

30. See e.g., Rebecca Leung, *Eminent Domain: Being Abused?*, 60 *MINUTES* (Feb. 11, 2009, 8:28 PM), [http://www.cbsnews.com/8301-18560\\_162-575343.html](http://www.cbsnews.com/8301-18560_162-575343.html).

31. E.g., Anna Cuevas, *Is Eminent Domain to Seize Mortgages the Solution to California's High Foreclosure Problem?*, *HUFFINGTON POST* (Aug. 08, 2012), [http://www.huffingtonpost.com/anna-cuevas/eminent-domain-mortgages-california\\_b\\_1754519.html](http://www.huffingtonpost.com/anna-cuevas/eminent-domain-mortgages-california_b_1754519.html).

32. Melissa Griffin, *Could California Use Eminent Domain to Save Troubled Mortgages?*, *CBS* (July 30, 2012, 12:50 PM), <http://sanfrancisco.cbslocal.com/2012/07/30/melissa-griffin-could-california-use-eminent>



would be justly compensated (Part III.C.). Part IV will discuss the policy arguments for and against Richmond's proposed use of eminent domain. Part V concludes and encourages municipalities throughout the nation to set proposals like Richmond's aside.

## II. MORTGAGE STRUCTURE AND ITS DEVELOPMENT

Simply put, a mortgage is a "type of loan that is secured by real estate."<sup>43</sup> This type of contract conveys the conditional right of ownership of property to the lender as security or collateral for the loan.<sup>44</sup> The lender has the right to take the home if the owner is unable to meet his mortgage obligation. The lender's security interest is voided once the loan is repaid and the borrower's obligation is met.<sup>45</sup> The borrower pays not only the principal, or amount of the original loan, but also interest on the principal.<sup>46</sup>

Once a homeowner obtains a mortgage, the investment bank is able to purchase the mortgage from the original lender.<sup>47</sup> The original lender sells its security interest in order to obtain payments sooner, and ensure that their investment is returned.<sup>48</sup> The investment bank purchasing mortgages essentially becomes the homeowners' lender,<sup>49</sup> the security interest is then transferred to the investment bank, and the homeowner is indebted to the investment bank instead of the original lender.<sup>50</sup>

For example, if the borrower owes a lender a principal amount of \$100 with a 20% interest rate on a gold necklace, the lender may sell that loan to an investment bank for \$110. The lender is then guaranteed his original investment of \$100 plus a profit. The investment bank now holds the loan and stands to obtain the extra \$10 from interest, depending on whether the borrower makes his payments. The investment bank, in the event that the borrower does not make his payments, has the right to take the necklace and sell it. The amount the investment bank gets in return after exercising its security interest rights depends on the necklace's value at the time of the sale, which can be less than the amount of the original loan (\$120). The investment bank, having to seize the collateral property due to the borrower's default on payments can then suffer a loss or gain, depending on the property's value at the time. This system allows the borrower to obtain property without paying the full cost

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43. Know Your Options, *Mortgage Basics*, FANNIE MAE: KNOW YOUR OPTIONS, <http://knowyouroptions.com/buy/buying-process/qualify-for-a-mortgage/mortgage-basics> (last visited Feb. 1, 2014).

44. *Id.*

45. *Security Interest*, BUSINESS DICTIONARY (2013), <http://www.businessdictionary.com/definition/security-interest.html> (last visited Jan. 20, 2013).

46. *Know Your Options*, *supra* note 43.

47. Sal Khan, *Collateralized Debt Obligation Overview*, Khan Academy (Jul. 20, 2011), <http://www.khanacademy.org/science/core-finance/derivative-securities/CDO-tutorial/v/collateralized-debt-obligation-overview>.

48. Deb Powers, *Simple Explanation of Mortgage Backed Securities And How They Contributed to the Economic Crisis*, YAHOO! VOICES (Oct. 8, 2008), <http://voices.yahoo.com/simple-explanation-mortgage-backed-securities-and-1975646.html>.

49. *Id.*

50. *Id.*

up front, the original lender to secure repayment of his loan amount with profit, and the investment bank to receive at least the property's value and potentially the amount of the original loan plus interest. Because the original lender's original expense is repaid by the investment bank for more than the original lender paid, this system allows the original lender to sell as many loans as it can while gaining profit, regardless of the borrower's repayments.

Similar to the original lender, investment banks are also able to sell its mortgages. Investment banks may then put those mortgages into a special purposes entity (SPE), apportion those SPEs into shares, and sell those shares as mortgage backed securities (MBSs).<sup>51</sup> Relying on the assumption that home prices would continue to rise, the investment banks created the SPEs and sold the MBS shares at increasing rates with little consideration of repayment issues.<sup>52</sup> Between 2000 and 2006, home prices rose at an average rate triple that of the decade prior.<sup>53</sup> In 2005, the rate of increase hit a high of 21%.<sup>54</sup>

While creating the SPEs and MBSs, the investment banks soon developed a process called "tranching." These entities pooled the mortgages, securitized<sup>55</sup> them, then divided each pool into three groups called tranches.<sup>56</sup> The entities then rated each tranche based on its credit-risk from lowest to highest: senior, intermediate or mezzanine, and junior.<sup>57</sup> Once mortgages are paid back, investors are reimbursed in order of their credit-risk rating: senior, then mezzanine, then junior tranches.<sup>58</sup> Lower tranches are typically re-securitized through collateralized mortgage obligations (CMOs).<sup>59</sup> The lower tranches backed by CMOs are then pooled, securitized, and tranced in the same way as the original loans.<sup>60</sup> This process gives countless third parties a financial stake in the underlying mortgages, how they are paid, and how they are modified<sup>61</sup> creating a "complex web of arrangements."<sup>62</sup> As if the web was

51. See Khan, *supra* note 46.

52. *Id.*

53. *Id.*

54. James R. Barth et. al., *The Rise and Fall of the U.S. Mortgage and Credit Markets: Buildup and Meltdown of the Mortgage and Credit Markets* 8 (Jan. 2009) (unpublished document), available at <http://www.milkeninstitute.org/pdf/riseandfallexcerpt.pdf>.

55. To securitize is to turn assets into securities, or financial instruments readily bought and sold in financial markets similar to stocks. Cam Merritt, *What is the meaning of securitization?* SFGATE <http://homeguides.sfgate.com/meaning-securitization-6615.html> (last visited July 31, 2013).

56. Harvard Law Review Association, *The Perils of Fragmentation and Reckless Innovation*, 125 HARV. L. REV. 1799, 1803 (2012); see also, Dana, *supra* note 10, at 103.

57. Dana, *supra* note 10.

58. *Id.*

59. See CONGRESSIONAL OVERSIGHT PANEL, FORECLOSURE CRISIS: WORKING TOWARD A SOLUTION, MARCH OVERSIGHT REPORT 1 (Mar 6, 2009), available at <http://cybercemetery.unt.edu/archive/cop/20110402010739/http://cop.senate.gov/documents/cop-030609-report.pdf> ("Oversight Report"); see also Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1098-1102 (2009); Joshua D. Coval, et al., *The Economics of Structured Finance* 10-15 (Harvard Business School Working Paper No 09-060, 2008), available at <http://www.hbs.edu/research/pdf/09-060.pdf>.

60. See Dana, *supra* note 10, at 103.

61. *Id.*

62. Kathryn Judge, *Fragmentation Nodes: A Study in Financial Innovation, Complexity, and Systemic Risk*, 64 STAN. L. REV. 657, 669-84 (2012).

not complicated enough, borrowers often take out second mortgages held by investors unrelated to the first but fragmented and securitized in the same way.<sup>63</sup>

Although mortgages are incredibly useful in that they provide a means of purchasing a home without having to pay upfront, the sudden increase in mortgages is one of the key causes of the Great Recession.<sup>64</sup> The problem, more specifically, was the push for home-ownership, i.e. giving home-ownership opportunities to individuals traditionally unable to qualify.<sup>65</sup> Fannie Mae and Freddie Mac, government sponsored entities, sought to help lower-income borrowers otherwise unable to qualify for mortgages to buy homes.<sup>66</sup> High-risk, low-income borrowers were able to obtain mortgages, specifically adjustable-rate mortgages (ARMs),<sup>67</sup> which allowed borrowers to refinance their loans in order to meet their payments.<sup>68</sup> However, this model of refinancing to avoid the ARM rate increase is significantly reliant on home value's continued appreciation.<sup>69</sup> The flood of new borrowers, higher demand, and the previous decade's increase in home value have made investors and potential borrowers believe in a promising future.<sup>70</sup> As a result, mortgage lenders sold to as many people as they could,<sup>71</sup> but more interest rates rose and the influx of low-income ARM borrowers evolved into the influx of loan defaults.<sup>72</sup>

63. The multiple layers of tranching coupled with multiple mortgages associated with the same property may create issues in regards to identifying investors, their entitlements, and the ultimate effects of each additional tranche on the investors or the original mortgage. The difficult question of who, if any one person or entity, has clear title of the seized property becomes further complicated. Although important issues, these concerns are beyond the scope of this Note. See Dana, *supra* note 10, at 103.

64. See e.g., Stephen Rose, *Understanding the Financial Crisis*, STATS (Sept. 26, 2008), [http://stats.org/stories/2008/understanding\\_financial\\_crisis\\_sept28\\_2008.html](http://stats.org/stories/2008/understanding_financial_crisis_sept28_2008.html).

65. *Id.*

66. See, e.g., Powers, *supra* note 48.

67. Adjustable-rate mortgages differ from fixed-rate mortgages. Fixed-rate mortgages require the borrower to pay an interest rate that remains constant every year. In comparison, an adjustable-rate mortgage requires the borrower to abide by an interest rate that changes periodically. Board of Governors of The Federal Reserve Board, *What is an ARM?: Consumer Handbook on Adjustable-Rate Mortgages 4* (last visited July 31, 2013), available at [http://files.consumerfinance.gov/f/201204\\_CFPB\\_ARMs-brochure.pdf](http://files.consumerfinance.gov/f/201204_CFPB_ARMs-brochure.pdf). When and how the rate changes differ, however, a typical program would offer a lower interest rate in earlier years. As long as the home prices continue to rise, the homeowner has the option to refinance his home and obtain a mortgage on the remaining balance with a lower interest rate. The problem these homeowners with adjustable-rate mortgages faced prior to and during the Great Recession was the decline in home values and their inability to refinance their mortgages. Due to the higher interest rates, these homeowners were unable to make their payments and foreclosure rates rose. Barth, *supra* note 54 at 10.

