Boston College Law Review

Volume 54 | Issue 5 Article 9

11-22-2013

Coming Up for Air: The Constitutionality of Using Eminent Domain to Condemn Underwater Mortgages

Andrew Peace
Boston College Law School, andrew.peace@bc.edu

Recommended Citation
Andrew Peace, *Coming Up for Air: The Constitutionality of Using Eminent Domain to Condemn Underwater Mortgages*, 54 B.C.L. Rev. 2167 (2013), http://lawdigitalcommons.bc.edu/bclr/vol54/iss5/9

COMING UP FOR AIR: THE CONSTITUTIONALITY OF USING EMINENT DOMAIN TO CONDEMN UNDERWATER MORTGAGES

Abstract: Following the Great Recession, home prices in many areas capsized, leaving many homeowners "underwater." Today, home prices have not yet returned to pre-recession levels, leading many commentators to fear that these underwater mortgages will default and bring about a flood of new foreclosures. Local governments are now contemplating using the power of eminent domain to condemn these mortgages and reduce the principal owed. This move would allow homeowners to build equity and, in turn, reduce the fear of default and foreclosure. This Note analyzes the constitutionality of using eminent domain in this manner and discusses whether it would pass constitutional muster under the Fifth Amendment's Takings Clause.

Introduction

Beginning in late 2007 the U.S. economy faltered, leading to one of the worst recessions in the country's history.[1] The turbulence of the U.S. economy had been precipitated by problems arising in the mortgage and housing markets.[2] Though the cause of the current mortgage market collapse has been fiercely debated, its negative effect on the larger economy is undeniable.[3] With the housing market still struggling, the larger economy has been slow to fully recover.[4]

---

[1] *See The Recession and Recovery in Perspective*, Fed. Reserve Bank of Minneapolis, http://www.minneapolisfed.org/publications_papers/studies/recession_perspective/index.cfm? (last visited Nov. 13, 2013); *Weekend Edition Saturday: The Great Recession, Five Years Later*, Nat'l Pub. Radio (Dec. 8, 2012, 8:00AM), http://www.npr.org/2012/12/08/166784038/the-great-recession-five-years-later.

[2] Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. Dayton L. Rev. 33, 37 (2009); Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev. 1359, 1359 (2010); Aleatra P. Williams, *Foreclosing Foreclosure: Escaping the Yawning Abyss of the Deep Mortgage and Housing Crisis*, 7 Nw. J.L. & Soc. Pol'y 455, 456 (2012).

[3] Williams, *supra* note 2, at 463; *see* Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 Geo L.J. 1177, 1179–81 (2012). Ben Bernanke, Chairman of the Federal Reserve, described the relationship between the mortgage markets and the overall economy, stating that "[d]eclining home prices, delinquencies and foreclosures, and strains in mortgage markets are now symptoms as well as causes of our general financial and economic difficulties." Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Re-

Problems in the housing markets have been largely attributable to the dramatic decrease in home values following the financial meltdown in 2008.[5] For a long time, investing in a home was considered to be a safe investment that would yield steady appreciation.[6] The recent decline in home values, however, has forced a reevaluation of this assumption.[7] Many people purchased homes just before the market crashed, taking on monthly payments that accounted for a large percentage of their budgets.[8] Given the traditional wisdom that homes always appreciate in value, homeowners justified these expensive mortgages as safe investments.[9] But when home prices dropped precipitously, many homeowners were left underwater with negative equity—owing more on their mortgage than their home was worth.[10]

Having a large number of underwater homeowners can have negative effects on a community.[11] For example, underwater homes are significantly more likely to go through foreclosure.[12] Foreclosure, in turn,

---

serve Sys., Speech at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm.

[4] *See* Williams, *supra* note 2, at 463–65; Robert Samuelson, *Why Is the U.S. Economy Struggling?*, Real Clear Politics (Feb. 18, 2013), http://www.realclearpolitics.com/articles/2013/02/18/why_job_creation_is_so_hard_117050.html.

[5] Williams, *supra* note 2, at 463. Although home prices have since stabilized, there was a steady decline in home prices for almost six years, starting in 2007 and ending only recently. Christopher Matthews, *Should Eminent Domain Be Used to Save Underwater Homes?*, Time (July 12, 2012), http://business.time.com/2012/07/12/should-eminent-domain-be-used-to-save-underwater-home; *Talk of the Nation: The Housing Market: Have We Finally Hit Bottom?*, Nat'l Pub. Radio (Sept. 10, 2012, 1:00PM), http://www.npr.org/2012/09/10/160886672/the-housing-market-have-we-finally-hit-bottom.

[6] *See* Creola Johnson, *Fight Blight: Cities Sue to Hold Lenders Responsible for the Rise in Foreclosures and Abandoned Properties*, 2008 Utah L. Rev. 1169, 1171; Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 Wake Forest L. Rev. 971, 982 (2010).

[7] Johnson, *supra* note 6, at 1170; *see* White, *supra* note 6, at 982.

[8] *See* Johnson, *supra* note 6, at 1170; White, *supra* note 6, at 981–82.

[9] Johnson, *supra* note 6, at 1170; *see* White, *supra* note 6, at 981–82.

[10] *See* Johnson, *supra* note 6, at 1170; White, *supra* note 6, at 981–83.

[11] *See* White, *supra* note 6, at 981–83; Dustin A. Zacks, *The Grand Bargain: Pro-Borrower Responses to the Housing Crisis and Implications for Future Lending and Homeownership*, 57 Loy. L. Rev. 541, 545 (2011).

[12] Black's Law Dictionary 719 (9th ed. 2009) (defining "foreclosure"); Christopher Matthews, *Why Is Ed DeMarco Blocking a Win-Win Housing Program?*, Time (Aug. 1, 2012), http://business.time.com/2012/08/01/why-is-ed-demarco-blocking-a-win-win-housing-program/; Charles Hugh Smith, *Real Estate: The Worrying Numbers Behind Underwater Homeowners*, Daily Fin. (Aug. 7, 2010, 6:00 AM), http://www.dailyfinance.com/2010/08/07/real-estate-underwater-homeowners/.

puts a community and homeowners at risk of lower property values, increased crime rates, and strained government resources.[13]

Despite the large number of underwater mortgages, there has been very little government action to provide relief to these homeowners.[14] Consider, for example, principal reduction, which has proven to be more effective at preventing default than other modifications.[15] Even with this success, the federal government has done little to encourage lenders to lower the principal on underwater mortgages.[16] In fact, the Federal Housing Finance Agency has even discouraged principal reduction for underwater mortgages.[17] By not taking these proac-

---

[13] White, *supra* note 6, at 981–83; Zacks, *supra* note 11, at 543–55.Moreover, foreclosures beget more foreclosures in neighborhoods already experiencing high rates of default, further exacerbating the negative consequences that foreclosures bring to a community. Zacks, *supra* note 11, at 555–57.

[14] Gregory Scott Crespi, *The Trillion Dollar Problem of Underwater Homeowners: Avoiding a New Surge of Foreclosures by Encouraging Principal-Reducing Loan Modifications*, 51 SANTA CLARA L. REV. 153, 178–88 (2011); Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt That Can Benefit Literally Everyone*, CURRENT ISSUES IN ECON. & FIN., June 2013, at 1, 4.

[15] Laurie S. Goodman et al., *The Case for Principal Reductions*, J. STRUCTURED FIN., Fall 2011, at 29, 32 (relying on data from 2008 to 2010 to find that principal reductions were more effective than other types of loan modifications to alleviate homeowners with negative equity); *see also* Memorandum from Michael Stegman, Counselor, Hous. Fin. Policy, to Ed Demarco, Acting Dir., Fed. Hous. Fin. Agency 1 (July 31, 2012), *available at* http://www.treasury.gov/connect/blog/Documents/letter.to.demarco.pdf (stating that "[p]rincipal reduction benefits individual homeowners and the housing market as a whole").

[16] Hockett, *supra* note 14, at 4; *see* Crespi, *supra* note 14, at 159 (discussing how the current federal programs do not seek to prevent strategic default by borrowers who are able to make their payments). The federal government instituted the Home Affordable Modification Program ("HAMP") to help eligible homeowners modify their home mortgages. *See Home Affordable Modification Program*, MAKING HOME AFFORDABLE, http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx?gclid=CMbbi5uA57oCFSbNOgodhF0Arw (last visited Nov. 15, 2013). HAMP imposes significant restrictions on which underwater homeowners can be eligible for the program, but HAMP does not prioritize principal write-downs, or provide ways to avoid certain restrictions on servicer actions. S*ee* Crespi, *supra* note 14, at 159; Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 146–47 (2012). These shortcomings have led some to criticize HAMP as being ineffective and a waste of taxpayer money. *See* Hockett, *supra*, at 146–47; *NTU Vote Alert: Vote YES on H.R. 839, the HAMP Termination Act of 2011*, NAT'L TAXPAYERS UNION (Mar. 29, 2011), http://www.ntu.org/news-and-issues/government-reform/hamp-terminate.html. *But see* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-433, REPORT TO CONGRESSIONAL REQUESTERS: MORTGAGE FORECLOSURES, DOCUMENTATION PROBLEMS REVEAL NEED FOR ONGOING REGULATORY OVERSIGHT 26–27 (2011) (proposing that the deficiencies in mortgage loan servicer responsibilities may be a possible explanation for HAMP's ineffectiveness).

[17] Statement by Edward J. Demarco, Acting Dir., Fed. Hous. Fin. Agency, On the Use of Principal Forgiveness by Fannie Mae and Freddie Mac (July 31, 2012), *available at* http://www.fhfa.gov/webfiles/24113/PFStatement73112.pdf (discussing how HAMP did not im-

tive steps and discouraging others from doing so, the federal government has not adequately addressed the underwater mortgage crisis.[18] Given the lack of action at the federal level, many reformers have called for a more localized solution to address the problem of negative equity.[19]

Local governments and scholars are all currently exploring a plan ("the Plan") that would have municipalities use the power of eminent domain to condemn underwater mortgages.[20] Under the Plan, the municipality would acquire the mortgage by paying the lender 20–25% below the fair market value of the home.[21] Owning the mortgage would

---

prove foreclosure avoidance); *see* Jon Prior, *FHFA Refuses Principal Reduction for Fannie, Freddie*, HOUS. WIRE (July 31, 2012, 1:54 PM), http://www.housingwire.com/news/2012/07/31/fhfa-refuses-principal-reduction-fannie-freddie. The FHFA's decision not to pursue principal reduction was largely based on the ineffectiveness of HAMP. Demarco, *supra*. The FHFA has objected to principal reduction despite insistence from the former Secretary of the Treasury, Timothy Geithner, that principal reduction could be an effective method of addressing the problems in the mortgage markets. Letter from Timothy F. Geithner, Sec'y of the Treasury, to Edward J. Demarco, Acting Dir., Fed. Hous. Fin. Agency (July 31, 2012), *available at* http://www.housingwire.com/sites/default/files/editorial/Sec%20Geithner%20Letter%20to%20FHFA%20on%20Principal%20Reduction.PDF. Others have criticized the FHFA's position on principal reduction as well. *See, e.g.*, Matthews, *supra* note 12; George Zornick, *Will Mel Watt Back Principal Reduction?*, NATION (June 27, 2013, 1:36 PM), http://www.thenation.com/blog/175016/will-mel-watt-back-principal-reduction#. President Obama's appointment of Mel Watt to head the FHFA could change the FHFA's stance against principal reduction, but no action has yet to be taken. Zornick, *supra*.

[18] *See* Hockett, *supra* note 14, at 4.

[19] Hockett, *supra* note 16, at 150; Joe Nocera, Op-Ed., *Housing's Last Chance?*, N.Y. TIMES, July 10, 2012, at A21; David J. Reiss, *Comment on the Use of Eminent Domain to Restructure Performing Loans* 5 (Brooklyn Law Sch. Legal Studies Research Paper, Working Paper No. 292, 2012); Brad Miller, *No Wonder Eminent Domain Mortgage Seizures Scare Wall Street*, AM. BANKER (July 11, 2012, 7:00 AM), http://www.americanbanker.com/bankthink/eminent-domain-mortgage-seizures-terrify-wall-street-1050811-1.html.

[20] Richard E. Gottlieb & Vivian I. Kim, *Eminent Domain: Will Local Governments Attempt to Use This Extraordinary Power to Purchase Troubled Residential Mortgages?*, BANKING & FIN. SERVS. POL'Y REP., Nov. 2012, at 1, 1; David Reiss, Opinion, *Eminently Reasonable*, NAT'L LAW J., Sept. 24, 2012, at 35, 35; Terry Sheridan, *Eminently Controversial*, MORTGAGE BANKING, Oct. 1, 2012, at 112, 113; *FAQs*, MORTGAGE RESOL. PARTNERS, http://mortgageresolutionpartners.com/faqs (last visited Nov. 14, 2013) [hereinafter MRP FAQs]; *infra* notes 101–119 and accompanying text (describing the doctrine of eminent domain). This Note refers to the plan devised by Professor Robert Hockett as "the Plan" and will use this scholar's proposal as the basis for this Note's evaluation, critique, and suggestions. *See* Hockett, *supra* note 16, at 150–155.

[21] Gottlieb & Kim, *supra* note 20, at 4; Memorandum from Walter Dellinger, Jonathon Hacker, and Matthew Close to Secs. Indus. and Fin. Mkt. Ass'n 2 (July 16, 2012) [hereinafter "Memorandum from Dellinger et al. to SIFMA"], *available at* http://www.sifma.org/uploadedfiles/issues/capital_markets/securitization/eminent_domain/memorandumfromo'melvenymyerstosifmaresanbernardinoeminentdomainproposal071612.pdf; Kate Berry, *California Laws Could Make Eminent Domain 'DOA,'* NAT'L MORTGAGE NEWS (Aug. 27, 2012, 9:36AM),

then allow the municipality to write down the principal owed by the homeowner to below the home's current worth.[22] The homeowner, no longer underwater, could then refinance to receive lower interest rates and start to build equity in the home immediately.[23]

Although the Plan faces many practical hurdles, including getting sufficient political support, the Plan also raises a number of legal concerns.[24] One such concern is whether the Plan satisfies the Fifth Amendment's Takings Clause.[25] The Takings Clause states that the government may only take property when the property is taken for a public purpose and when the owner is provided just compensation.[26]

This Note argues that although this plan's proposal to condemn underwater mortgages easily satisfies the public purpose prong of the Takings Clause, it likely fails the just compensation prong.[27] For the Plan to pass constitutional muster, municipalities would have to provide additional compensation to lenders to condemn these underwater mortgages.[28] Consequently, the increased costs associated with provid-

---

http://www.nationalmortgagenews.com/dailybriefing/Eminent-domian-mortgage-seizure-strat egy-1031960-1.html.

[22] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35.

[23] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35.

[24] Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 1; Jayant W. Tambe et al., *They Can't Do That, Can They? Constitutional Limitations on the Seizure of Underwater Mortgages*, JONES DAY 4 (June 2012), http://www.jonesday.com/files/Publication/f7c9569 5-ebfe-4a7f-b16a-6fe451e922e6/Presentation/PublicationAttachment/77af6361-ec8a-4a7a-a 1bf-702398a462a9/They%20Can't%20Do%20That.pdf; *see* Editorial, *This Dog Won't Hunt*, MORTGAGE SERVICING NEWS, Nov. 2012, at 2, 2. Critics have, for example, claimed that the Plan violates the Contract Clause of the Constitution. Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 8; Tambe et al., *supra*, at 3–4; *see* U.S. CONST. art. 1, § 10, cl. 1; Gottlieb & Kim, *supra* note 20, at 8. Further, opponents have argued that the use of eminent domain to condemn mortgages would violate the Dormant Commerce Clause of the Constitution. Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 9; *see* U.S. CONST. art. 1, § 8, cl. 3; Gottlieb & Kim, *supra* note 20, at 8. And given the states' ability to protect constitutional rights beyond what protections are given by the Constitution, opponents assert that state law could prevent execution of the Plan even if it passes constitutional muster. *See* Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 10–12.

[25] *See* U.S. CONST. amend. V; Sheridan, *supra* note 20, at 114.

[26] *See* U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation."). Although the Takings Clause has the language "public use," the text has been interpreted to mean public purpose. *See* U.S. CONST. amend. V; Kelo v. City of New London, 545 U.S. 469, 479–80 (2005) ("Accordingly, when this Court began applying the Fifth Amendment to the States at the close of the 19th century, it embraced the broader and more natural interpretation of public use as 'public purpose.'"); Lucas J. Asper, Note, *The Fair Market Value Method of Property Valuation in Eminent Domain: "Just Compensation" or Just Barely Compensating?*, 58 S.C. L. REV. 489, 492 (2007).

[27] *See infra* notes 224–283 and accompanying text.

[28] *See infra* notes 284–307 and accompanying text.

ing just compensation would no longer make the Plan politically feasible.[29]

Part I of this Note explores why so many underwater mortgages go through foreclosure, the negative impact that foreclosure has on the surrounding community, and why lenders are not independently addressing this problem.[30] Part I goes on to explain the law of eminent domain and how it could potentially be used to address the problems of underwater mortgages.[31] Part II analyzes the constitutional requirements of public use and just compensation and how these requirements affect the Plan.[32] Finally, Part III argues that although the Plan satisfies the public use requirement of the Fifth Amendment's Takings Clause, the calculation of just compensation is going to determine the Plan's feasibility.[33]

I. The Problem of Underwater Mortgages and a Potential Solution

A. *The Foreclosure Crisis*

Following the housing bubble, the precipitous dropping of home prices has left many homeowners underwater.[34] With homeowners owing more on their mortgages than the value of the home, many families have stopped viewing their home as an investment and instead view it as a liability.[35] For some families, the principal owed on the mortgage is more than twice the actual fair market value of the home.[36] Given this large discrepancy, some homeowners have had to reevaluate the value of homeownership.[37]

Subsection 1 of this Section examines the recent phenomena of underwater mortgages and discusses the problems associated with

---

[29] *See infra* notes 284–307 and accompanying text.

[30] *See infra* notes 34–100 and accompanying text.

[31] *See infra* notes 101–160 and accompanying text.

[32] *See infra* notes 161–218 and accompanying text.

[33] *See infra* notes 219–307 and accompanying text.

[34] *See* White, *supra* note 6, at 981–83.

[35] *Id.*

[36] *Id.* Hypotheticals of home prices before and after the collapse can be illustrative. *See id.* For example, a couple buying a home in Salinas, California before the collapse could expect to pay around $609,000. *Id.* That same home today, however, would be worth only $236,000. *Id.*

[37] *Id.* The sample couple in Salinas, California would be able to rent an equivalent home for around $1800 per month, compared to their current mortgage payments of $4450 per month. *Id.*

them.[38] Then, Subsection 2 explains why lenders and loan servicers are not independently decreasing principal on underwater mortgages, despite incentives to do so.[39]

1. Negative Equity and Its Related Problems

Homes with underwater mortgages—those with negative equity—are significantly more likely to enter foreclosure than homes with equity.[40] In fact, equity is the single most important predictor of default behavior.[41] Underwater homeowners often stretch their budgets to pay their bills, including mortgage payments, leaving them with little margin for error in their efforts to keep up with these payments.[42] In contrast, homeowners with equity built in their homes can access that money through refinancing for emergencies.[43] With no similar recourse for underwater homeowners, foreclosure becomes a financial necessity.[44]

Normally, properties are foreclosed because the owners are unable to make payments, but financially stable underwater homeowners are now considering strategically defaulting on their loans.[45] In a strategic default, a homeowner chooses to stop payments on an underwater mortgage despite the ability to pay.[46] Many underwater homeowners stand to benefit greatly from default.[47] These homeowners would be better off by defaulting because renting a home of equal size and worth would cost far less than their monthly mortgage payments on their un-

---

[38] *See infra* notes 40–78 and accompanying text.

[39] *See infra* notes79–100 and accompanying text.

[40] Matthews, *supra* note 12; *see also* Smith, *supra* note 12 (noting that "[t]here's a direct correlation between negative equity and foreclosures").

[41] Goodman et al., *supra* note 15, at 29; *see* Smith, *supra* note 12.

[42] *See* Smith, *supra* note 12.

[43] *Why Foreclosure Happens*, Prop. Radar, http://www.propertyradar.com/foreclosure-guides/foreclosure-101/why-foreclosure-happens/ (last visited Oct. 23, 2013).

[44] *See id.*

[45] Brent T. White, *The Morality of Strategic Default*, 58 UCLA L. Rev. Discourse 155, 156 (2010); Tess Wilkinson-Ryan, *Breaching the Mortgage Contract: The Behavioral Economics of Strategic Default*, 64 Vand. L. Rev. 1545, 1549 (2011).

[46] White, *supra* note 6, at 983; Wilkinson-Ryan, *supra* note 45, at 1548; Zacks, *supra* note 11, at 555.

[47] *See* Johnson, *supra* note 6, at 1170; White, *supra* note 6, at 981–83. Recently, there has been an increase in information available to these homeowners regarding the financial advantages of going through foreclosure. *See, e.g.*, You Walk Away, http://www.youwalkaway.com/ (last visited Nov. 15, 2013) (providing homeowners with information regarding the benefits of strategic defaults).

derwater residence.[48] Additionally, the cost of foreclosure for many homeowners—including moving costs and the negative impact of their credit histories—pales in comparison to its benefits.[49] Although most underwater homeowners have not yet strategically defaulted on their loans, commenters have posited that the number of strategic defaults could rise sharply if the number of foreclosures reaches a tipping point.[50]

Foreclosures have many associated costs to both homeowners and lenders.[51] For homeowners, beyond having to leave their home—which, no doubt, can carry significant sentimental value—there is also a sense of shame associated with going through foreclosure.[52] Further, the adverse effect on one's credit history can impact future job prospects and, in some circumstances, even result in job loss.[53] For lenders, there are many transaction costs associated with foreclosure which add to the

---

[48] *See* White, *supra* note 6, at 983; *supra* notes 36–37. For example, a family purchasing a home in Miami at the peak of the housing bubble might have paid around $360,000, with monthly mortgage payments totaling almost $2400. White, *supra* note 6, at 983 & n.46. Today, that home would be worth only about $159,000, and renting an equivalent home would cost around $1000 per month. *Id.* If the family continues to pay the original mortgage, it could take up to twenty-five years to recover the lost equity. *Id.*

[49] *See id.* (noting the benefits of foreclosures, but conceding that "[t]o be sure, foreclosure comes with costs, including a significant negative impact on one's credit rating"). Some states, such as California, even protect homeowners through non-recourse statutes which insulate homeowners from liability for any remaining money owed on mortgages after the property goes through foreclosure. Wilkison-Ryan, *supra* note 45, at 1556–57. Accordingly, such statutes provide an even greater incentive to underwater homeowners in these states to default. *Id.* at 1556. Even in states without non-recourse statutes, banks often lack the resources to pursue defaulting homeowners, allowing homeowners to escape default without the bank pursuing the homeowner for the full amount still owed on the loan. *Id.*

[50] Crespi, *supra* note 14, at 179; White, *supra* note 6, at 971–72, 977; Wilkinson-Ryan, *supra* note 45, at 1575; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 2; *see also* Martha C. White, *Is the Stigma of Ditching Your Underwater Mortgage Fading?*, TIME (Oct. 15, 2012), http://business.time.com/2012/10/15/is-the-stigma-of-ditching-your-underwater-mortgage-fading/ (discussing the decreasing stigma attached to strategic default).