68. See Steven L. Schwarcz, Keynote Address, *Understanding the Subprime Financial Crisis*, 60 S.C. L. REV. 549, 550-51 (2009).

69. *Id.* at 551.

70. See, e.g., *Episode 355: The Giant Pool of Money*, THIS AMERICAN LIFE (May 9, 2008), <http://www.thisamericanlife.org/radio-archives/episode/355/transcript>.

71. Rose, *supra* note 64.

72. Christopher J. Mayer, et al., *The Rise in Mortgage Defaults 2* (Finance & Economics Discussion Series, Division of Research & Statistics & Monetary Affairs, Federal Reserve Board, Washington, D.C., 2008), available at <http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf> (as the higher interest rates on ARMs kicked in low-income, high-risk borrowers were unable to meet payments, defaulting on their loans).

### III. RICHMOND AND MRP'S PROPOSAL

In early 2011, a group of politically connected venture capitalists formed Mortgage Resolution Partners (MRP) in San Francisco, California. MRP sought to advance one of the proposed solutions to the housing crisis: using eminent domain to seize underwater mortgages and replace those mortgages with more affordable ones.<sup>73</sup> This self-styled "community advisory firm,"<sup>74</sup> originally planned to raise money from private investors to purchase the underwater mortgages for a fair value, allowing the homeowners bound by those mortgages to avoid potential foreclosure and remain in their homes.<sup>75</sup> This process would reduce homeowners' mortgage principals and assign the reduced monthly payments to MRP.<sup>76</sup> MRP's executive chairman Phil Angelides vehemently supported this proposal, projecting that MRP and its investors "just might do a good thing for America, and along the way get a great return on investment."<sup>77</sup> As a former State Treasurer and Democratic gubernatorial candidate for California,<sup>78</sup> Angelides hoped to use "legal and political leverage," as well as claims of up to 20% annual returns for investors, to secure private funds.<sup>79</sup> Executive Chairman Angelides also assured potential investors that if losses occurred they would likely be deductible for tax purposes.<sup>80</sup> Despite Angelides' enthusiastic support, he withdrew from MRP less than a month after announcing his involvement.<sup>81</sup>

MRP's plan to use eminent domain to seize underwater mortgages was developed after it became clear that the mortgage contracts barred voluntary sale to private investors.<sup>82</sup> To overcome this hurdle, MRP revised its plan to enlist local governments to use their eminent domain power to seize the mortgages.<sup>83</sup>

While MRP has been clear in its plan's overall purpose of reducing the risk of foreclosures, they have been alarmingly vague with regard to the details of the plan itself. MRP has demonstrated a failure to develop concrete goals for the eminent domain plan by periodically releasing contradicting proposals for the plan's implementation.<sup>84</sup> Graham Williams, CEO of MRP, acknowledged this issue when

73. Jennifer Ablan & Matthew Goldstein, *Exclusive: Angelides to lead distressed mortgage firm*, REUTERS (Jan. 13, 2012), <http://www.reuters.com/article/2012/01/13/us-usa-housing-angelides-idUSTRE80C26820120113> [hereinafter, *Angelides to lead*].

74. MORTGAGE RESOLUTION PARTNERS WEBSITE, <http://mortgageresolutionpartners.com> (last visited July 31, 2013).

75. *Angelides to lead*, *supra* note 73.

76. *Id.*

77. *Id.*

78. *Id.*

79. *Angelides to lead*, *supra* note 73.

80. *Id.*

81. Jennifer Ablan & Matthew Goldstein, *Financial crisis chair Angelides quits mortgage firm*, REUTERS (Feb. 13, 2012, 5:15pm EST), <http://www.reuters.com/article/2012/02/13/us-mortgages-angelides-idUSTRE81C20A20120213>.

82. *FAQs*, MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolutionpartners.com/faqs> (last visited July 31, 2013).

83. *Id.*

84. See e.g., Griffin, *supra* note 32 (stating the eligible mortgages must be underwater and the mortgagor



he warned the Federal Housing Finance Agency in late 2012 that any action against their proposal would be premature, given the plan had not yet been fully formulated.<sup>85</sup> Accordingly, the information MRP has presented do not provide sufficient details regarding eligibility for the plan or the mortgage selection process, reasons for preferring up-to-date mortgages over those more at risk of foreclosure, whether a threshold of negative equity exists for eligibility, nor whether the investors or the original lenders are deemed the mortgagees. Despite the current holes in MRP's eminent domain plan, the following is an aggregation of what can be ascertained from the available information on MRP's current proposal.

MRP's aspirations are to earn a profit<sup>86</sup> and prevent foreclosures by using local governments' eminent domain power to seize mortgages, transfer these mortgages to the local government, and restructure the mortgages, enabling the mortgagors to make lower monthly payments to MRP.<sup>87</sup> As opposed to a traditional eminent domain taking, the property seized would be the loan and not the home itself.<sup>88</sup> The homeowner would stay in her home and, the local government would then own the homeowner's mortgage.<sup>89</sup>

The first step to implementing MRP's proposal is to identify which homeowners and loans meet the proposal's requirements.<sup>90</sup> The mortgages in consideration need not secure property from any particular neighborhood or concentrated area, but must be the homeowner's primary residence.<sup>91</sup> The loan must have a higher remaining balance than the fair market value of the mortgaged property, or be considered "underwater."<sup>92</sup> In order to be eligible homeowners must also be current on their loan payments.<sup>93</sup> Finally, MRP aims to limit the option to private loans to avoid conflicts between state and federal authorities.<sup>94</sup> For example, the Federal Housing Finance Agency has threatened to bring legal action against the state or local governments that implement this type of proposal or restrict business activities with

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must be current on his or her payments); see also Joe Nelson, *Underwater mortgage acquisition proposal expands to include delinquent or defaulted homeowners*, SAN BERNITO COUNTY SUN (Sept. 6, 2012), [http://www.sbsun.com/news/ci\\_21482566/underwater-mortgage-acquisition-proposal-expands-include-delinquent-or](http://www.sbsun.com/news/ci_21482566/underwater-mortgage-acquisition-proposal-expands-include-delinquent-or) (stating defaulted or delinquent mortgagors will qualify for the proposal); but see *Center for American Progress: Eminent Domain and the Housing Market* (C-SPAN television broadcast Jan. 8, 2013), available at <http://www.c-spanvideo.org/program/310257-1> (proposal opponents criticized the proposal for disqualifying defaulted mortgages and Steven Gluckstern of MRP failed to contest the disqualification).

85. Letter from Graham Williams, Chief Executive Officer, Mortgage Resolution Partners, to Alfred Pollard, General Counsel, Federal Housing Finance Agency (Sept. 7, 2012), [http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa\\_comment\\_letter\\_9.7.12.pdf](http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa_comment_letter_9.7.12.pdf) [hereinafter, Letter from Williams].

86. See *Center for American Progress*, *supra* note 84 (Chairman of MRP Steven Gluckstern describes MRP as a profit-seeking organization).

87. MORTGAGE RESOLUTION PARTNERS WEBSITE, *supra* note 74; see also *Center for American Progress*, *supra* note 84.

88. See *Center for American Progress*, *supra* note 84 (MRP Chairman description of the proposal).

89. *FAQs*, *supra* note 82.

90. *Id.*

91. Griffin, *supra* note 32; *Center for American Progress*, *supra* note 84.

92. Griffin, *supra* note 32; *Center for American Progress*, *supra* note 84.

93. Griffin, *supra* note 32; *Center for American Progress*, *supra* note 84.

94. See Letter from Williams, *supra* note 85.

jurisdictions that implement this type of plan.<sup>95</sup>

After establishing which homeowners are eligible for this benefit, the local government is able to choose eligible mortgages, although it is unclear who ultimately selects the mortgages for the proposal.<sup>96</sup> If the owners of the mortgages choose not to sell their loans to the local government, MRP can then use eminent domain to seize the mortgages and pay fair market value for the loans.<sup>97</sup> The criterion governing the investors' decision-making process has yet to be detailed, resulting in a lack of definitive requirements for eligibility and opens questions as to the fairness of the program's application.<sup>98</sup>

Finally, the loans would be restructured, thus providing more affordable options for the homeowners.<sup>99</sup> The local government would work with MRP to determine the fair market value, or the price a willing buyer would pay a willing seller, of the loan in consideration.<sup>100</sup> MRP proposes to use appraisers<sup>101</sup> as well as the Federal Housing Finance Agency's valuations to determine fair value of the loans.<sup>102</sup> After determining the fair market value of the loans, the owners of the loans may contest the amount via jury trial.<sup>103</sup> The local government would then pay the determined fair market value to the original lenders using investor funding, transferring the right to the homeowner's future loan payments from the original lenders to MRP investors.<sup>104</sup> The result is the homeowner paying lower mortgage payments to MRP that represent the actual value of the loan<sup>105</sup> and, hopefully, protecting the homeowner from foreclosure.<sup>106</sup>

The proposal utilizes funding from MRP investors to seize the homeowners' mortgages and replace them with loans based on the homes' updated fair market value.<sup>107</sup> The mortgagees then pay their new mortgage payments to MRP at rates lower than their previous mortgage but above the fair market value of the loans.<sup>108</sup>

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95. *FHFA Statement on Eminent Domain*, FEDERAL HOUSING FINANCE AGENCY (Aug. 8, 2013), available at <http://www.fhfa.gov/webfiles/25419/FHFAStmntEminentDomain080813.pdf>.

96. Griffin, *supra* note 32.

97. See Letter from Williams, *supra* note 85; see also *FAQs*, *supra* note 82; see also *Center for American Progress*, *supra* note 84.

98. See *Center for American Progress*, *supra* note 84 (Jim Carr, Senior Policy Fellow with Opportunity Agenda urged during the panel discussion that although the proposal can be successful, the plan is flawed due to unclear homeowner qualifications and implementation procedures).

99. *Id.*

100. *FAQs*, *supra* note 82; see also *Center for American Progress*, *supra* note 84.

101. Letter from Williams, *supra* note 85.

102. Gluckstern Comment, *MRP Releases Comment Letter to the FHFA on Eminent Domain*, MORTGAGE RESOLUTION PARTNERS WEBSITE, <http://mortgageresolutionpartners.com/mrp-releases-comment-letter-to-the-fhfa-on-eminent-domain> (last visited Jan. 28, 2013).

103. See *Center for American Progress*, *supra* note 84; CAL. CONST. art. 1 §19(a).

104. Because MRP will use the fair market value of the property, MRP will not be required to negotiate values with the original lenders. Furthermore, the original lenders have a right to contest the fair market value by way of trial. *FAQs*, *supra* note 82; Griffin, *supra* note 32.

105. Griffin, *supra* note 32.

106. *FAQs*, *supra* note 82.

107. *FAQs*, *supra* note 82.

108. *Center for American Progress*, *supra* note 84 (amount above fair value accounting for payments to MRP and private investors).

With each payment, MRP takes a fee before transferring the rest to its private investors.<sup>109</sup> Although this is the financing structure MRP illustrates, MRP also indicates the local government pays the fair value for the taken loans.<sup>110</sup> MRP claims the community does not finance the firm, a “funder” does, yet who the “funder” is precisely remains unclear.<sup>111</sup>

Additional details have surfaced in light of MRP's recent contract with Richmond, California. Richmond has already implemented the first step of its plan, to send letters to owners of underwater mortgages offering to buy their loans.<sup>112</sup> Each of the eligible loans is either current or delinquent and tied to private label securities.<sup>113</sup> The city has offered to purchase each homeowner's mortgage for 80% of the home's fair market value.<sup>114</sup> In its next step the city will likely write down the debt, enabling the homeowners to refinance through a government-lending program.<sup>115</sup> The city will not have the need to utilize its eminent domain power to condemn and buy the loans unless the owners of the loan reject the city's offer to purchase the loans.<sup>116</sup> MRP's role is to assist the city in negotiating with “owners of loans, attorneys, lenders, data companies, other government agencies, and others as necessary to implement [the] program.”<sup>117</sup> Most importantly, MRP is responsible for identifying companies willing to fund the program.<sup>118</sup> Added details in Richmond's plan have shed some light on the proposal, however still do not clarify specifics regarding eligibility, the selection process, or negative equity thresholds.

#### IV. EMINENT DOMAIN

For a taking of private property to be legitimate, the object of the taking must be “property,” the property must be taken for public use, and the government entity must provide just compensation for that property.<sup>119</sup> This section addresses whether local governments have the legal authority to implement a proposal such as MRP's, more specifically, whether MRP is able to seize the loans for its proposed purpose. Since no statute or case has specifically endorsed the idea of using eminent domain to seize a loan, several state statutes as well as federal authorities must be considered in

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109. *FAQs*, *supra* note 82.

110. *Id.*

111. *Id.*

112. Issues, such as those MRP originally encountered, arise in regarding voluntary sales in the original mortgage contracts' language. Although whether the contracts allow voluntary sale of the loans is an important factor for the proposal's implementation, the answer is indeterminable and beyond the scope of this Note. *See also* McDill, *supra* note 38.

113. Private label securities are those pooled and sold to private investors. *See* Dewan, *supra* note 40. This type of security does not conform to government-required criteria and carries much higher risks. *See, e.g., Private-Label MBS: Understanding Mortgage Securitization*, SECURITIZATION, <http://securitization.weebly.com/private-label-mbs.html> (last visited Jul. 31, 2013).

114. McDill, *supra* note 38; Dewan, *supra* note 40.

115. McDill, *supra* note 38.

116. *Id.*

117. Advisory Services Agreement, *supra* note 39, at 1.

118. *Id.* at 2.

119. U.S. CONST. amend. V.

evaluating the legality of the eminent domain portion of MRP's proposal.<sup>120</sup> Subsection A discusses qualifications for "property" in the legal sense. Subsection B discusses conditions for "public use" under federal and California law. Finally, Subsection C discusses the requirements for just compensation.

### A. Are Mortgages Considered "Property?"

The Takings Clause of the Fifth Amendment of the United States Constitution declares "nor shall *private property* be taken for public use, without just compensation."<sup>121</sup> The Due Process Clause of the Fourteenth Amendment binds all states to the provisions of the Fifth Amendment.<sup>122</sup> All state constitutions, except North Carolina, include a takings clause that emulates that of the federal version.<sup>123</sup> In terms of the Takings Clause, "property" means a bundle of rights associated with the person's relation to the physical object, such as the right to possess, use and dispose of the object, and includes nearly all interests the citizen may possess in that object.<sup>124</sup> Traditionally takings involved only land-use regulations,<sup>125</sup> but over time private property has included tangible as well as intangible property, such as leases, trade secrets, and security interests.<sup>126</sup> Like the Fifth Amendment, California's Eminent Domain Law<sup>127</sup> applies to "property and any interest therein,"<sup>128</sup> even including property rights related to a professional football team.<sup>129</sup> Whether taken property qualifies as "property" under the Fifth Amendment is seemingly uncontested, so it is unnecessary to provide extensive analysis on the issue.<sup>130</sup> Accordingly, the U.S. Supreme Court has already determined that security interests constitute "property."<sup>131</sup> Therefore, security interests such as mortgages are considered property.

### B. "Public Use"

Throughout eminent domain's history, courts have generally adopted two

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120. See *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528 (2005) (describing the government's "physical" occupation of an owner's property as a *de facto* taking).

121. U.S. CONST. amend. V (emphasis added).

122. See *Chicago, Burlington & Quincy R.R. Co. v. Chicago*, 166 U.S. 226 (1897).

123. 1 PHILIP NICHOLS, NICHOLS' THE LAW OF EMINENT DOMAIN § 1.3, at 1-95 (Julius Sackman ed., 3d ed. 2001).

124. *United States v. Gen. Motors Corp.*, 323 U.S. 373 (1945) (includes all interest besides collateral interests incident to the citizen's relation to the object).

125. *Id.*

126. *Id.* (lease); see also *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986 (1984) (trade secrets); *United States v. Sec. Indus. Bank*, 459 U.S. 70 (1982) (security interest).

127. CAL. CIV. PROC. CODE § 1235.170 (West 2007).

128. *Id.*

129. See *City of Oakland v. Oakland Raiders*, 646 P.2d 835 (Cal. 1982).

130. Contracts are well established in federal case law as property within the meaning of the Fifth Amendment. See, e.g., *Omnia Commercial Co. v. U.S.*, 261 U.S. 502, 508 (1923); *Lynch v. United States*, 292 U.S. 571, 579 (1934).

131. *Sec. Indus. Bank*, 459 U.S. 70.

dominant views regarding “public use.”<sup>132</sup> The first is the broad view, describing “public use” as an advantage or benefit to the public.<sup>133</sup> The second is the narrow view, meaning the public’s actual use or right to use the condemned property.<sup>134</sup> If the public owns, controls, and can use the property, then it qualifies as a public use.<sup>135</sup> The remarkably different interpretations at all levels of the federal judiciary have caused confusion on the state court level.<sup>136</sup> This part attempts to analyze the disparate holdings to conceptualize a public use framework under which the California law analysis may proceed.

## 1. Federal Authority

### (a) *The Fifth Amendment*

Pursuant to the Fifth Amendment Takings Clause, government use of the eminent domain power to take private property must be for some “public use.”<sup>137</sup> The Constitution does not prohibit government takings of private property, “but instead places a condition on the exercise of that power.”<sup>138</sup> For example, a taking simply transferring property from one private party to another is often said to be unconstitutional.<sup>139</sup> However, some scholars question this assertion since the Takings Clause does not expressly proscribe takings for private use.<sup>140</sup> Disagreements between scholars continue, even with a few key cases attempting to clarify the Court’s interpretation of “public use.”

### (b) *Case Law*

Three Supreme Court decisions have somewhat clarified what qualifies as public use and have indicated the Court’s preference for the broad view of public “use” as public “purpose.”

#### i. *The Berman and Midkiff Decisions*

In 1954, the U.S. Supreme Court decided *Berman v. Parker*<sup>141</sup> regarding condemnation proceedings initiated pursuant to legislation. Congress made a

132. See Lawrence Berger, *The Public Use Requirement in Eminent Domain*, 57 OR. L. REV. 203, 205 (1977-1978) (citing 2A C. NICHOLS, EMINENT DOMAIN §§ 7.01[4]–7.02[2] (rev. 3d. ed. J. Sackman & P. Rohan 1976); see also EMINENT DOMAIN USE AND ABUSE: KELO IN CONTEXT 3 (Dwight H. Merriam & Mary Massaron Ross eds., American Bar Association 2006) [hereinafter, *KELO IN CONTEXT*].

133. Berger, *supra* note 132.

134. Charles E. Cohen, *Eminent Domain After Kelo v. City of New London: An Argument for Banning Economic Development Takings*, 29 HARV. L. & POL’Y REV. 491, 493-94 (2006).

135. *Id.*

136. Berger, *supra* note 132; see also *KELO IN CONTEXT*, *supra* note 132.

137. U.S. CONST. amend. V.

138. *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 536 (2005) (quoting *First English Evangelical Lutheran Church of Glendale v. Cnty. of Los Angeles*, 482 U.S. 304, 314 (1987)).