[51] Adam J. Levitin, *Resolving the Foreclosure Crisis: Modifications of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 568–69; *see* Glenn Setzer, *Foreclosures Cost Lenders, Homeowners, the Community Big Bucks*, MORTGAGE NEWS DAILY (June 2, 2008, 7:00 AM), http://www.mortgagenewsdaily.com/622008_Foreclosure_Costs.asp.

[52] White, *supra* note 6, at 993; Zacks, *supra* note 11, at 543. Even in private decision making, such as whether foreclosure is in the family's best financial interest, societal norms often influence the final decision. Wilkinson-Ryan, *supra* note 45, at 1575.

[53] Zacks, *supra* note 11, at 544. In the finance industry and in jobs requiring security clearance, foreclosure can mean immediate job loss. *Id.*

losses already suffered.[54] Lenders traditionally lose a significant percentage of their investment in a foreclosure situation, but even greater losses are expected in the current market.[55]

In addition to negatively impacting homeowners and lenders, foreclosures have negative effects on the community as well.[56] One negative effect often linked to foreclosures is an increase in crime.[57] Vacant homes serve as a "broken window," signaling to vandals and criminals that a level of disorder and apathy exists in the home, which further invites crime.[58] Moreover, the decrease in homeownership causes a breakdown both in anti-crime surveillance and investment, thereby compromising the safety and stability of the neighborhood.[59] Scholars have confirmed the link between foreclosures and crime, noting a rise in both burglary and violent crimes in communities with increased foreclosure rates.[60]

Furthermore, vacant homes often decline from an overall lack of maintenance.[61] Lenders—who own the property following foreclosure—often do not uphold their responsibility to ensure the property's

---

[54] Levitin, *supra* note 51, at 568–69; *see* Setzer, *supra* note 51. In 2008, the Joint Economic Committee of Congress concluded that the average foreclosure costs a homeowner $77,935, while preventing a foreclosure costs $3300. Setzer, *supra* note 51.

[55] Levitin, *supra* note 51, at 568–69. One estimate had lenders historically losing 40–50% in foreclosure, but this loss percentage is expected to grow in the current environment. *Id.*

[56] Zacks, *supra* note 11, at 545.

[57] *Id.* at 546–49.

[58] *Id.* at 546. The "broken window theory" posits that if one window in a building is broken and is left unrepaired, all of the remaining windows in the building will soon be broken. *See generally* George L. Kelling & James Q. Wilson, *Broken Windows*, Atlantic Monthly, Mar. 1982, at 29, *available at* http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/2/. The theory is based on the assumption that broken windows signal to outsiders that the inhabitants are apathetic as to whether windows are broken or not, so breaking more will cost nothing. *Id.* With foreclosures, uninhabited homes often signal the same level of indifference that broken windows signal. *See id.*

[59] Zacks, *supra* note 11, at 546. This phenomenon is, in large part, a result of there being fewer community members to contact authorities and less money earned through property taxes to fund police efforts. *See id*; Ryan M. Goodstein & Yan Y. Lee, *Do Foreclosures Increase Crime?* 2 (Fed. Deposit Ins. Corp. Ctr. for Fin. Research, Working Paper No. 2010-05, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1670842.

[60] Zacks, *supra* note 11, at 546–49; *see* Goodstein & Lee, *supra* note 59, at 3; Lin Cui, Foreclosure, Vacancy & Crime 3 (Nov. 1, 2010) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1773706. One study found that a 1% increase in foreclosure rates correlated with a 10% increase in burglary rates. Goodstein & Lee, *supra* note 59, at 4–5. While other studies show that foreclosure alone does not increase crime, vacancy of homes—often the product of foreclosure—does. Cui, *supra*. In fact, violent crime increases by more than 15% in the areas that surround vacant foreclosed homes. *Id.*

[61] Johnson, *supra* note 6, at 1171.

maintenance and upkeep.[62] Due to the complexity of the secondary mortgage markets, city officials oftentimes have difficulty discerning the legal owner of both the home and the loan.[63] Though the deed may list the original lender's name, loans are often securitized and sold in the secondary mortgage market with a private registry system handling the mortgage assignments.[64] As a result, it can be very difficult for city officials to discern the legal owner of a property in order to hold the owner accountable for blight.[65]

In addition to increasing crime and blight, vacant homes also lower surrounding property values.[66] Foreclosures decrease property values by simultaneously creating both an increase in supply and a decrease in demand for homes in a particular area.[67] Furthermore, foreclosed homes are sold at auctions where banks will accept less than an optimum price, which is often below fair market value.[68] Given that real estate appraisals are influenced by the prices of neighboring homes, the vacant homes drive down property values for the entire community.[69]

---

[62] *See id.*

[63] *Id.*; *see* Christopher Cifrino, Comment, *Now UCC Me, Now You Don't: The Massachusetts Supreme Judicial Court Ignores the UCC in Requiring Unity of Note and Mortgage for Foreclosure in* Eaton v. Fannie Mae, 54 B.C. L. Rev. E. Supp. 99, 104 (2013), http://lawdigitalcommons.bc.edu/bclr/vol54/iss6/9.

[64] Johnson, *supra* note 6, at 1171. Securitization is the process through which an issuer creates a financial instrument by combining financial assets and then markets different tiers of the financial instrument to investors. *Securitization*, Investopedia, http://www.investopedia.com/terms/s/securitization.asp (last visited Nov. 15, 2013). Mortgage backed securities ("MBS") combine mortgages into a large pool and then divides the pool into smaller pieces for issuers to sell to investors. *Id.* Today, most mortgages are financed through securitization. Levitin & Wachter, *supra* note 3, at 1187. Despite their popularity, MBS received blame as being a major cause of the financial meltdown. *See* Alan Feuer, *Poof! How Home Loans Transform*, N.Y. Times, Sept. 20, 2009, at MB9.

[65] Johnson, *supra* note 6, at 1171; *see supra* note 64 and accompanying text.

[66] Johnson, *supra* note 6, at 1181; Zacks, *supra* note 11, at 550–54.

[67] Zacks, *supra* note 11, at 550.

[68] *Id.* There is a perception that homes sold at auction are substandard or problematic. Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 Duke L.J. 1399, 1419 (2004). It is generally well-recognized that foreclosed properties may have been poorly maintained, vandalized, or gutted. *Id.* This reputation discourages many prospective buyers and subsequently drives down the price that these homes are sold for at auction. *Id.*

[69] Zacks, *supra* note 11, at 550. This difficulty in appraising homes in a foreclosure-burdened neighborhood is further compounded by the overall difficulties in appraising homes in the current economy. Thomas A. Jaconetty, *Real Property Valuation in the Face of the National Foreclosure Crisis*, Tax Analyst: Special Report, Jan. 28, 2013, at 235, 235. Turmoil in the real estate market, with decreased property values stemming from foreclosures and short sales, has led some experts to question the accuracy of the real property valuation in this economy. *See id.* Appraisals for property taxes have proven difficult, given the economic stresses and challenges that the current market has caused. *Id.* As a result, dif-

The decreased property values cause problems for the community as a whole.[70] For example, decreased property values lower the tax revenue cities can collect.[71] As a result, the municipality will have fewer resources to fight crime, alleviate blight, or combat public nuisances such as fire hazards.[72]

The increasing rate of foreclosures also increases the likelihood that other homeowners will default on their mortgages.[73] This phenomenon can be explained both by the continued depreciation of their home as well as by changes in societal norms.[74] Although borrowers feel a moral obligation to pay their loan even if it is not financially prudent to do so, seeing friends and neighbors go through the process can help to alleviate the stigma.[75] This explains why in areas that have a greater number of foreclosures, the homeowners located therein are more likely to strategically default on their loans, even despite their ability to continue making payments.[76] Although there are many personal negative effects of foreclosure, the personal gains to some underwater homeowners are so great that very little aside from stigma is preventing strategic default.[77] This vicious cycle has led some to characterize foreclosures as a "contagion" that spreads throughout areas.[78]

2. Why Lenders and Servicers Are Not Addressing Negative Equity Themselves

For lenders, foreclosure is an undesirable outcome due to the transaction costs associated with foreclosure as well as the large losses they suffer on their initial investment.[79] Given the increased risk of

---

ferent jurisdictions have had to rely on different valuation methods to adequately measure property values for taxes. *See id.* at 242–45.

[70] Johnson, *supra* note 6, at 1181; Zacks, *supra* note 11, at 550–54.

[71] Johnson, *supra* note 6, at 1181; Zacks, *supra* note 11, at 550–54.

[72] Johnson, *supra* note 6, at 1181; Zacks, *supra* note 11, at 550–54. This issue is exacerbated by the fact that abandoned properties are often significant fire hazards. *See* Johnson, *supra* note 6, at 1181; Zacks, *supra* note 11, at 550–54.

[73] White, *supra* note 6, at 996; Zacks, *supra* note 11, at 555–57.

[74] *See* Zacks, *supra* note 11, at 555–57 (providing statistics from a study that found that the "increase in [surrounding] foreclosure rates . . . significantly increases the probability of default"); *see also* John P. Harding et al., The Contagion Effect of Foreclosed Properties 27 (July 13, 2009) (unpublished manuscript) (confirming that foreclosures lower the property values of surrounding homes), *available at* http://www.business.uconn.edu/Realestate/publications/pdf%20documents/406%20contagion_080715.pdf.

[75] White, *supra* note 6, at 996; Zacks, *supra* note 11, at 555–57.

[76] White, *supra* note 6, at 996; Zacks, *supra* note 11, at 555–57.

[77] *See* White, *supra* note 6, at 979–86; Wilkinson-Ryan, *supra* note 45, at 1554.

[78] White, *supra* note 6, at 996; Zacks, *supra* note 11, at 555–57.

[79] Levitin, *supra* note 51, at 568–69; *see* Setzer, *supra* note 51.

foreclosure for underwater mortgages, and the potential that many more homeowners may strategically default despite their ability to pay, banks have an incentive to reduce homeowners' principal to ensure continued timely mortgage payments.[80] In a perfectly functioning market without agency or transaction costs, lenders would prefer to incur smaller losses from loan modifications rather than larger losses from foreclosures.[81]

Despite the benefits of loan modifications, mortgage loan servicers have been reluctant to engage in such practices.[82] This reluctance to modify, in large part, results from the securitization of many mortgage loans, through which mortgages are pooled together, packaged, and sold to numerous parties.[83] As a result of this securitization, many parties, beyond the original lender, would need to be involved in the negotiation process, thereby making it difficult to find consensus among all parties involved.[84] Given this difficulty, loan servicers often leave the mortgage with its original terms, but they remain fearful that future litigation may arise that will call into the question the prudence of a modification.[85]

Another explanation for low renegotiation rates is that servicers often have the perverse financial incentive to foreclose, rather than modify a loan.[86] Loan servicers often hold no ownership interest in the

---

[80] *See* Levitin, *supra* note 51, at 576; *see* Crespi, *supra* note 14, at 169; Goodman et al., *supra* note 15, at 32.

[81] Levitin, *supra* note 51, at 576 ("In a perfectly functioning market without agency and transaction costs, lenders would be engaged in large-scale modification of defaulted or distressed mortgage loans, as the lenders would prefer a smaller loss from modification than a larger loss from foreclosure."); *see* Crespi, *supra* note 14, at 169; Goodman et al., *supra* note 15, at 32.