139. Berger, *supra* note 132.

140. *Id.*

141. 348 U.S. 26 (1954).

legislative determination that the substandard living conditions associated with blighted areas in Washington D.C. were injurious to health and welfare.<sup>142</sup> Based on this legislative determination, the government was able to administer "all means necessary and appropriate" to eliminate such injurious conditions.<sup>143</sup> To combat substandard housing and blighted areas,<sup>144</sup> Congress passed the District of Columbia Redevelopment Act of 1945.<sup>145</sup> The Act created the District of Columbia Redevelopment Land Agency, responsible for planning and undertaking neighborhood development programs.<sup>146</sup> The Agency was also authorized to use eminent domain power to seize property for the redevelopment of blighted areas.<sup>147</sup> Congress determined the acquisition of real property for redevelopment purposes pursuant to a redevelopment plan constituted a public purpose, legitimizing the use of eminent domain power.<sup>148</sup>

Although the Agency seized private residential property to implement its redevelopment plan, the Agency also seized private commercial property. The appellants, owners of a department store, contested the seizure arguing the property was commercial rather than residential, ultimately managed by a private party rather than a public agency, and redeveloped for private rather than public use.<sup>149</sup> Furthermore, the appellants contested the redevelopment plan's purpose itself, arguing takings to improve aesthetics did not qualify as a public use.<sup>150</sup>

Relying on Congress' police power over the District of Columbia, the Court ultimately disagreed with the appellants' contentions.<sup>151</sup> The Court described the legislature as the "main guardian of the public," to whom deference must be afforded when determining whether the public use requirement has been met.<sup>152</sup> The Court elaborated, stating the judiciary has only an "extremely narrow" role in determining whether using eminent domain was based on a public use.<sup>153</sup> Congress not only has the authority to determine the public use but once it is determined, Congress has the exclusive authority to determine the means of attaining that purpose, regardless of whether the means entail eminent domain.<sup>154</sup>

The Court also disagreed with the appellants' position that because their particular structure did not contribute to blight, it could not be seized in order to

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142. *Berman*, 348 U.S. at 28.

143. *Id.*

144. *Id.*

145. 42 U.S.C. §§ 1469–1469c (omitted).

146. *Id.*

147. *See Schneider v. Dist. of Columbia*, 117 F. Supp. 705, 711 (D. D.C. 1953).

148. *Berman v. Parker*, 348 U.S. 26, 29 (1954).

149. *Id.* at 31.

150. *Id.*

151. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 240 (1984) ("The 'public use' requirement is thus coterminous with the scope of the sovereign's police power.")

152. *Berman*, 348 U.S. at 32; *see Old Dominion Land Co. v. United States*, 269 U.S. 55, 66 (1925); *see also McCulloch v. Maryland*, 17 U.S. 316, 421 (1819) ("Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional.").

153. *Berman*, 348 U.S. at 32 (citing *Old Dominion Co. v. United States*, 269 U.S. 55, 66 (1925)).

154. *Id.* at 33–34 (citing *United States v. Gettysburg Electric R. Co.*, 160 U.S. 668, 679 (1896)).

prevent blight and provide low-cost housing. The Court relied on the government's overall plan to redevelop the designated community rather than the individual takings themselves,<sup>155</sup> and decided since the redevelopment plan concerned the community as a whole rather than the individual structures within that community, each taking contributed to the overall success of the neighborhood development plan.<sup>156</sup> The Court ultimately affirmed the lower court decision legitimizing the use of eminent domain to seize real private property because a redevelopment plan to address blight qualified as a public purpose.<sup>157</sup>

The Supreme Court extended the Berman reasoning in *Hawaii Housing Authority v. Midkiff*.<sup>158</sup> The Court stated that, when the local legislature determines that use of eminent domain is "rationally related to a conceivable public purpose," the compensated taking will likely be deemed constitutional.<sup>159</sup> The Court reiterated that the legislative, state or federal, determination of a public use must be given deference.<sup>160</sup> In *Midkiff*, the legislature passed the Land Reform Act of 1967, which created a land condemnation proposal that transferred title in real property from lessors and to the existing lessees in order to reduce concentration of land ownership.<sup>161</sup> The public purpose was a breakup of the state's oligopoly, which was deemed a common use of the state's police powers.<sup>162</sup> Because the Act was meant "not to benefit a particular class of identifiable individuals but to attack certain perceived evils of concentrated property ownership",<sup>163</sup> the Court was able to conclude that the taking, although a transfer of property from one private party directly to another, qualified as a public use.<sup>164</sup>

## ii. *The Kelo Decision*

In 2005, the U.S. Supreme Court decided *Kelo v. City of New London*,<sup>165</sup> a case that has become one of the leading authorities distinguishing public use from abuse of eminent domain power. After being designated a "distressed municipality," the city of New London attempted to implement an economic redevelopment plan to prevent blight.<sup>166</sup> The plan's purpose was to redevelop the Fort Trumbull area to stimulate economic activity and serve as a "catalyst to the area's rejuvenation."<sup>167</sup> The city council authorized New London Development Corporation, a private, nonprofit organization, to help the city plan its economic development, to initiate

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155. *Id.* at 34.

156. *Id.*

157. *Id.* at 36.

158. 467 U.S. 229 (1984).

159. *Midkiff*, 467 U.S. at 230.

160. *Id.* at 244.

161. *See id.* at 233.

162. *See id.* at 241-42; *see also* *Exxon Corp. v. Governor of Md.*, 437 U.S. 117 (1978).

163. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 245 (1984).

164. *See id.*; *see also* *Rindge Co. v. Los Angeles*, 262 U.S. 700, 707 (1923).

165. 545 U.S. 469 (2005).

166. *Id.* at 473.

167. *Id.* at 473-75.

condemnation proceedings, and to take private property through eminent domain if it was unable to negotiate a sale with the property owners.<sup>168</sup> Thereafter, the property would be leased to private developers.<sup>169</sup>

The Supreme Court of Connecticut relied on state law and decided New London's actions were constitutional.<sup>170</sup> Based on Connecticut's municipal development statute,<sup>171</sup> the court considered the taking to be based on a public purpose because it was part of a public use economic development project.<sup>172</sup> The court also took into consideration that, despite the relative lack of blight in New London,<sup>173</sup> the State approved of the development plan.<sup>174</sup>

Ultimately, in a five-to-four decision, the U.S. Supreme Court decided the use of eminent domain to condemn private property pursuant to an economic development plan qualifies as a constitutional taking.<sup>175</sup> Considering the purpose of New London's revitalization plan itself, the Supreme Court concluded the implementation was for "public use," since the plan did not limit its benefit to a "particular class of identifiable individuals."<sup>176</sup> The Court also denounced any express requirements that condemned property be used for the general public.<sup>177</sup> Essentially, the Court dismissed the narrow definition of "public use" for practicality's sake.<sup>178</sup> The Supreme Court preferred the broad view of public use, and determined New London's development plan encompassed a "public purpose," and therefore a public use.<sup>179</sup> However, some justices were not persuaded.

Four justices deemed New London's use of eminent domain unconstitutional. Justices O'Connor, Rehnquist, Scalia, and Thomas jointly argued the Court had misinterpreted the Fifth Amendment's Public Use Clause.<sup>180</sup> Justice O'Connor's dissent, with which all dissenting justices joined, argued the majority's decision "effectively delete[d] the words 'for public use' from the Takings Clause of the Fifth Amendment" by concluding that all private property can be taken and transferred to another as long as the property may be used in a way the legislature believes is more beneficial to the public.<sup>181</sup> Justice O'Connor then distinguished this case from the *Berman* and *Midkiff* decisions, emphasizing the properties' precondemnation use in those cases "inflicted affirmative harm on society" and the legislative body

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168. *Id.*

169. *Kelo v. City of New London*, 843 A.2d 500, 509-10 (Conn. 2004).

170. *Kelo*, 545 U.S. 469.

171. CONN. GEN. STAT. ANN. § 8-186 (West 2012) (Chapter 132).

172. *Kelo*, 545 U.S. at 476.

173. *Id.* at 475.

174. *Id.* at 473-74.

175. *Id.* at 489-90.

176. *Id.* at 478.

177. *Id.* at 479.

178. *See id.* (stating the "use by the public" test would be difficult to administer due to potential inconsistencies or complexities in determining how much public use is sufficient); *see also* *Berger*, *supra* note 132 at 205.

179. *Kelo*, 545 U.S. at 480.

180. *Id.* at 494 (Chief Justice Rehnquist, Justices O'Connor, Scalia, and Thomas dissenting).

181. *Id.* at 494 (O'Connor, J. dissenting).



determined condemnation was necessary to eliminate that harm.<sup>182</sup> Here, the legislature did not present a claim that the property caused any harm on society, but that there was a predicted secondary public benefit to the new use.<sup>183</sup> However, as Justice O'Connor stated, nearly any lawful use of private property can result in some incidental public benefit.<sup>184</sup> With this standard, she argued, the legislature can seize any property currently used for ordinary private use only to transfer it to another private party for a new, ordinary private use.<sup>185</sup>

Further, in Justice Thomas' dissent, he refuted the Court's broad interpretation by concentrating on the text of the Constitution.<sup>186</sup> He argued the word "use" should be interpreted akin to "employ" instead of simply a purpose, as "use" is interpreted in other parts of the Constitution.<sup>187</sup> Moreover, Justice Thomas argued the Public Use Clause is a limitation on the Takings Clause that must be given significance; otherwise, it would be considered surplus.<sup>188</sup> Further, Justice Thomas asserted if the Public Use Clause were not interpreted as a limitation, the Takings Clause would be read as giving the government the right to take property for private or public use, but only requiring just compensation when asserting the right for a public use.<sup>189</sup> Justice Thomas also argued that if economic development of this type may qualify as a "public use," takings could be constitutional based on "any conceivable [public] benefit from the taking."<sup>190</sup> In light of these decisions, federal case law suggests that economic development plans may qualify as a constitutional taking; however, California law places additional limitations on the state's eminent domain authority.

## 2. California Law

### (a) *Article I, Section 19*

California's constitution emulates the Fifth Amendment's Taking Clause, which reads, "private property may be taken or damaged *for a public use* and only when just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner".<sup>191</sup> In accordance with a state's right to impose stricter rules on its citizens, the California Constitution imposes additional limiting clauses on local government use of eminent domain as compared to the federal government.<sup>192</sup>

182. *Id.* at 501 (O'Connor, J. dissenting).