[82] Crespi, *supra* note 14, at 168–69; Levitin, *supra* note 51, at 624. Loan servicers are the entities that collect payments for mortgages, provide billing and tax payments to the homeowners, and have sole control over the modification of a loan. Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755, 776 (2011). Although some servicers are affiliated with the original lender, many are not. *Id.* In fact, most loan servicers have no ownership interest in the loans they service. *Id.* at 767.

[83] Crespi, *supra* note 14, at 169–70; Hockett, *supra* note 16, at 139; *see* Levitin, *supra* note 51, at 647.

[84] Crespi, *supra* note 14, at 169–70.

[85] *Id.*

[86] *Id.* at 172–73; Hockett, *supra* note 16, at 139–40; Thompson, *supra* note 82, at 770. Although some servicers are affiliated with the original lender, many are not. Thompson, *supra* note 82, at 767. In fact, most loan servicers have no ownership interest in the loans they service. *Id.* Despite this, loan servicers are the only entity with the power to modify loans. *Id.* at 764. As a result, investors—who bear all of the risk of loss from foreclosure—rarely have a say in whether to modify loans to prevent foreclosure. *Id.*

loan, so even though foreclosure often results in a loss of value for both the direct and indirect holders of the mortgage, the loan servicer itself has little incentive to foreclose.[87] Instead, where the loan servicer is often compensated on a fixed price basis for performing loans, which will be reduced if a loan's principal or interest rate is modified downward, the servicer is incentivized to keep mortgage payments high.[88] Moreover, loan servicers are often paid extra for their work during foreclosures.[89] Accordingly, the structure of servicer fee arrangements provide little incentive for the loan servicers to modify existing loans, despite the fact that this often leaves both the lenders and borrowers in a worse position.[90]

Moreover, lenders are further reluctant to modify loans as they fear that modifying loans will result in overall lost profits.[91] Lenders believe that homeowners will continue to make payments, even on underwater mortgages accruing negative equity, and therefore view any modification to the loan as money wasted.[92] They are also aware that many borrowers who receive loan modifications quickly re-default, so the time lost by postponing default represents lost money to the lender.[93] Additionally, lenders worry that showing their willingness to rene-

---

[87] *See* Thompson, *supra* note 82, at 767. In fact, the investors with ownership interest in the loan can seldom influence the servicer's actions on loan modifications. *Id.* at 768. To take action against a servicer, a majority of investors must agree, which is often impractical, if not impossible, given the large number of potential investors in each security. *Id.* Even when modification is in the best interest of the investors, servicers often choose inaction, despite their duty to work at the behest of the investors. *Id.*

[88] Crespi, *supra* note 14, at 173; Thompson, *supra* note 82, at 770–72. Performing loans are those loans where the borrower is still paying the mortgage payments. Berry, *supra* note 21.

[89] Crespi, *supra* note 14, at 173; *see* Thompson, *supra* note 82, at 771–72. The servicer pay fee arrangement was crafted before the current economic climate, so investors and servicers alike never envisioned having to modify or foreclose such a large proportion of their loans. Crespi, *supra* note 14, at 173. The growth in the number of foreclosures has also left servicers with a severe shortage of qualified staff to perform loan modifications. *Id.*

[90] Crespi, *supra* note 14, at 173; Thompson, *supra* note 82, at 767–68. Simply stated, servicers can make more money from foreclosing homes than from modifying loans. Thompson, *supra* note 82, at 771–72. This incentive structure depresses the number of loan modifications below what is the most economically prudent action from the perspective of the investors. *Id.* at 770–71.

[91] Crespi, *supra* note 14, at 174.

[92] *Id.*

[93] *Id.* Moreover, lenders believe that borrowers who face a high likelihood of eventually losing their homes will do little or nothing to maintain their homes and may even contribute to their deterioration, which would further reduce the lender's expected recovery. Manuel Adelino et al., *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 7 (Fed. Reserve Bank of Bos. Pub. Policy Discussion Paper Series, Paper No. 09-4, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf.

gotiate loans will cause other borrowers to expect modifications in the future and cause further losses.[94]

Currently, underwater homeowners have only a few options to help improve their economic situation.[95] Although the federal government has attempted to bolster the housing market by increasing demand and reducing interest rates, these efforts have not restored housing prices to their pre-recession levels.[96] Instead, they have merely stabilized the market.[97] Similarly, the government has expended no appreciable effort in encouraging loan modification for underwater borrowers.[98] Bankruptcy remains a non-option for underwater borrowers as well because the bankruptcy system generally lacks the authority to reduce the principal owed on mortgages.[99] Given the lack of avenues of recourse for underwater homeowners, there remains the potential for a cascade of strategic defaults and foreclosures that could wreak havoc on the mortgage markets and the overall economy.[100]

B. *Eminent Domain*

Without sustained improvements in the housing market or effective efforts at the federal level to address negative equity, many reformers are calling for more localized solutions.[101] One proposed solution suggests that municipalities should use the power of eminent domain to condemn underwater mortgages.[102] Eminent domain is the power of government to take privately owned property and convert it for a pub-

---

[94] Crespi, *supra* note 14, at 174–75. Lenders are, in effect, worried about the contagious effect of modifying loans. *Id.* Lenders fear that loan modifications will spread to other borrowers if the lenders show a willingness to modify in the first instance. *Id.*

[95] *See id.*; Thompson, *supra* note 82, at 770.

[96] Crespi, *supra* note 14, at 178–79. The government has chosen to try to increase housing prices rather than try to decrease principal owed by homeowners. *Id.* The government attempted to increase housing prices by providing general economic stimulus and tax credits, intervening in the markets for mortgage-backed securities, and encouraging government-sponsored entities to make purchases. *Id.* An increase in housing prices to the peak levels seen in 2006 and 2007 would largely eliminate the homeowner negative equity problem. *Id.* at 179. These efforts, however, have not yet successfully increased housing prices. *Id.*

[97] *Id.* at 179.

[98] *Id.* at 179–80; *see infra* note 96 and accompanying text.

[99] Levitin, *supra* note 51, at 571.

[100] Crespi, *supra* note 14, at 179; Wilkinson-Ryan, *supra* note 45, at 1575; *see also* White, *supra* note 50 (discussing the decreasing stigma attached to strategic default).

[101] Hockett, *supra* note 14, at 7; Robert J. Schiller, *Reviving Real Estate Requires Collective Action*, N.Y. Times, June 24, 2012, at BU6; Reiss, *supra* note 19, at 5.

[102] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35; Berry, *supra* note 21.

lic use.[103] By using eminent domain, municipalities would be forcing the sale of the mortgage from the lender to the government, thereby putting the government in the shoes of the lender.[104] After doing so, municipalities could then control the mortgages and adjust the homeowner's principal below fair market value.[105]

The power of eminent domain predates the Constitution and is a natural power designated to sovereign governments.[106] The Fifth Amendment's Taking Clause both confirms this power and acts as a limit, stating "nor shall private property be taken for public use, without just compensation."[107] States, as sovereign governments, possess the power of eminent domain and have delegated it to its municipalities.[108] As such, municipalities can participate in condemnation proceedings to take property for public use.[109]

Eminent domain is traditionally used to acquire land or real property.[110] The taken property is often used to build roads, waterways, and defense installations, as well as government and public buildings.[111] The process has also been used to help alleviate blight in troubled areas.[112] More recently, the power has been a tool to develop urban areas, as it has been used to convert private land into shopping malls and large retailers.[113]

Although eminent domain is usually used to acquire land and real property, in the case of underwater mortgages the municipality would be condemning contracts.[114] Even still, the power is not limited to only

---

[103] 26 AM. JUR. 2D *Eminent Domain* § 2 (2013); BLACK'S LAW DICTIONARY, *supra* note 12, at 601.

[104] Reiss, *supra* note 20, at 35; Sheridan, *supra* note 20, at 113.

[105] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35.

[106] 26 AM. JUR. 2D *Eminent Domain* § 3; BLACK'S LAW DICTIONARY, *supra* note 12, at 601; *see* Asper, *supra* note 26, at 491–92 (stating that the "Takings Clause of the Fifth Amendment is a 'tacit recognition of a preexisting power to take private property for public use, rather than a grant of new power'" (quoting U.S. v. Carmack, 329 U.S. 230, 242–43 (1946))).

[107] U.S. CONST. amend. V; Asper, *supra* note 26, at 491–92.

[108] 26 AM. JUR. 2D *Eminent Domain* § 26 (2013).

[109] *Id.*

[110] Daniel P. Dalton, *Introduction*, *in* EMINENT DOMAIN: A HANDBOOK OF CONDEMNATION LAW, at xv, xv (William Scheiderich et al. eds., 2011); *see also* BLACK'S LAW DICTIONARY, *supra* note 12, at 601 (defining "eminent domain" as "[t]he inherent power of a government entity to take privately owned property, *esp. land*" (emphasis added)).

[111] Dalton, *supra* note 110, at xv.

[112] *See, e.g.*, Berman v. Parker, 348 U.S. 26, 32–33 (1954) (interpreting the role of the judiciary narrowly, thereby recognizing a municipality's broad discretion in determining whether redesign of an area containing blight was a constitutional taking for eminent domain purposes).

[113] Dalton, *supra* note 110, at xv.

[114] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35.

real property.[115] Of particular interest, eminent domain has been authorized to condemn securities and contract rights.[116] Further, the Connecticut legislature has authorized its municipalities to use the power of eminent domain to condemn income tax exclusions from bond covenants.[117] Bond covenants are the legally binding terms between a bond issuer and a bond holder.[118] By condemning the bond covenants, Connecticut was functionally condemning debt in the interests of collecting taxes.[119]

C. *The Plan*

Advocates for reform have recently proposed that municipalities should use eminent domain to condemn mortgages with negative equity—i.e., the Plan.[120] Municipalities in states such as California, New York, Illinois, and Massachusetts have looked into the feasibility of implementation.[121] One California city has passed a bill to implement the Plan, but the city has been unable to proceed without a supermajority of support.[122]

---

[115] *See, e.g.*, Cincinnati v. Louisville & Nashville R.R. Co., 223 U.S. 390, 398 (1912) (discussing the condemnation of a right of way).

[116] *See* U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 29 n.27 (1977) ("The States remain free to exercise their powers of eminent domain to abrogate such contractual rights, upon payment of just compensation."). For example, in the 1906 U.S. Supreme Court case *Offield v. New York, New Haven & Hartford Railroad Co.*, shares of stock were condemned to enable the company to improve a section of railroad. 203 U.S. 372, 375 (1906).

[117] CONN. GEN. STAT. § 12-242gg (2013); *see Billions in Tax Revenue Stays in State, Thanks to Squire Sanders*, SQUIRE SANDERS, http://www.squiresanders.com/de/experience/casestudies/CaseStudyDetail.aspx?StudyID=493 (last visited Nov. 15, 2013).

[118] *See* BLACK'S LAW DICTIONARY, *supra* note 12, at 205.

[119] Comment Letter from Graham Williams, Chief Exec. Officer, Mortg. Resolution Partners, to Alfred Pollard, General Counsel, Fed. Hous. Fin. Agency (Sept. 7, 2012) [hereinafter MRP Comment Letter], *available at* http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa_comment_letter_9.7.12.pdf; *see* CONN. GEN. STAT. § 12-242gg.

[120] Hockett, *supra* note 16, at 150–55; John E. Husing, Opinion, *The Housing Crisis, Eminent Domain and the Public Interest*, SAN BERNADINO COUNTY SUN (Calif.), (Oct. 9, 2012, 9:00AM), http://www.sbsun.com/general-news/20121010/the-housing-crisis-eminent-domain-and-the-public-interest; Brad Miller, *supra* note 19; Reiss, *supra* note 19, at 5.

[121] Josh Harkinson, *Take My Mortgage, Please*, MOTHER JONES, Mar.-Apr. 2013, at 13, 13 (stating that California, Illinois, and New York have all investigated the feasibility of such plans); Eleazar David Melendez, *Brockton, Massachusetts, Considers Eminent Domain to Address Foreclosures*, HUFFINGTON POST (Jan. 11, 2013, 4:52 PM), http://www.huffingtonpost.com/2013/01/11/brockton-eminent-domain-foreclosure_n_2458369.html (discussing how a Massachusetts city investigated such a plan).

[122] David Morrison, *California City May Leverage Eminent Domain on Mortgages*, CREDIT UNION TIMES (Sept. 25, 2013), http://www.cutimes.com/2013/09/25/california-city-may-leverage-eminent-domain-on-mor?ref=hp. The Richmond City Council located in Rich-

The Plan proposes that municipalities condemn mortgages where the homeowners owe more than the appraised worth of the home.[123] Specifically, the Plan would likely target underwater mortgages which are securitized in private trusts.[124] Loan servicers are significantly less likely to modify principal down on these mortgages than on a comparable mortgage held in a bank portfolio.[125] Despite the current structure of the Plan to include all underwater mortgages, municipalities could alter the Plan to condemn only mortgages which have been performing and exclude those which are delinquent or defaulting.[126]

Under the Plan, a municipality would pay the lender 20–25% less than the fair market value of the home as compensation for the mortgage.[127] This calculation—described as the "foreclosure discount"—is based on the predicted fair market value of the loan, due to the high rate of foreclosures on underwater mortgages.[128] Proponents of the Plan justify the calculation given the projected savings of transaction costs that the lender would incur if the property went through foreclosure.[129] Advocates also claim that this calculation mirrors what underwater mortgages are traded for in secondary mortgage markets.[130]

Then, the municipality would own the loan and functionally act as the lender.[131] Accordingly, the municipality would have the power to

---

mond, California voted 4–3 to go forward with the plan, but the city cannot proceed without an additional vote because state law requires a supermajority. *Id.*

[123] *See* MRP Comment Letter, *supra* note 119, at 1.

[124] *See id.* at 1, 3–4; *supra* notes 83–85 and accompanying text (discussing the process and difficulties of securitized mortgages).

[125] *See* MRP Comment Letter, *supra* note 119, at 2; *supra* notes 83–85 and accompanying text. The competing interests of different parties who have an ownership interest in the mortgage make it difficult for servicers to ensure that no party is unhappy with a modification. Crespi, *supra* note 14, at 169–70.

[126] Gottlieb & Kim, *supra* note 20, at 8; MRP FAQs, *supra* note 20. Although the Plan originally sought to condemn only underwater mortgages that were performing, it has since been amended to include delinquent and defaulting mortgages as well. Gottlieb & Kim, *supra* note 20, at 8.

[127] Gottlieb & Kim, *supra* note 20, at 4; Sheridan, *supra* note 20, at 115; Berry, *supra* note 21. These numbers, though widely cited, are preliminary estimates of what municipalities believe could be just compensation. MRP Comment Letter, *supra* note 119, at 5. Until the mortgages are condemned and good faith negotiations (or litigation) are used to determine the price of the property, the proposed foreclosure sale price is just an estimate. *Id.*

[128] Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21; *see* Smith, *supra* note 12.

[129] Gottlieb & Kim, *supra* note 20, at 4; *see* Berry, *supra* note 21.

[130] *See* MRP FAQs, *supra* note 20. MRP also claims that their valuation methodologies mirror those used by Fannie Mae and Freddie Mac, the quasi government entities that purchase mortgages to provide a secondary home mortgage market. MRP Comment Letter, *supra* note 119, at 1–2.

[131] MRP Comment Letter, *supra* note 119, at 6.

adjust the principal owed by the homeowner to below fair market value.[132] Given that the municipality paid less than the fair market value of the home for the mortgage, lowering principal to make the home no longer underwater can be done without having taxpayers bear the cost.[133] The municipality could then sell the adjusted mortgages back to established lenders, thereby returning them to the market at a decreased rate for the homeowners.[134]

Given the large up-front costs associated with buying these mortgages—even at their discounted rate—municipalities would need initial investors to fund the Plan.[135] An advocacy group, Mortgage Resolution Partners ("MRP"), has agreed to pair the municipality with investors to fund the capital needed to condemn such mortgages.[136] In turn, these investors would be repaid with interest after the loan is resold.[137] MRP would collect a flat fee per mortgage from the investors—not the municipality—for facilitating the process.[138]

This Plan would be extremely beneficial to underwater homeowners.[139] Homeowners would regain a mortgage where the outstanding principal is below the fair market value of the home.[140] The lower principal owed would lead to lower monthly mortgage payments.[141] Furthermore, given that the principal owed is less than the fair market value, homeowners would be able to immediately build equity in their homes.[142] Homeowners could then refinance at the current low interest rates, further lowering their monthly mortgage payments.[143]

---

[132] *Id.*

[133] *See* Gottlieb & Kim, *supra* note 20, at 6; MRP Comment Letter, *supra* note 119, at 6. To lower principal, the municipality—as the lender—would simply refinance the loan and adjust the terms. *See* Gottlieb & Kim, *supra* note 17, at 4; Sheridan, *supra* note 20, at 113.

[134] *See* Gottlieb & Kim, *supra* note 20, at 4; Sheridan, *supra* note 20, at 113.

[135] *See* Gottlieb & Kim, *supra* note 20, at 4.

[136] *Id.*; *see* MRP FAQs, *supra* note 20.

[137] MRP FAQs, *supra* note 20.

[138] *Id.* The current proposal has MRP receiving $4500 from investors for its role in facilitating the process. Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21. MRP argues that this fee is similar to the fee paid by the federal government to banks that modify loans under federal programs. MRP FAQs, *supra* note 20.

[139] *See* Reiss, *supra* note 20, at 35; Sheridan, *supra* note 20, at 115; Husing, *supra* note 120.

[140] Gottlieb & Kim, *supra* note 20, at 4; Sheridan, *supra* note 20, at 115; Husing, *supra* note 120.

[141] Gottlieb & Kim, *supra* note 20, at 4; Reiss, *supra* note 20, at 35.

[142] Husing, *supra* note 120.

[143] Gottlieb & Kim, *supra* note 20, at 4; Husing, *supra* note 120. This is especially true as current interest rates on home loans are at historic lows. *See Interest Rate Trends*, MORTGAGE INFO. SERV., http://mortgage-x.com/trends.htm (last visited Nov. 10, 2013) (providing data that shows that at the heyday of the housing crisis in 2008, interest rates were significantly higher than the interests now available to homeowners).

Additionally, the municipality could directly benefit from implementing the Plan.[144] For a municipality wherein a large number of homes have negative equity, preventing foreclosures is a major concern.[145] Modifying the principal owed by homeowners to below the fair market value of the home could prevent foreclosures that act to drain government resources, decrease surrounding property values, and lower tax revenue.[146] The municipality and, in turn, the taxpayers do not bear the costs of implementing the proposal, despite the significant benefits.[147] By compensating lenders below the fair market value of the home, the municipality can modify the principal to any amount in excess of this price without having to expend any additional funds.[148]

Lenders, on the other hand, would bear most of the costs associated with this Plan.[149] They would be compensated only for the foreclosure discount price of the home despite being owed the full value of the mortgage.[150] As a result, lenders receive significantly less—the adjusted price of the home minus transaction costs—than they would have received had the loan been repaid.[151] The foreclosure discount price necessarily assumes that all mortgages will go through foreclosure around the time of condemnation.[152] This is true because any mortgages that would not go through foreclosure would require that the municipality compensate lenders the full value of the outstanding mortgages.[153] Lenders oppose the Plan largely because of the disparity between the

---

[144] Hockett, *supra* note 14, at 6; Husing, *supra* note 120.

[145] *See* Smith, *supra* note 12.

[146] Husing, *supra* note 120; *see* Goodman et al., *supra* note 15, at 32; *see supra* notes 66–69 and accompanying text (describing the negative effects that foreclosures inflict on municipalities and local communities).

[147] Gottlieb & Kim, *supra* note 20, at 6.

[148] *See id.* at 4; Sheridan, *supra* note 20, at 115.

[149] *See* Sheridan, *supra* note 20, at 115. Because the Plan only considers those mortgages that have been securitized, the investors of these MBS's would actually be bearing most of the cost of the Plan. *See* Sheridan, *supra* note 20, at 115. Although these investors took large risks investing in these mortgage pools, many of the shares are likely held by pension funds, 401k's, and other financial accounts held by the middle class. Gottlieb & Kim, *supra* note 20, at 6; *see* Husing, *supra* note 120.

[150] *See* Berry, *supra* note 21; *supra* note 128 and accompanying text.

[151] *See* Berry, *supra* note 21; *supra* note 129 and accompanying text.

[152] *See* Gottlieb & Kim, *supra* note 20, at 4.

[153] Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 2; *see* Gottlieb & Kim, *supra* note 20, at 4. In these situations, to pay less than the fair market value of the home would not satisfy the "just compensation" prong of the Takings Clause. *See infra* notes 271–276 and accompanying text.

full value of the mortgage that they are owed and the very low foreclosure discount price that they would receive under the Plan.[154]

Since the Plan's emergence, various groups have both supported and opposed its proposal.[155] The benefit to homeowners in reducing their mortgage principal is obvious, but proponents of the Plan have further claimed that it will benefit communities as a whole and stabilize the larger economy.[156] Opponents of the Plan, however, are worried not only about the negative effect on banks, but also the instability that such a proposal could bring to housing markets and the economy at large.[157] Opposition has been so fierce that the banking industry has stepped up its lobbying efforts against the Plan.[158] A bill was even proposed to Congress to make implementation functionally impossible.[159]

---

[154] *See* Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 2.

[155] *Compare, e.g.*, *This Dog Won't Hunt*, *supra* note 24, at 2 (supporting the Plan), *with* Husing, *supra* note 120 (opposing the Plan). For example, the FHFA, the Security Industry and Financial Markets Association ("SIFMA"), Chicago Mayor Rahm Emmanuel, and numerous Wall Street firms have specifically opposed the Plan. Gottlieb & Kim, *supra* note 20, at 6. Alternatively, a number of economists, law professors, and politicians have supported the Plan. Brad Miller, *supra* note 18; *see* Reiss, *supra* note 19, at 5; Husing, *supra* note 120. In a show of support, Lieutenant Governor of California Gavin Newsom wrote a letter to the Department of Justice to urge the Department to investigate whether the threats of lenders and MBS investors—promising to restrict consumers' access to capital in municipalities condemning underwater mortgages—constituted restraint of trade. Letter from Gavin Newsom, Lieutenant Governor of Cal., to Eric Holder, U.S. Att'y Gen., (Sept. 10, 2012), *available at* http://www.ltg.ca.gov/09102012_LTG_DOJ_LETTER.pdf.

[156] *See* Hockett, *supra* note 14, at 3; Husing, *supra* note 120.

[157] *See This Dog Won't Hunt*, *supra* note 24, at 2. Opponents have expressed concern that the Plan could limit credit access and make mortgages more expensive in communities that implement the Plan. Gottlieb & Kim, *supra* note 20, at 6; Sheridan, *supra* note 20, at 116–17. Some observers fear that the use of eminent domain to condemn mortgages could make lenders more unwilling to lend in municipalities for fear of future condemnation of their investments if home prices decline again. *See* Brad Finkelstein, *California Trade Chief: Eminent Domain Will Curtail Lending*, NAT'L MORTGAGE NEWS (Aug. 10, 2012, 8:41AM), http://www.nationalmortgagenews.com/dailybriefing/eminent-domain-California-mortgage-lending-curtail-Fred-Kreger-1031742-1.html. The FHFA echoed this argument in its opposition to the Plan, as it feared that the Plan could have a chilling effect on the extension of credit to borrowers. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 9, 2012). Other commentators have refuted this theory, claiming that if there is money to be made by lending in a particular region, investors will invest. Reiss, *supra* note 19, at 35; *see* Hockett, *supra* note 14, at 8. Even if there is not a chilling of the credit markets, however, the price of a mortgage could marginally increase to account for the future potential of condemnation. Reiss, *supra* note 19, at 4.