183. *Id.*

184. *Kelo v. City of New London*, 545 U.S. 469, 501 (2005)(O'Connor, J. dissenting).

185. *Id.*

186. See *id.* at 505-23 (Thomas, J. dissenting).

187. *Id.* at 509 (Thomas, J. dissenting) (citing Article 1 § 8 of the Constitution) (where "use" means "employed to raise and support Armies").

188. *Id.* at 508 (Thomas, J. dissenting) (citing *Marbury v. Madison*, 5 U.S. 137, 174 (1803) ("It cannot be presumed that any clause in the constitution is intended to be without effect")).

189. Justice Thomas argued the Fifth Amendment would not be logically written had the Public Use Clause not limited the Takings Clause, thus disregarding any requirement for just compensation for takings of private property for private use but not public use. See *id.*

190. *Kelo v. City of New London*, 545 U.S. 469, 510 (2005)(Thomas, J. dissenting).

191. CAL. CONST. art. 1, § 19(a) (amended 2008) (emphasis added).

192. *Id.*; *supra* Part III.B.1.

(b) *The Eminent Domain Law*

In 1975, California's legislature passed the Eminent Domain Law,<sup>193</sup> limiting the exercise of eminent domain power.<sup>194</sup> Its first general limitation relates to public use: the government may only use eminent domain to acquire property for public use.<sup>195</sup> Yet, the direct transfer of private property to another private party may still qualify as a constitutional taking.<sup>196</sup> The state courts must also give deference to the state legislature's interpretation of what is considered a "public use" unless the purpose is "demonstrably pretextual."<sup>197</sup> Therefore, statutory authorization to use eminent domain is "deemed to be a declaration by the Legislature that such use. . . is a public use."<sup>198</sup> The courts must afford deference to the legislature's determinations, but may exercise a narrow scope of review regarding public use.<sup>199</sup> For example, deference is not required in cases such as when the supposed public use is clearly pretextual of private benefits. The courts, then, have the final say and simple legislative action would not automatically deem the public use sufficient for a constitutional taking.<sup>200</sup>

i. *The Community Redevelopment Law*

The Eminent Domain Law imposes restrictions on government takings, even for established public uses,<sup>201</sup> such as economic redevelopment.<sup>202</sup> Redevelopment agencies<sup>203</sup> could condemn property on behalf of a retailer or revenue generator to stimulate a blighted area pursuant to the Community Redevelopment Law,<sup>204</sup> which aims to assist local governments in eliminating blight.<sup>205</sup> However, the mere

193. Eminent Domain Law, CAL. CIV. PROC. CODE §§ 1230.010, .020 (West 2013).

194. Eminent Domain Law, CAL. CIV. PROC. CODE ch. 1.

195. CIV. PROC. § 1240.010.

196. *See* *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 243-44 (1984); *Rindge Co. v. Los Angeles*, 262 U.S. 700, 707 (1923).

197. CIV. PROC. § 1240.010; 99 Cents Only Stores v. Lancaster Redev. Agency, 237 F. Supp. 2d 1123, 1129 (C.D. Cal. 2001).

198. 99 Cents Only Stores, 237 F. Supp. 2d at 1129.

199. *See id.* (public use is not established as a matter of law simply through statutory action).

200. *Id.*

201. *See, e.g.*, CIV. PROC. § 1240.030 (imposing three requirements be met prior to condemnation: (a) public interest and necessity require the proposed project; (b) the project is conducted in a way that imposes "the greatest public good with the least personal injury"; (c) property sought is required to implement the project).

202. *See* *In Re Redev. Plan for Bunker Hill*, 61 Cal. 2d 21, 71 (1964) (clearance of blighted areas and redevelopment of those areas are public uses); Community Redevelopment Law, CAL. HEALTH & SAFETY CODE §§ 33030-33031 (West 2013); *Berman v. Parker*, 348 U.S. 26, 33-36 (1954).

203. HEALTH & SAFETY §§ 33100-33142 (Agencies created pursuant to the Community Redevelopment Law authorized to create and help implement redevelopment plans for blighted areas).

204. HEALTH & SAFETY §§ 33342, 91.

205. *See, e.g.*, *Redevelopment Dissolution*, LACOUNTY.GOV, [http://redevelopmentdissolution.lacounty.gov/wps/portal/rdd?ldmy&page=dept.rdd.home.detail.hidden&urile=wcm%3Apath%3A/lacounty+content/lacounty+site/home/redevelopment+dissolution/rdd+home/home+link+of+interests/rd\\_history+of+redevelopment+in+california](http://redevelopmentdissolution.lacounty.gov/wps/portal/rdd?ldmy&page=dept.rdd.home.detail.hidden&urile=wcm%3Apath%3A/lacounty+content/lacounty+site/home/redevelopment+dissolution/rdd+home/home+link+of+interests/rd_history+of+redevelopment+in+california) (last visited July 31, 2013).

prevention of future blight does not qualify as a public use.<sup>206</sup> Therefore, even though redevelopment is an established public use, takings for such redevelopment with the goal of preventing future blight are unconstitutional.

In addition to prohibiting use of eminent domain to prevent future blight, the amended Community Redevelopment Law<sup>207</sup> limited the definition for “blight”<sup>208</sup> and increased oversight on redevelopment activities.<sup>209</sup> In 2006, the California legislature passed the Community Redevelopment Law Reform Act to “restrict the statutory definition of blight” and “to require better documentation of local officials’ findings regarding the conditions of blight.”<sup>210</sup> The amendment defined blight as a predominantly urbanized area with conditions so substantial as to prohibit the proper utilization of the area and to cause serious physical and economic harm to that area.<sup>211</sup> A blighted area must also be characterized by one of the following: conditions unsafe or unhealthy for people to work or live, conditions inhibiting proper use of buildings or lots, “adjacent or nearby incompatible land uses” that prevent development, or the existence of subdivided lots in multiple ownership that are prevented from physical development without redevelopment programs.<sup>212</sup> Although redevelopment purposes could conceivably be associated with any neighborhood or municipality, the Community Redevelopment Law limited condemnation pursuant to redevelopment programs to blighted areas only.<sup>213</sup>

As of 2012 eminent domain may not be used in California for redevelopment purposes at all.<sup>214</sup> As part of the Budget Act of 2011, and to “protect funding for core public services at the local level”,<sup>215</sup> Governor Jerry Brown signed Assembly Bills X1 26, eliminating redevelopment agencies, and X1 27, allowing voluntary redevelopment programs.<sup>216</sup> Thereafter, the California Supreme Court declared voluntary redevelopment programs unconstitutional<sup>217</sup> and redevelopment agencies dissolved in early 2012.<sup>218</sup> Since the Community Redevelopment Law restricts condemnation for redevelopment purposes to blighted areas and government<sup>219</sup> and

206. *Lancaster Redev. Agency*, 237 F. Supp. 2d at 1129-31 (requiring a valid public use for the plan and proof that the property was blighted at the time of its attempted taking); HEALTH & SAFETY §§ 33000-33855.

207. HEALTH & SAFETY § 33000-33855.

208. HEALTH & SAFETY § 33030(b)(1) (A blighted area is a predominantly urbanized area, underutilizing to the point of such a “serious physical and economic burden on the community that [it] cannot reasonably be expected to be reversed . . . without redevelopment.”).

209. S.B. 1206, 2006 Leg., Reg. Sess. (Cal. 2006) (amending HEALTH & SAFETY §§ 33328.7, 33378, 33500, and 33501, and adding §§ 33328.1, 33360.5, 33451.5, 33501.1, 33501.2, 33501.3, and 33501.7).

210. *Id.* at §1(e).

211. S.B. 1206, 2006 Leg., Reg. Sess. (Cal. 2006) (amending HEALTH & SAFETY § 33030(b)(1)).

212. *Id.* (amending HEALTH & SAFETY §§ 33030(b)(2) & 33031(a)).

213. *Id.*

214. *Redevelopment Agency Dissolution*, CALIFORNIA DEPARTMENT OF FINANCE WEBSITE <http://www.dof.ca.gov/redevelopment/> (last visited Feb. 1, 2014).

215. *Id.*

216. KEVIN H. BROGAN, *THE LAW OF EMINENT DOMAIN: FIFTY STATE SURVEY 66* (William G. Blake ed., 2012).

217. *California Redev. Ass’n v. Matosantos*, 53 Cal. 4th 231 (2011).

218. *Redevelopment Agency Dissolution*, *supra* note 214.

219. Legislative bodies may also elect to administer the powers granted to an agency pursuant to the Community Redevelopment Law. HEALTH & SAFETY § 33003.

volunteer redevelopment agencies have been eliminated, condemnation pursuant to redevelopment programs is no longer possible. Therefore, even condemnation for a public purpose such as redevelopment is not permitted in California.

Through sufficient legislative action, practically anyone can exercise eminent domain power. Under the Eminent Domain Law, municipalities and private persons must have an express right to condemn private property.<sup>220</sup> Legislation has authorized state agencies<sup>221</sup> as well as city,<sup>222</sup> county,<sup>223</sup> and school district<sup>224</sup> officials to use eminent domain power, giving these entities the ability to seize property necessary to exercise their powers or functions.<sup>225</sup> Although the Eminent Domain Law explicitly allows certain entities to utilize the power of condemnation,<sup>226</sup> those entities do not automatically have that right. The right to use eminent domain power must be “found in some statute of the state, and that such right must be expressly given, or arise by necessary implication from powers expressly given.”<sup>227</sup> The restriction on the right to use eminent domain along with a qualified public use, are contingent on the legislature.<sup>228</sup> The legislature may also permit a private entity<sup>229</sup> or person<sup>230</sup> to condemn property for public use, or the reasonable prospect of use within a reasonable time.<sup>231</sup> However, the authorized parties are still required to provide just compensation for the taking regardless of qualified public purposes.