[158] Brian Collins, *Industry Is Lining Up to Block Eminent Domain Laws*, NAT'L MORTGAGE NEWS (Sept. 25, 2012, 10:59AM), http://www.nationalmortgagenews.com/features/block-eminent-domain-laws-1032335-1.html.

[159] Press Release, Rep. John Campbell, Campbell Introduces The Defending American Taxpayers from Abusive Government Takings Act (Sept. 13, 2012), *available at* http://www.campbell.house.gov/press1/release-campbell-reintroduces-bill-to-protect-taxpayers-from-em

Even beyond whether municipalities should put the Plan into action, observers question whether local governments have the legal authority to use eminent domain to condemn mortgages in this way.[160]

II. Satisfying the Takings Clause

The Plan has drawn ire from critics who have argued that the Plan is both bad policy and illegal.[161] Although there are numerous potential legal issues implicated by the Plan, the first hurdle it must clear is the Fifth Amendment's Takings Clause.[162] The Takings Clause acts as a limit on the government's power of eminent domain, requiring that a taking be for a public use and for payment of just compensation.[163] Accordingly, for the Plan to be constitutional under the Takings Clause, there must be both a showing that the condemnation of underwater mortgages benefits the public and that the government justly compensates the lenders.[164]

Section A of this Part examines the public use requirement of the Takings Clause and recent decisions that have impacted its interpretation.[165] Then, Section B discusses the just compensation requirement of the Takings Clause.[166]

A. *Public Use*

Legal commentators have fiercely debated the precise meaning of the "public use" requirement of the Takings Clause, but there remains no consensus.[167] The term has been interpreted broadly as meaning

---

inent-domain-schemesan-taxpayers-from-abusive-government-takings-act/. The bill, "The Defending American Taxpayers from Abusive Government Takings Act," would prohibit federal agencies like Fannie Mae, Freddie Mac, the FHA, and the Veterans Administration from purchasing, making, insuring, or guaranteeing loans in any county which used eminent domain to condemn mortgages. *Id.*

[160] Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 1; Tambe et al., *supra* note 24, at 4.

[161] Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 1; Tambe et al., *supra* note 24, at 4; *see This Dog Won't Hunt*, *supra* note 24, at 2.

[162] *See* U.S. Const. amend. V; Sheridan, *supra* note 20, at 114.

[163] *See* U.S. Const. amend. V.

[164] *See id.*; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 2.

[165] *See infra* notes 167–203 and accompanying text.

[166] *See infra* notes 204–218 and accompanying text.

[167] Alberto B. Lopez, *Weighing and Reweighing Eminent Domain's Political Philosophies Post-*Kelo, 41 Wake Forest L. Rev. 237, 240 (2006) (stating that "[t]he oscillating definition of public use is a magnet for eminent domain debate"); Asper, *supra* note 26, at 492 (describing that "[o]ne aspect of the Takings Clause that American courts have never truly agreed upon is what constitutes a public use for the purposes of eminent domain").

"for a public purpose," but there is disagreement about what exactly constitutes a public purpose.[168]

Certain uses of eminent domain have long been considered public uses and are uncontroversial.[169] For example, the condemnation of private land for public ownership to build public buildings, parks, and roads is directly for public use and therefore constitutional.[170] The condemnation and transfer of property to a private party, often common carriers who make the property available to the public, is similarly uncontroversial and constitutional.[171] Moreover, the condemnation of blighted property is also recognized as a public use in that it benefits the surrounding community.[172]

Other uses of eminent domain, however, have proven more controversial.[173] The use of eminent domain to transfer property between private parties is particularly controversial, though not necessarily unconstitutional.[174] For example, in 1984, in *Hawaii Housing Authority v. Midkiff* the U.S. Supreme Court determined that transferring property from one private party to another to disband an oligopoly over land ownership was constitutional.[175] There, the taking was upheld, despite the fact that the recipients of the taken land were private parties with no intent to use the land for any purpose that one often considers to be for public use.[176] Instead, the Court decided that the potential benefit

---

[168] *See* Kelo v. City of New London, 545 U.S. 469, 520 (2005) (Thomas, J., dissenting) (noting that "[o]nce one permits takings for public purposes in addition to public uses, no coherent principle limits what could constitute a valid public use"); Asper, *supra* note 26, at 492–93.

[169] *Kelo*, 545 U.S. at 497–98 (O'Connor, J., dissenting); *see infra* notes 170–172 and accompanying text.

[170] *Kelo*, 545 U.S. at 497 (O'Connor, J., dissenting); *see, e.g.*, Old Dominion Land Co. v. United States, 269 U.S. 55, 66 (1925) (holding that the condemnation of land for the acquisition of military buildings qualified as a public purpose).

[171] *Kelo*, 545 U.S. at 498 (O'Connor, J., dissenting); *see, e.g.*, Nat'l R.R. Passenger Corp. v. Bos. & Me. Corp., 503 U.S. 407, 422–23 (1992) (holding that the condemnation of railroad property to supply to a common carrier qualifies as a public purpose).

[172] *See, e.g.*, Berman v. Parker, 348 U.S. 26, 32–33 (1954) (interpreting the role of the judiciary narrowly in holding that the redesign of an area containing blight was constitutional).

[173] *See Kelo*, 545 U.S. at 498 (O'Connor, J., dissenting); Ilya Somin, *What If* Kelo v. City of New London *Had Gone the Other Way?*, 45 Ind. L. Rev. 21, 21 (2011); *infra* notes 174–181 and accompanying text.

[174] *Kelo*, 545 U.S. at 498 (O'Connor, J., dissenting); *see* Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243–44 (1984); Somin, *supra* note 173, at 21.

[175] 467 U.S. at 243–44.

[176] *Id.* at 244.

in disbanding the oligopoly over land in Hawaii was itself a sufficient public use.[177]

Similarly, in 2005, in *Kelo v. City of New London*, the Supreme Court held that the transfer of property from one private owner to another for economic revitalization was constitutional as a public use under the Takings Clause.[178] There, the government used eminent domain to condemn privately owned homes in order to build a privately owned research facility.[179] In *Kelo*, the plan was proposed to create jobs, generate tax revenue, and improve the aesthetics of the area.[180] Again, despite the transfer of property from one private party to another, the potential benefit of economic revitalization was sufficient for the Court to find a public use.[181]

The Court's holdings in both *Midkiff* and *Kelo* are partially due to the judiciary's deferential approach to the public use clause.[182] Courts are traditionally reluctant to strike down the use of eminent domain for fear of preventing worthwhile government projects.[183] The judiciary has recognized that the local body determining condemnations will be more cognizant of the needs of the community than a federal court.[184]

Given this deferential approach to the public use clause, courts do not require the government to prove with reasonable certainty that the expected public benefits will occur.[185] Instead, the proposed benefits must be both rational and possible, rather than certain.[186] The Court in *Kelo* articulated this point when it emphasized that judicial evaluation

---

[177] *Id.* The concentration of land ownership in Hawaii was staggering. *See id.* at 232. Although governments owned almost 49% of Hawaii's land, another 47% was in the hands of only seventy-two land owners. *Id.* In fact, eighteen landholders owned more than 40% of this land. *Id.*

[178] 545 U.S. at 477–90.

[179] *Id.* at 474–75.

[180] *Id.* at 474.

[181] *Id.* at 477–90.

[182] *Id.* at 480; *Midkiff*, 467 U.S. at 244; Paul W. Tschetter, Student Article, Kelo v. New London*: A Divided Court Affirms the Rational Basis Standard of Review in Evaluating Local Determinations of 'Public Use,'* 51 S.D. L. Rev. 193, 194 (2006).

[183] *See Kelo*, 545 U.S. at 480 ("Without exception, our cases have defined [the public use] concept broadly, reflecting our longstanding policy of deference to legislative judgments in this field."); *Midkiff*, 467 U.S. at 244 ("Judicial deference is required because, in our system of government, legislatures are better able to assess what public purposes should be advanced by an exercise of the taking power.").

[184] *Midkiff*, 467 U.S. at 244.

[185] *Kelo*, 545 U.S. at 487–88; Tschetter, *supra* note 182, at 205.

[186] *Kelo*, 545 U.S. at 488; Tschetter, *supra* note 182, at 205.

of the likelihood of success of different plans would impede and delay worthwhile projects.[187]

Despite giving broad latitude to the government in takings cases, a legitimate public benefit is nevertheless required.[188] Justice Anthony Kennedy's concurring opinion in *Kelo* emphasized this point, noting that the stated public purpose needs to be paramount, and not merely incidental to the benefits of the private parties.[189] This focus is intended to limit the potential for abuse by municipalities.[190] When private parties benefit greatly from a condemnation, the standard ensures that the government did not engage in any impropriety by engaging in "impermissible favoritism."[191] In *Kelo*, for example, the Court determined that New London's plan for economic revitalization was the reason for condemnation, and not that the owners of the new research facility would enjoy private benefits.[192]

The Court in *Kelo* analyzed the comprehensive nature of the proposed plan to determine whether the public benefits were paramount to any private benefits.[193] Specifically, the construction of the research facility would require condemnation of numerous individual parcels of private property.[194] Taken individually, the condemnation of each individual parcel does not benefit the public, because one plot of land would not be sufficient to revitalize the neighborhood.[195] Taken together, however, the plan used the taken lands in an organized way to redevelop an underutilized area of the city.[196]

Alternatively, the Court has relied on a second approach whereby it considers the degree to which eminent domain will prevent or alleviate harm.[197] This reasoning offers justification for the traditional use of

---

[187] *Kelo*, 545 U.S. at 488 (noting that postponing condemnation until courts can determine the success of a project would create "a significant impediment to the successful consummation of many such plans").

[188] *Id.* at 487–88; *id.* at 491 (Kennedy, J., concurring).

[189] *Id.* at 491 (Kennedy, J., concurring).

[190] *See id.* at 493.

[191] *See id.* at 491.

[192] *See id.* at 492.

[193] *Kelo*, 545 U.S. at 483–84 (majority opinion).

[194] *See id.* at 474.

[195] *See id.* at 484. It would be difficult to argue that a section of a parking lot by itself, or any other isolated piece of the plan in *Kelo*, would benefit the public without viewing it in the context of the larger development. *See id.*

[196] *See id.* The Court also emphasized that requiring a comprehensive plan would assuage some fear held by some that believed that municipalities would condemn single parcels or even small groups of parcels to sell to wealthy developers for increased tax revenue. *Id.* at 486–87.