### C. “Just Compensation”

For a constitutional use of eminent domain power, California requires the taking of “property” and that property be utilized for a “public use.” The California constitution also imposes a third requirement of *just compensation* for the condemned property and reads, “Private property may be taken or damaged for a public use and only when *just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner.*”<sup>232</sup> Unlike public use, verification of just compensation is exclusively a judicial function.<sup>233</sup> The goal of the clause is fairness,

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220. Eminent Domain Law, CAL. CIV. PROC. CODE § 1240.020 (West 2013).

221. CAL. GOV'T CODE § 15853 (West 2013); CIV. PROC. § 1240.020.

222. GOV'T § 37350.5; CIV. PROC. § 1240.020.

223. GOV'T § 2530.5; CIV. PROC. § 1240.020.

224. CAL. EDUC. CODE § 1047 (West 2013); CIV. PROC. § 1240.020.

225. CIV. PROC. § 1238 (repealed 1975) (Legislative Committee Comment-Senate) (repealed because the Eminent Domain Law preserves these authorities' eminent domain power).

226. See *supra* notes 231-34 and accompanying text.

227. See *Marin Cnty. v. Superior Court of Marin Cnty.*, 53 Cal. 2d 633, 636 (1960) (referencing *S. Pac. R. Co. v. S. Cal. Ry. Co.*, 111 Cal. 221, 227 (1896)).

228. See *supra* notes 155-57, 197-99 and accompanying text.

229. See, e.g., *People v. Oken*, 324 P.2d 58, 61 (Cal. Ct. App. 1958).

230. CIV. PROC. § 1235.160 (A “person” can mean “any public entity, individual, association, organization, partnership, trust, limited liability company, or corporation.”).

231. See CIV. PROC. § 1240.020 (restricting eminent domain power to only those legislatively authorized); see, e.g., *Woodland Sch. Dist. v. Woodland Cemetery Ass'n*, 344 P.2d 326, 327 (1959).

232. CAL. CONST. art. 1, § 19(a)(emphasis added).

233. *United States v. New River Collieries Co.*, 262 U.S. 341, 343-44 (1923) (citing *Monongahela Nav. Co. v. United States*, 148 U.S. 312, 327 (1893)); *Seaboard Air Line Ry. Co. v. United States*, 261 U.S. 299, 306

equity, efficiency, and making the condemnee whole after the taking.<sup>234</sup> Pursuant to this goal, judges have established their own standard for evaluating just compensation, traditionally requiring fair market value of the property.<sup>235</sup>

In California, a property's fair market value is property's highest price on the date of valuation that a willing buyer would pay to a willing seller.<sup>236</sup> This assessment takes into account the property's "highest and best use,"<sup>237</sup> the highest and "most profitable use to which the property might be put in the reasonably near future."<sup>238</sup> For property with no relevant, comparable market, the value is determined by "any method of valuation that is just and equitable."<sup>239</sup> Fact-finders determining fair market value may consider the same factors a knowledgeable, nongovernmental buyer would consider in purchasing the property for private use.<sup>240</sup>

While fair market value is the general standard when determining just compensation for a condemned property, sometimes an even higher valuation is required.<sup>241</sup> Judge-made law requires at least fair market value be awarded; however, legislatures are able to provide additional compensation.<sup>242</sup> The legislative purpose for its higher standard is to protect not only the landowner but also the public, seeking to limit the public's liability to losses attributed to the taking.<sup>243</sup> California's concept of just compensation is based on what the property owner has lost,<sup>244</sup> seeking to provide the "full and perfect equivalent in money of the property taken," and bringing the condemnee to a pecuniary position tantamount to his position had the taking never occurred.<sup>245</sup> The measure of just compensation also includes "all damages that [would] reasonably accrue from the taking."<sup>246</sup>

Additionally, California's constitution explicitly requires jury determination for just compensation. The constitution requires the condemning party to provide just compensation "*ascertained by a jury unless waived.*"<sup>247</sup> Therefore, unless the

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(1923) (holding Congress cannot constitutionally set just compensation).

234. See *United States v. Commodities Trading Corp.*, 339 U.S. 121, 124 (1950) (equating the word "just" to ideas of "fairness" and "equity"); *United States v. Miller*, 317 U.S. 369, 373 (1943) (condemnees must be put in the same financial position they would have been had they kept their property).

235. *Kimball Laundry Co. v. United States*, 338 U.S. 1, 6 (1949); *United States v. Gen. Motors Corp.*, 323 U.S. 373, 379 (1945).

236. Eminent Domain Law, CAL. CIV. PROC. CODE § 1263.320(a) (West 2013).

237. *City of San Diego v. Rancho Penasquitos P'ship*, 130 Cal. Rptr. 2d 108, 119 (Ct. App. 2003).

238. *City of San Diego v. Neumann*, 25 Cal. Rptr. 2d 480, 483 (1993) (citation omitted).

239. CIV. PROC. § 1263.320(b).

240. See *City of Fremont v. Fisher*, 73 Cal. Rptr. 3d 54, 63 (Ct. App. 2008) (citation omitted); *Cnty. of San Diego v. Rancho Vista Del Mar, Inc.*, 20 Cal. Rptr. 2d 675, 686 (Ct. App. 1993).

241. CIV. PROC. § 1263.310 (comments); see, e.g., *Ventura Cnty. Floor Control Dist. v. Campbell*, 83 Cal. Rptr. 2d 725, 730 (Ct. App. 1999) (citation omitted).

242. See *Joslin Mfg. Co. v. City of Providence*, 262 U.S. 668, 676-77 (1923) (legislatures are able to provide compensation above the minimum set by just compensation).

243. See, e.g., *Emeryville Redev. v. Harcros Pigments, Inc.*, 125 Cal. Rptr. 2d 12, 19 (Ct. App. 2002).

244. See, e.g., *Merced Irrigation Dist. v. Woolstenhulme*, 483 P.2d 1, 7 (Cal. 1971).

245. *City of San Diego v. Rancho Penasquitos P'ship*, 130 Cal. Rptr. 2d 108, 119 (Ct. App. 2003) (citation omitted).

246. *Ellena v. State*, 138 Cal. Rptr. 110, 119-20 (Cal. Ct. App. 1977) (citation omitted).

247. CAL. CONST. art. 1 § 19(a) (emphasis added).

condemnee and state<sup>248</sup> waive this right, a jury is required to determine just compensation before administering any taking.<sup>249</sup> At trial, the jury would consider the same factors a buyer would consider when determining fair market value, as if the jury was considering purchasing the property.<sup>250</sup> Jury determination is limited to the amount of compensation, however, and the court determines any other question of fact.<sup>251</sup>

## V. SHOULD MRP'S PROPOSAL BE IMPLEMENTED?

Proponents and opponents of the proposal agree on at least one thing: something needs to be done to prevent the housing crisis from getting worse. The issue is which avenue to take towards that common goal. Legality, procedural, efficiency, and political concerns must be considered. Careful consideration of these concerns should persuade municipalities to reject MRP's proposal.

### A. Lack of a Public Use

Despite the need for some kind of active response to the housing crisis, opponents have vigorously questioned the proposal's constitutionality.<sup>252</sup> They have remained unconvinced notwithstanding MRP's assurance that its proposal is within the confines of the U.S. Constitution and California law. At present, the proposal is impermissible under federal as well as state eminent domain law.

For decades, the United States Supreme Court has stated that public use is "coterminous with the . . . police powers" and has given the legislature deference in its determination of public use.<sup>253</sup> In *Kelo*, the Court emphasized the redevelopment plan as a whole and the plan's purpose, rather than the purpose of each individual taking.<sup>254</sup> The Court concluded that, the taking was constitutional based the taking's necessity as part of a comprehensive plan to redevelop the area. However, with regard to MRP's proposal, there is no comprehensive plan authorized by the state legislature. Because no plan to redevelop the immediate area has been authorized by the legislature no redevelopment plan can be said to exist for public use determination purposes. The proposal is the takings themselves. MRP's proposal relinquishes any and all control of the property after restructuring the loans; thereafter, allowing the homeowners to use the money they previously used on their mortgage however they

248. See *United States v. 21 Acres of Land, More or Less*, 61 F.Supp. 268, 274 (S.D.Cal. 1945) (both the state and property owner are entitled to jury trial).

249. See, e.g., *City of Carlsbad v. Rudvalis*, 135 Cal. Rptr. 2d 194, 200 (Ct. App. 2003) (the question of amount of compensation goes to the jury); *Weber v. Bd. of Supervisors of the Cnty. of Santa Clara*, 59 Cal. 265, 266 (1881); *Trahern v. Bd. of Supervisors of San Joaquin Valley*, 59 Cal. 320, 320-21 (1881).

250. *City of Fremont v. Fisher*, 73 Cal. Rptr. 3d 54, 63 (Ct. App. 2008) (citation omitted).

251. See, e.g., *Redev. Agency v. Contra Costa Theatre, Inc.*, 185 Cal. Rptr. 159, 163 (Ct. App. 1982) (citation omitted).

252. See, e.g., Jann Swanson, *Eminent Domain Calls Down Thunder From FHFA*, MORTGAGE NEWS DAILY (Aug. 9, 2013), [http://www.mortgagenewsdaily.com/08092013\\_eminent\\_domain.asp](http://www.mortgagenewsdaily.com/08092013_eminent_domain.asp).

253. *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 240 (1984) (citation omitted); see also *Nat'l R.R. Passenger Corp. v. Boston and Maine Corp.*, 503 U.S. 407, 422 (1992).

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

wish. The public purpose behind MRP's proposal is the expectation that those homeowners will spend their windfalls and stimulate the economy.<sup>255</sup> Again, this is only an assumption because the proposal allows the homeowners to save the money and not use it at all.

Further, the takings in *Kelo* only served as the first step of an overall plan approved by the legislature<sup>256</sup> whereas MRP's proposal has no comprehensive plan. This distinction could force judges to evaluate each individual taking, meaning the judges would need to test each taking for a qualified public purpose. MRP's supposed purpose is also to reduce the risk of foreclosures by restructuring current mortgages. However, MRP originally disqualified homeowners who were behind on mortgage payments. Even though MRP revised its plan to include homeowners who have defaulted on payments, including any mortgages that are up-to-date would not advance MRP's goal to reduce the risk of foreclosures since those mortgages already carry significantly less risk of foreclosure. Additionally, as there is no comprehensive plan, review of each individual taking would be necessary. At the very least, the judge could consider the individual takings of up-to-date mortgages as inhibiting the stated public purpose since those takings prohibit restructuring of loans much more likely of default. However, the purpose of each taking, especially of up-to-date mortgages, would not help to reduce the risk of foreclosures thus nullifying MRP's supposed public purpose. Standing alone, MRP's takings would lack public purpose because the individual takings of up-to-date mortgages inhibit the reduction in risk of foreclosure and they are not a necessary part of an overall plan to revitalize the local economy.<sup>257</sup> Further, the Eminent Domain Law requires that projects necessitating a taking must be "planned or located in the manner that will be most compatible with the greatest public good and the least private injury."<sup>258</sup> Targeting underwater mortgages rather than foreclosures and including up-to-date mortgages instead of exclusively taking delinquent mortgages would not serve the greatest public good.

Additionally, the Supreme Court in *Midkiff* authorized the transfer of property from one private party to another because the benefit was not directed to a particular class of identifiable individuals.<sup>259</sup> MRP's proposal would target private persons themselves, disqualifying the purpose of preventing foreclosures with the hope of revitalizing the economy as public use. The mortgagors would receive a windfall from their restructured mortgages with no restriction on how their income<sup>260</sup> should be utilized. MRP and its investors are another particular class of identifiable

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255. Matthew C. Klein, *California Mortgage Grabs Are a Terrible Idea*, BLOOMBERG (Sept. 17, 2013, 11:10 AM), available at <http://www.bloomberg.com/news/2013-09-17/california-mortgage-grabs-are-a-terrible-idea.html>.

256. *Kelo*, 545 U.S. at 473-75 (condemned property was necessary for redevelopment of the immediate area, and to fulfill the redevelopment plan's requirements).

257. CAL. CONST. art. 1 § 19(b).

258. CAL. CIV. PROC. CODE § 1240.030.

259. *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 243-44 (1984).

260. The IRS considers debt cancellation, such as after a loan is restructured, as taxable income. 26 U.S.C.A. § 108; *The Mortgage Forgiveness Debt Relief Act and Debt Cancellation*, IRS (Sept. 12, 2013), <http://www.irs.gov/Individuals/The-Mortgage-Forgiveness-Debt-Relief-Act-and-Debt-Cancellation->.

individuals who will profit from this proposal. MRP is a venture-capitalist firm projecting up to 20% profits for its investors.<sup>261</sup> The high profit potential for the homeowners, MRP, and MRP's investors, coupled with of a comprehensive plan to promote economic stimulation demonstrates that MRP's supposed public purpose is only pretext for private benefits for identifiable individuals.

As compared to federal authority, California law imposes a stricter standard for what satisfies the public use requirement. Through its Eminent Domain Law,<sup>262</sup> the legislature restricted eminent domain use so much that it can be prohibited in even decidedly troubled communities, such as blighted areas characterized by serious physical and economic burden, dilapidation, and danger of unhealthy conditions.<sup>263</sup> Likewise, the law proscribes condemnation to prevent future blight.<sup>264</sup> The fact that the legislature sought to restrict the use of eminent domain in circumstances as serious as these may indicate its reluctance to permit takings in almost any circumstance. The purpose of MRP's proposal is to prevent foreclosures<sup>265</sup> and the negative effects concentrated foreclosures have on communities.<sup>266</sup> This purpose is akin to the prevention of future blight, rather than addressing existing blight, especially since the proposal targets underwater mortgages rather than foreclosures. Further, Richmond has not been deemed a blighted area. Since the Eminent Domain Law prohibits condemnation to prevent future blight, the law would also likely prohibit condemnation pursuant to MRP's proposal.

Allowing MRP and Richmond to implement their plan would be a slippery slope towards qualifying any residual public benefit as a valid actual purpose for eminent domain use. When considering redevelopment plans, and recognizing the ease of manufacturing "conceivable [public] benefit[s]" for plans such as these,<sup>267</sup> the Supreme Court emphasized the need to evaluate the *actual purpose* behind each plan.<sup>268</sup> MRP claims its actual purpose for the proposal is to mitigate the amount of foreclosures as well as help mortgagees stay in their homes.<sup>269</sup> Opponents of the plan could argue the plan's actual purpose is merely a private benefit. MRP, a venture-capital firm, is unapologetically motivated by profits<sup>270</sup> and has induced private investors with potential profits of up to twenty percent for their participation.<sup>271</sup> Additionally, MRP's original proposal only targeted those who were up-to-date on their payments, disqualifying delinquent mortgagees entirely.<sup>272</sup> MRP claimed its proposal would target those in serious danger of foreclosure, however the public

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261. *Center for American Progress*, *supra* note 84.

262. Eminent Domain Law, CAL. CIV. PROC. CODE §§ 1230.010, .020 (West 2013).

263. *Id.*

264. *See supra* note 206.

265. *See FAQs*, *supra* note 82.

266. *See supra* notes 24-29.

267. *Kelo v. City of New London, Conn.*, 545 U.S. 469, 510 (2005) (Thomas, J. dissenting).

268. *See Kelo*, 545 U.S. at 478.

269. MORTGAGE RESOLUTION PARTNERS WEBSITE, *supra* note 74; *see also Center for American Progress*, *supra* note 84.

270. *Center for American Progress*, *supra* note 84.

271. *Angelides to lead*, *supra* note 73.

272. Griffin, *supra* note 32; *see also Center for American Progress*, *supra* note 84.



purpose of preventing foreclosures would more reasonably support targeting homeowners unable to meet their mortgage payments. Therefore, allowing a plan such as MRP's would allow the government to use an illusory veil of practically any consequential public purpose to mask actual purposes of private benefit.

### *B. Lack of Just Compensation*

Another matter of contention is the proposal's mode of compensation. The court determines whether the just compensation requirement is met<sup>273</sup> and precedent requires "fair market value" of the taken property.<sup>274</sup> Much like public use, state legislatures are free to establish higher standards of just compensation than imposed by federal law and because there has been no endorsement by the CA legislature, they have not had the opportunity to impose a higher valuation requirement.<sup>275</sup>

In its plan with Richmond, MRP proposes compensating condemnees with eighty percent of the associated home's fair market value,<sup>276</sup> while it originally proposed compensation of the fair market value of the loan.<sup>277</sup> Eighty percent of the fair market value of the collateral cannot qualify as just compensation. If the mortgagors continues to make payments and fulfills their obligations, the mortgagee would receive the full value of the originally contracted loan. If the mortgagor defaults, the mortgagee would receive the collateral, which would provide the fair market value of the collateral. Although MRP is unclear of the reasoning for decreasing compensation to eighty percent of the collateral's fair market value, the full fair market value of the collateral would not suffice. Just compensation determinations must consider the property's highest and "most profitable use"<sup>278</sup> as well as its "full and perfect equivalent in money."<sup>279</sup>

Since the full and perfect equivalent of the loan would reflect the full payment of the loan or the full fair market value of the collateral, eighty percent of the collateral's fair market value is not just compensation for the takings.

Under California law, even the fair market value of the associated homes may not reflect the true value of the loans. California requires consideration of the condemnees' position had the taking not occurred<sup>280</sup> as well as any damages that would reasonably ensue from the taking.<sup>281</sup> In these terms, damages could reasonably mean the damages from a breach of contract. Condemnees could sue the

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273. *United States v. New River Collieries Co.*, 262 U.S. 341, 343-44 (1923) (citing *Monongahela Nav. Co. v. United States*, 148 U.S. 312, 327 (1893)); *Seaboard Air Line Ry. Co. v. United States*, 261 U.S. 299, 306 (1923) (holding Congress cannot constitutionally set just compensation).

274. *See Kimball Laundry Co. v. United States*, 338 U.S. 1, 6 (1949); *United States v. Gen. Motors Corp.*, 323 U.S. 373, 379 (1945).

275. *Eminent Domain Law*, CAL. CIV. PROC. CODE ch. 1; *see Joslin Mfg. Co. v. City of Providence*, 262 U.S. 668, 676-77 (1923).

276. McDill, *supra* note 38.

277. *See FAQs*, *supra* note 82.

278. *See supra* notes 238.

279. *City of San Diego v. Rancho Penasquitos P'ship*, 130 Cal. Rptr. 2d 108, 119 (Ct. App. 2003) (citation omitted).

280. *Id.*

281. *Ellena v. State*, 138 Cal. Rptr. 110, 119-20 (Ct. App. 1977).

homeowners for the difference between the originally contracted loan and the amount ultimately compensated for the taking. MRP has argued against this contention, referring to *Midkiff* and the Court's assertion that the "Contract Clause has never been thought to protect against the exercise of the power of eminent domain,"<sup>282</sup> but *Midkiff* was not subject to California law and its requirement to consider potential damages did not apply.<sup>283</sup>

Even assuming MRP did not have to consider damages from breach of contract into their just compensation assessments, alternative California laws requiring consideration of the property's "highest price"<sup>284</sup> and "most profitable use"<sup>285</sup> would be enough to demonstrate fair market value's insufficiency for just compensation. The highest price or most profitable use for a contract would be the full value of the contract if the mortgagors were to fulfill their obligations, especially regarding cases where the mortgagors are up-to-date on their payments. Under California law, fair market value of the home may arguably be the loan's least profitable value. It is much more likely that up-to-date mortgagors would ultimately pay the full value of the contract had the taking not occurred. There is approximately a two-year gap between the first missed mortgage payment and repossession,<sup>286</sup> and these mortgagors have yet to miss a payment on their loans. During those two years, many things can happen to the mortgagors to either better or worsen their financial situation and his ability to continue making payments. Because the proposal's selection process is rather vague, it is difficult to determine whether the mortgagees would have ever missed any payments.<sup>287</sup> Thus, there is a possibility that but for the taking the loan servicer would have received the full value of the contract, the originally contracted value. Although MRP aims to target those mortgagors in serious danger of defaulting, whether they actually would have is indeterminable. In calculating just compensation, the jury would be required to consider contract fulfillment in its evaluation of the most profitable use of the property, arguably leaving anything less than the full value of the mortgage as unjust compensation.