[197] *Id.* at 500 (O'Connor, J., dissenting).

eminent domain: to build public projects.[198] Private landowners could potentially harm the public if they required compensation greatly exceeding the actual worth of the property because such demands would halt government projects.[199] This rationale also helps to explain condemnation of blight where the property being condemned can damage a neighborhood's property values and potentially breed crime.[200] For example, in *Midkiff*, the Court justified the use of eminent domain to allow for more landowners because it would help to alleviate the problem of an inequitable housing market caused by Hawaii's oligopoly of land ownership.[201] Moreover, *Kelo* serves as an example of where condemnation was appropriate to improve a community, but where the taken property was not previously causing any harm.[202] Despite the proposed benefits of the urban revitalization plan, Justice Sandra Day O'Connor argued that the condemnation was not appropriate because the private homes being condemned were not causing any harm to the community.[203]

B. *Just Compensation*

In addition to requiring that property must be taken for a public use, the Takings Clause also requires payment of just compensation.[204] Although courts have interpreted the public use requirement deferentially for fear of halting worthwhile government projects, the just compensation requirement has been dutifully enforced to prevent the government from imposing significant harm on the property owner.[205] One scholar has described the just compensation requirement as the sole viable check on the government's constitutional power of eminent domain.[206] In its 1960 decision in *Armstrong v. United States*, the Supreme Court described the just compensation requirement as a way of preventing a small group of citizens from bearing the costs of a project

---

198 *See* Thomas J. Miceli, The Economic Theory of Eminent Domain: Private Property, Public Use 27–31 (2011) (discussing the holdout problem and how eminent domain is a solution to this potential market failure).

199 *See id.*

200 *See Kelo*, 545 U.S. at 500 (O'Connor, J., dissenting).

201 *Id.*; *see Midkiff*, 467 U.S. at 243–44.

202 *See Kelo*, 545 U.S. at 500–01 (O'Connor, J., dissenting).

203 *Id.* (articulating that the homes being condemned for the development project were not causing any harm to the community despite the proposed public benefit).

204 U.S. Const. amend. V.

205 *See* James Geoffrey Durham, *Efficient Just Compensation as a Limit on Eminent Domain*, 69 Minn. L. Rev. 1277, 1278 (1985).

206 *Id.*

that should be absorbed by society.[207] Just compensation mitigates the loss suffered by landowners when their land is seized because it attempts to place them in the same financial position they were in before the taking.[208]

The most common method to determine just compensation is to consider the property's fair market value.[209] Fair market value is the price that a willing buyer would pay a willing seller for the property at an arm's length transaction.[210] Although fair market value attempts to evaluate the cost to the property owner, its deferential nature prevents it from accounting for costs beyond the market value.[211] For example, fair market value does not consider the tangible costs associated with having to replace property or the intangible costs associated with the owner's personal appreciation of the particular piece of property.[212]

A court determines just compensation by analyzing both the government's and the private party's calculation of fair market value.[213] Advocates usually present comparable properties and their sale prices as evidence of fair market value.[214] As such, when considering the fair market value of underwater mortgages, the price at which similar mortgages with similar negative equity were valued and sold for could inform the calculation of just compensation.[215]

---

[207] 364 U.S. 40, 49 (1960); *see* Asper, *supra* note 26, at 496.

[208] United States v. Miller, 317 U.S. 369, 373 (1943).

[209] Durham, *supra* note 205, at 1285.

[210] *Miller*, 317 U.S. at 374.

[211] *See* Durham, *supra* note 205, at 1288; Brett Talley, Recent Development, *Restraining Eminent Domain Through Just Compensation:* Kelo v. City of New London*, 125 S. Ct. 2655 (2005)*, 29 Harv. J.L. & Pub. Pol'y 759, 766 (2006).

[212] Talley, *supra* note 211, at 766; *see* Durham, *supra* note 205, at 1288. Fair market value ignores, for example, the replacement of land and improvements, relocation and moving costs, loss of business revenues, lost customer goodwill, and demoralization. Talley, *supra* note 211, at 766. Because of this, some argue that fair market value is instead the practical minimum that the court could have chosen as constituting just compensation under the Takings Clause. Durham, *supra* note 205, at 1288. One scholar has argued that due to fair market value's already under-compensation of property owners, any payment below that level would contradict the logical meaning of "just compensation" as required by the Takings Clause. *Id.*; *see* U.S. Const. amend. V. Despite this, the scholar argues that courts remain seemingly more worried about overpaying property owners than about undercompensating them. *See* Durham, *supra* note 205, at 1292–93.

[213] *See* Durham, *supra* note 205, at 1291–92; Asper, *supra* note 26, at 496.

[214] *See* Durham, *supra* note 205, at 1291–92; Asper, *supra* note 26, at 496. In general, appraisers look at data concerning the sales of similar properties and adjust the valuation based on differences between the properties. Asper, *supra* note 26, at 496.

[215] *See* Asper, *supra* note 26, at 496.

Although fair market value is the traditional standard for determining just compensation, alternative measures could be used.[216] Courts have favored fair market value as a practical general rule, but courts have never designated it as the sole measure of just compensation.[217] Courts can apply standards with more just results when the typical application of fair market value would result in injustice to the owner or to the public.[218]

III. Is the Plan Constitutional?: A Public Benefit Short on Compensation

Although the Plan as currently construed satisfies the public use requirement of the Fifth Amendment's Takings Clause, it fails to provide just compensation.[219] To pass constitutional muster, municipalities would need to provide additional compensation to lenders.[220] This extra compensation might, however, make the Plan economically, and thereby politically, infeasible.[221]

Section A of this Part argues that the Plan likely satisfies the public use requirement due to the proposed benefits to the community.[222] Then, Section B argues that municipalities' calculation of just compensation will likely be viewed skeptically by courts and—if valued higher than the fair market value of the underlying home—likely make the Plan impracticable for local governments.[223]

A. *The Plan Satisfies the Public Use Requirement*

Traditionally, courts grant municipalities broad discretion in defining the public purpose that justifies the municipality's use of eminent domain.[224] This deference stems from the fear of preventing worth-

---

[216] United States v. 564.54 Acres of Land, 441 U.S. 506, 512 (1979) (recognizing how courts have applied standards other than fair market value to avoid a "manifest injustice" to property owners or the public").

[217] *Id.*

[218] *Id.*; *see* United States v. Fuller, 409 U.S. 488, 490 (1973) (stating that just compensation stems from principles of equity and fairness in addition to property law).

[219] *See* U.S. Const. amend. V; *infra* notes 224–249, 258–283 and accompanying text.

[220] *See infra* notes 258–283 and accompanying text.

[221] *See infra* notes 284–303 and accompanying text.

[222] *See infra* notes 224–249 and accompanying text.

[223] *See infra* notes 250–307 and accompanying text.

[224] *See, e.g.*, Kelo v. New London, 545 U.S. 469, 480 (2005); *see also supra* notes 182–184 and accompanying text (describing the broad discretion used by courts regarding the public use requirement).

while public projects.[225] A court may be hesitant to prevent the execution of the Plan where it achieves bedrock community goals like preventing foreclosure, stimulating the economy, and stabilizing the housing markets.[226]

For the Plan to be constitutional, it must first provide a legitimate public benefit to the community.[227] Here, it is possible that decreased negative equity will reduce the number of foreclosures.[228] Additionally, the decrease in the number of underwater mortgages could serve to stabilize local housing markets.[229] The increased well-being of the mortgage and housing markets could greatly benefit not only the local community, but the general economy as well.[230] Furthermore, with decreased mortgage payments, homeowners will retain more disposable income to help stimulate the local economy.[231]

The economic consequences of enacting the Plan are unclear, but it is rational to believe that lowering principal on underwater mortgages will prevent foreclosures and bring stability to the housing market.[232] Potential benefits to the community need only be possible, however, not reasonably certain.[233] In the Supreme Court's 2005 decision *Kelo v. City of New London*, the construction of a research facility was not guaranteed to revitalize the community, but the possibility of revitalization was sufficient for the Court to hold that the taking was for a public use.[234]

The fact that underwater mortgages are causing harm to the economic stability of many communities also supports the Plan's constitutionality.[235] Although Justice O'Connor opposed the use of eminent domain in *Kelo* because the residential properties were not causing any harm, here underwater mortgages are actively handicapping economic

---

[225] *See* Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 244 (1984); *supra* notes 182–184 and accompanying text.

[226] *See Midkiff*, 467 U.S. at 244; Husing, *supra* note 120.

[227] *See supra* notes 188–192 and accompanying text.

[228] *See* Hockett, *supra* note 16, at 175; Husing, *supra* note 120.

[229] *See* Nocera, *supra* note 18; Husing, *supra* note 120.

[230] *See* Hockett, *supra* note 14, at 3; Reiss, *supra* note 19, at 35.

[231] *See* Husing, *supra* note 120.

[232] *See Kelo*, 545 U.S. at 487–88; MRP Comment Letter, *supra* note 119, at 3.

[233] *See Kelo*, 545 U.S. at 487–88; *supra* notes 185–187 and accompanying text.

[234] *Kelo*, 545 U.S. at 487–88.

[235] *See* White, *supra* note 6, at 981–83; Zacks, *supra* note 11, at 545; *supra* notes 56–78 and accompanying text (describing the numerous negative side effects that an onslaught of underwater mortgages and foreclosures can have on a community).

recovery.[236] Negative equity has a deleterious effect on housing markets and the overall economy.[237] Implementing the Plan could potentially alleviate these negative effects and improve mortgage and housing markets and the overall economy.[238] Moreover, there remains a fear of a cascade of strategic defaults when considering the benefits underwater homeowners are able to receive by going through foreclosure.[239] The resulting increase in foreclosure rates could cripple an already weakened economy and cause havoc in the mortgage markets.[240] As such, preventing all of these harms could be used as further evidence of a public use by courts.[241]

Additionally, the Plan follows a comprehensive development program that has established set criteria to achieve the goal of economic recovery.[242] As in *Kelo*, such a comprehensive development program assuages the fear that a transfer of property is done primarily for private gain.[243] Here, the Plan does not condemn any mortgage with the individual homeowner in mind as a beneficiary; instead the Plan focuses on the community's goal of minimizing negative equity, thereby preventing future foreclosures.[244] Although investors stand to profit from implementation, they are merely collecting interest on the loan provided to the city.[245] MRP will also profit, but they are collecting only a flat fee per mortgage from investors.[246] Regardless of the benefits received by inves-

---

[236] *See Kelo*, 545 U.S. at 500–01 (O'Connor, J., dissenting) (articulating that the homes being condemned for the development project were not causing any harm to the community despite the proposed public benefit); Husing, *supra* note 120.

[237] *See* White, *supra* note 6, at 981–83; Zacks, *supra* note 11, at 545; *supra* notes 56–78 and accompanying text.

[238] *See* Hockett, *supra* note 14, at 2; Husing, *supra* note 120.

[239] Crespi, *supra* note 14, at 179; Wilkinson-Ryan, *supra* note 45, at 1575; *see also* White, *supra* note 50 (discussing the decreasing stigma attached to strategic default); *supra* notes 95–100 and accompanying text.

[240] *See* Crespi, *supra* note 14, at 179; Wilkinson-Ryan, *supra* note 45, at 1575.

[241] *See Kelo*, 545 U.S. at 500 (O'Connor, J., dissenting); Husing, *supra* note 120.

[242] *See Kelo*, 545 U.S. at 483–84; MRP Comment Letter, *supra* note 119, at 1.

[243] *See Kelo*, 545 U.S. at 493 (Kennedy, J., concurring).

[244] *See id.* at 483–84 (majority opinion); MRP FAQs, *supra* note 20. Opponents contest this point, claiming that the Plan is primarily intended to enrich MRP. Tambe et al., *supra* note 24, at 4; *see* Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 12. Despite these opponents' claims, law professors, economists, and politicians with no financial interests in the proposal have come forward supporting the Plan as beneficial to the public. Miller, *supra* note 18; *see* Reiss, *supra* note 19, at 5; Husing, *supra* note 120.

[245] MRP FAQs, *supra* note 20.