MRP argues bondholders are not entitled to the full value of the mortgages because they have already suffered the loss since the value of the mortgage has

282. *FAQs*, *supra* note 82.

283. California law does, however, allow for deficiency judgments if the fair market value of the foreclosed home is less than the loan's outstanding balance. CAL. CIV. PROC. CODE § 580(a). Mortgagees may be able to sue for lost funds based on the home fair market value, but that possibility is beyond the scope of this Note. If such deficiency judgments were allowed, the judgments would likely remove all incentives to establish MRP's proposal in the first place, depending on who is required to pay such judgments.

284. Eminent Domain Law, CAL. CIV. PROC. CODE § 1263.320(a) (West 2013); *Rancho Penasquitos*, 130 Cal. Rptr. 2d at 119.

285. *City of San Diego v. Neumann*, 863 P.2d 725, 728 (Cal. 1993).

286. See Les Christie, *Foreclosure free ride: 3 years, no payment*, CNN (Jan. 1, 2012), [http://money.cnn.com/2011/12/28/real\\_estate/foreclosure/index.htm](http://money.cnn.com/2011/12/28/real_estate/foreclosure/index.htm) (nationwide average time between first defaulted payment and foreclosure is 674 days according to LPS Applied Analytics); see also Les Christie, *Flood of foreclosures to hit the housing market*, CNN (Apr. 13, 2012) [http://money.cnn.com/2012/04/13/real\\_estate/foreclosures/index.htm](http://money.cnn.com/2012/04/13/real_estate/foreclosures/index.htm) (nationwide average time between first defaulted payment and foreclosure is 370 days in the first quarter according to RealtyTrac).

287. See *FAQs*, *supra* note 82; see also *Center for American Progress*, *supra* note 84 (Steven Gluckstern, Chairman for MRP, does not give details on the selection process for eligible mortgages).

decreased due to the reduction in home values.<sup>288</sup> The condemnees, however, have contracted for a specific loan amount and that amount remains constant independent of the present value of the loan's collateral. The loan servicers do not suffer a loss, as MRP argues, until forced to foreclose the homes.<sup>289</sup> Again, since the proposal also targets those current on their payments, the servicers owning the up-to-date mortgages have yet to suffer a loss and it is unclear if they ever will.

### C. *Bad Public Policy*

Separate from legality concerns, the proposal itself has come into contention. From its inception, opponents have criticized the proposal for being poor public policy.<sup>290</sup> For example, Representative John Campbell of California deplores the proposal, and has gone as far as introducing legislation twice<sup>291</sup> in order to prohibit this type of eminent domain use.<sup>292</sup> Representative Campbell's opposition stems from his argument that the proposal's impact on the housing market may be opposite of its professed intent,<sup>293</sup> hypothesizing the proposal would "chill investment in the mortgage market."<sup>294</sup> Banking and other trade groups have echoed these arguments, fearing the proposal will deplete the availability of credit for future mortgages.<sup>295</sup> The Securities Industry and Finance Markets Association has already planned to prohibit loans from areas using eminent domain,<sup>296</sup> and the Federal Housing Finance Agency has threatened to take action against the proposal.<sup>297</sup> Supporters do not agree, claiming the reduction in principal for qualified mortgages would stimulate the economy and energize the housing market.<sup>298</sup> Steven Gluckstern asserts that not only would the reduction stimulate the economy, it is the only way the housing

288. *Center for American Progress*, *supra* note 84.

289. Since the loans are underwater, foreclosing the home will not make up for the remaining balance of the originally contracted loan. At this point, the mortgage holders would suffer a loss from the decreased value of the home depending on the possibility for deficiency judgments.

290. For example, the Federal Housing Finance Agency has opposed the proposal because of potential risks to Fannie Mae and Freddie Mac, the taxpayer-supported firms working under conservatorship to support the housing market. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47652 (Aug. 6, 2012). Tom Deutsch, Executive Director of American Securitization Forum, argues the proposal would essentially act as a reward for bad behavior. Jim Carr, Senior Policy Fellow from Opportunity Agenda, argued against the proposal because it ignores those who really need the help, i.e. those defaulting on their loan payments. *Center for American Progress*, *supra* note 84.

291. H.R. 2733, 113th Cong. (1st Sess. 2013); H.R. 6397, 112th Cong. (2d Sess. 2012).

292. Alan Zibel, *Eminent Domain Furor Hits Capitol Hill*, WALL STREET JOURNAL (Sept. 13, 2012), <http://blogs.wsj.com/developments/2012/09/13/eminent-domain-furor-hits-capitol-hill/>.

293. *Id.*

294. *Id.*

295. Jim Kim, *FHFA opposes eminent domain plan*, FIERCE FINANCE (Aug. 14, 2012), <http://www.fiercefinance.com/story/fhfa-opposes-eminent-domain-plan/2012-08-14>.

296. *Id.*; Zibel, *supra* note 292; Katya Wachtel, *Calif. official urges AG Holder to stop eminent domain 'threats'*, REUTERS (Sept. 10, 2012), <http://www.reuters.com/assets/print?aid=USL1E8KA4CX20120910> (SIFMA warning of potentially scaring away future mortgage financiers).

297. See Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47652; see also Zibel, *supra* note 292.

298. Benn Hallman, *San Bernardino Eminent Domain Fight Closely Watched By Other Struggling Communities*, HUFFINGTON POST (Sept. 1, 2012), [http://www.huffingtonpost.com/2012/09/01/eminent-domain-mortgages\\_n\\_1836710.html?view=print&comm\\_ref=false](http://www.huffingtonpost.com/2012/09/01/eminent-domain-mortgages_n_1836710.html?view=print&comm_ref=false).

market may be stimulated.<sup>299</sup> His assertion, however, has not convinced these opponents, nor has it mitigated other concerns.

The plan is also likely to diminish municipal resources. California's constitution requires a jury to determine just compensation prior to each taking, unless waived.<sup>300</sup> Due to California's requirement that just compensation be based on the highest and most profitable use of the property,<sup>301</sup> the loan servicers would not likely waive this right because they would probably contest any offered amount lower than the full value of the contract. Each mortgage will potentially have different values since calculations are also based on various factors such as the home's neighborhood, amenities, delinquency history, and damages from the taking itself.<sup>302</sup> Due to the different factors, each evaluation would require special attention, and calling for a jury for each of hundreds of takings would be impractical, costly for local municipalities, and burdensome to the judicial system.

Opponents may also argue the proposal hinders free enterprise and contractual protections. The proposal would void otherwise valid contracts between willing competent parties, and the parties in a significant portion of these contracts would in fact be fulfilling their contractual obligations. Proponents may argue external help is necessary in order to refinance and stabilize these mortgagees; however, the taking and voiding of the original contracts would disregard freedom to contract and would result in future reluctance to enter into such contracts, at least for the lenders.

Additionally, the proposal makes no effort to disqualify mortgagors whose loans are delinquent or in danger of foreclosure based on pure irresponsibility. For example, the proposal does not specifically favor those parties who suffered financial hardship from debilitating injury or layoffs stemming from the Great Recession. Potentially irresponsible contract signers would simply be released from liability for their delinquency while the lenders are forced to pay for it, despite fulfilling their obligations. Moreover, funds used for refinancing irresponsible borrowers' mortgages are funds that could have helped a responsible, yet badly injured borrower who really deserves government assistance.

Proponents may also argue that the mortgage crisis was the banks' fault in the first place, and sympathy for the lenders' contractual losses is undeserved. But quid-pro-quo cannot be the standard for resolution and should not be the message the government seeks to convey.

## VI. CONCLUSION

Despite what seems to be a calamitous need for a solution to the housing crisis, MRP's proposal to condemn underwater mortgages to prevent foreclosures is the not

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299. See, e.g., Al Yoon, *New Roadblock for Eminent Domain Bid: Housing Regulator*, WALL STREET JOURNAL (Aug. 8, 2012), <http://blogs.wsj.com/developments/2012/08/08/new-roadblock-for-eminant-domain-bid-housing-regulator/>; see also *Center for American Progress*, *supra* note 84.

300. CAL. CONST. art. 1 § 19 cl. (a).

301. See, e.g., *City of San Diego v. Neumann*, 863 P.2d 725, 728 (Cal. 1993).

302. See *City of Fremont v. Fisher*, 73 Cal. Rptr. 3d 54, 62 (Ct. App. 2008); see also *Cnty. of San Diego v. Rancho Vista Del Mar, Inc.*, 20 Cal. Rptr. 2d 675, 686 (Ct. App. 1993).

answer. Federal and California law prohibit this proposal,<sup>303</sup> but its national implications go beyond legality concerns. This proposal would widen the scope of one of the most intrusive government powers, a power that should not be taken lightly. The Fifth Amendment exemplifies the importance of protecting a citizen's right to private property, "[p]roperty [that] must be secured, or liberty cannot exist."<sup>304</sup> This type of proposal transfers private property from one private party to another. Allowing this type of forcible acquisition may result in the diminished protection of property, ignoring private parties' legitimate contractual choices for the mere possibility of public gain. Moreover, the proposal's credible benefits are only to identifiable private third parties. This should not qualify as a public use, and the reduced value of a valid contract should not qualify as just compensation. Legitimizing this proposal would lead the way toward legitimizing takings based on just about any conceivable public benefit. Although the housing crisis is a problem that must be addressed, municipalities throughout the country should forego Richmond and MRP's proposal.

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303. Although some restrictions of eminent domain use mentioned in this Note are specific to California authority, the housing crisis is a national concern and countless municipalities throughout the country are considering proposals similar to Richmond's. Municipalities outside California should use the research and arguments in this Note to compare and contrast their controlling statutory and constitutional language, and to discover which restrictions may or may not apply.

304. Paul A. Freund, *The Supreme Court of the United States* 35 (1961)(quoting John Adams).