[246] *See* Gottlieb & Kim, *supra* note 20, at 4; MRP FAQs, *supra* note 20; *supra* note 138 and accompanying text. This fee is similar to the fee paid by the federal government to banks that modify mortgages under federal programs. MRP FAQs, *supra* note 20. More-

tors and MRP, compensating a private party for aiding implementation of the Plan does not take away from the overall public use element of the Plan.[247]

Although the Plan's constitutionality under the Takings Clause has been questioned, the Plan would almost certainly satisfy the public use prong of the Takings Clause.[248] The Plan's potential benefits, the deferential nature of public use review, and the lack of apparent impropriety all lead to the conclusion that the Plan serves a public purpose.[249]

B. *The Calculation of Just Compensation Will Determine the Plan's Fate*

Proponents would likely be successful in demonstrating the Plan's public use, but there is little margin for error in determining just compensation.[250] The current framework compensates lenders at the foreclosure sale price of the mortgage.[251] Given that this price is the lowest amount that a lender could receive for an underwater mortgage, it is

---

over, the fee is not paid by the municipality, but instead by investors, so MRP is not directly receiving public funds. *See id.*

[247] *See Kelo*, 545 U.S. at 477–90. For example, if compensating a private party to aid in implementing a public use project, the long recognized practice of taking land to construct public parks would no longer be considered a public use if contractors were required for construction. *See id.* In *Kelo*, the private company opening a research facility—largely paid for by public funds—was benefitting greatly, but the Court decided that the company was only aiding the city in its goal of economic revitalization. *See id.* at 492 (Kennedy, J., concurring).

[248] *See supra* notes 224–247 and accompanying text. Although rhetoric opposing the Plan speaks largely of redistribution norms, this discussion is largely irrelevant with regards to the Plan's constitutionality under the Takings Clause. Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 3; *see* U.S. Const. amend. V. If there are potential benefits to the public by condemning underwater mortgages, then the requirement is satisfied, regardless of whether private homeowners stand to benefit from condemnation of a bank's property. *See* Kelo, 545 U.S. at 484. Opponents also believe that the Plan could set precedent for municipalities to condemn rich peoples' property for the redistribution to the poor—that is unrealistic. *See id.* at 486–87; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 3. The just compensation requirement would minimize any potential harm to people whose property is being condemned for this kind of redistribution because the government must compensate the property owner before any possible redistribution takes place. *See* U.S. Const. amend. V; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 3. It would be nearly impossible for a municipality to condemn a rich community member's property for redistribution where the government would be forced to immediately compensate the community member for the lost property. *See* U.S. Const. amend. V; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 3.

[249] *See supra* notes 224–247 and accompanying text.

[250] *See* U.S. Const. amend. V; Durham, *supra* note 205, at 1285; Gottlieb & Kim, *supra* note 20, at 4.

[251] Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21; *supra* notes 127–128 and accompanying text (describing the compensation calculation under the Plan).

likely that courts will find this calculation inadequate.[252] Instead, courts will likely calculate just compensation to be the fair market value of the loan.[253] If, instead, courts calculate just compensation to be above the fair market value of the home, it would be impossible for the municipality to eliminate negative equity without expending additional funds.[254] Expending such additional funds—costs that the taxpayers would inevitably bear—would likely make the Plan politically impractical.[255]

Subsection 1 of this Section argues that the Plan's current calculation of just compensation inadequately compensates lenders and therefore does not pass constitutional muster.[256] Subsection 2 of this Section argues that if the Plan were altered to provide additional compensation to lenders, it ceases to be politically feasible.[257]

1. The Current Plan Does Not Provide Just Compensation

Based on traditional norms of just compensation, the calculation of just compensation would be determined by the fair market value of the mortgage.[258] Although the loan is issued for the home, the fair market value of the loan is not necessarily the fair market value of the home.[259] The proper determination of fair market value for the mortgage should be what a willing buyer would pay a willing seller at an arm's length transaction for the mortgage.[260] This calculation will likely

---

[252] *See* U.S. Const. amend. V; Durham, *supra* note 205, at 1285; Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21.

[253] *See* Durham, *supra* note 205, at 1291–92; Asper, *supra* note 26, at 496.

[254] *See* Gottlieb & Kim, *supra* note 20, at 4; *see also supra* note 148 and accompanying text (describing how only when a municipality pays under the fair market value of the home can the municipality ensure that it does not expend any additional funds to implement the Plan).

[255] *See* Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[256] *See infra* notes 258–283 and accompanying text.

[257] *See infra* notes 284–307 and accompanying text.

[258] *See* United States v. Miller, 317 U.S. 369, 374 (1943); Durham, *supra* note 205, at 1285.

[259] *See* Hockett, *supra* note 14, at 1 (arguing that the fair market value of the loan is significantly below the outstanding principal); Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7 (arguing that the fair market value of the loan is close to the outstanding balance plus anticipated interest payments). Although it could be easy to conflate the two ideas, they are very different. *See* Hockett, *supra* note 16, at 155; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7. The fair market value of the home is a fairly straightforward comparison of real estate appraisals. Asper, *supra* note 26, at 496. The fair market value of the mortgage—the crux of this discussion—is determined by what a willing buyer would pay a willing seller for the right to own the loan. *See Miller*, 317 U.S. at 374; Hockett, *supra* note 16, at 155; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[260] *See Miller*, 317 U.S. at 374.

be based on an independent valuation of the loans or based on what similar underwater loans are trading for on secondary markets.[261]

Advocates of the Plan propose that the fair market value of the mortgage is approximately 20–25% off the fair market value of the home.[262] This is the projected foreclosure sale price.[263] Advocates justify this price on the assumption that all of the underwater mortgages will eventually go through foreclosure.[264] If all of the underwater homes did go through foreclosure, proponents of the Plan argue that this would be the amount that the lenders would receive for the mortgages.[265] The fact that underwater mortgages have traded for this discount in secondary markets is used as further evidence of the correctness of this calculation of fair market value.[266]

It is very unlikely, however, that all underwater mortgages will go through foreclosure, despite this being an assumption necessary to make the foreclosure discount calculation under the Plan constitutionally adequate.[267] Most underwater mortgages which have been performing continue to perform, regardless of negative equity.[268] Further, despite the huge benefits, strategic default is still relatively rare among underwater homeowners.[269] As such, it is unlikely that just compensation will be calculated based on the assumption that all of the mortgages will end in default.[270]

Because not all underwater mortgages end in default, they will be valued at a price higher than this foreclosure sale price.[271] The foreclosure discount price is an estimate of the lowest possible value of the

---

261 *See* MRP Comment Letter, *supra* note 119, at 1–2 (arguing that the use of valuation methodologies employed by Fannie Mae and Freddie Mac could be used to calculate just compensation); MRP FAQs, *supra* note 20 (arguing that underwater mortgages being sold on secondary markets could be used as evidence to determine just compensation).

262 Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21; *supra* note 127 and accompanying text.

263 Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21; *supra* note 128 and accompanying text.

264 Gottlieb & Kim, *supra* note 20, at 4; Berry, *supra* note 21; *see* Smith, *supra* note 12.

265 *See* Gottlieb & Kim, *supra* note 20, at 4.

266 *See* MRP FAQs, *supra* note 20.

267 *See* White, *supra* note 6, at 971–72; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 7.

268 Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 7; *see* White, *supra* note 6, at 971–72.

269 *See* White, *supra* note 6, at 983. The stigma attached to foreclosure is strong and has led many homeowners to stay in their homes, even if not economically prudent. *Id.*

270 *See id.*; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 7.

271 *See* Durham, *supra* note 205, at 1285; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

mortgage.[272] Traditional just compensation of fair market value is not the lowest fire-sale price of the property—in this case the foreclosure discount price—but instead the price that a willing buyer would pay to a willing seller at an arm's length transaction.[273] A willing buyer would likely pay more than the assumed foreclosure sale price because that price only represents the lowest amount that the investment would recover.[274] If any of the mortgages continue to perform, they would necessarily be worth more than this minimum price.[275] Given that the mortgages are often worth more than this fire-sale foreclosure discount price, this valuation would be unlikely to pass constitutional muster.[276]

The instability in the mortgage markets may also lead courts to use a standard different than fair market value.[277] If courts truly felt that the application of fair market value principles resulted in injustice, the courts would have discretion to consult a different standard.[278] This alternative standard, however, would almost certainly result in greater compensation to lenders.[279] If a court decided that the value of an underwater mortgage in an arm's length transaction did not account for the full value of the property—given its value in diversifying risk in a securitized bundle, for example—lenders could be compensated in excess of fair market value.[280] Although a court may be sympathetic to underwater homeowners, it would be very unlikely for a court to use a standard different than fair market value in order to provide less compensation to the lenders whose mortgages are being condemned.[281]

---

[272] *See* Gottlieb & Kim, *supra* note 20, at 4. If home prices fell, the mortgages would actually be worth less than the foreclosure sale price. *See id.* The amount that would be recouped in case of foreclosure is based on what the home will sell for at auction minus transaction costs. *See id.* If home prices fell, mortgages that defaulted would be worth even less. *See id.*

[273] Durham, *supra* note 205, at 1284–85.

[274] *See id.* at 1285; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[275] *See* Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[276] *See* White, *supra* note 6, at 983; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 7.

[277] *See* United States v. 564.54 Acres of Land, 441 U.S. 506, 512 (1979).

[278] *See id.* One such example where fair market value would be an insufficient measure of just compensation would be in the case of property that is infrequently traded, which would make it too difficult to predict adequate prices because of the lack of previous transactions. *See 564.54 Acres*, 441 U.S. at 513.

[279] *See id.*

[280] *See id.*; Durham, *supra* note 205, at 1288.

[281] *See 564.54 Acres of Land*, 441 U.S. at 512; Durham, *supra* note 205, at 1288. Paying lenders less than the fair market value of the mortgage would likely not satisfy the just compensation requirement of the Takings Clause. *See* U.S. Const. amend. V.; Durham, *supra* note 205, at 1288.

The current Plan's foreclosure discount valuation of just compensation is constitutionally inadequate, because it is based on the faulty assumption that all underwater mortgages will default.[282] Given that most mortgages which are performing continue to perform regardless of negative equity, these mortgages would be worth more than this fire-sale valuation in an arm's length transaction, thereby compensating homeowners below what would be considered just compensation under the Takings Clause.[283]

2. The Eventual Calculation of Just Compensation Will Determine the Plan's Feasibility

The current Plan does not require municipalities to bear the costs of lowering principal on underwater mortgages.[284] Instead, the Plan proposes that lenders realize losses, which would allow the municipality to lower principal to below fair market value and avoid spending tax dollars.[285] If valuation of the mortgages is above the fair market value of the homes, it would be impossible for municipalities to adjust principal below fair market value without bearing some of the cost.[286] As such, the eventual calculation of just compensation will determine if municipalities can lower principal to eliminate a homeowner's negative equity without requiring taxpayers to expend additional funds to achieve this end.[287]

Although the foreclosure sale price would fail the just compensation requirement, the mortgages are also not worth the full value of the loan—the originally contracted principal plus interest.[288] This is true because underwater mortgages often end in foreclosure.[289] Moreover, owning a home with negative equity leaves homeowners with little margin for error, because refinancing is not available for emergencies.[290]

---

[282] *See supra* notes 258–276 and accompanying text.

[283] *See supra* notes 258–276 and accompanying text.

[284] Gottlieb & Kim, *supra* note 20, at 6.

[285] *See id.* at 4, 6; Sheridan, *supra* note 20, at 115. Importantly, if the amount lenders are compensated is accurately the fair market value of the loans, then the condemnation would not be causing losses for the lenders, but rather revealing already existing losses. Miller, *supra* note 19. Lenders oppose this realization, stating that it would force a mark to market event, where for accounting purposes they finally recognize the true value of these assets. Reiss, *supra* note 20, at 3. Although forcing banks to realize their losses is important to investors, it is irrelevant in determining constitutionality. *Id.*

[286] *See* Gottlieb & Kim, *supra* note 20, at 6; *supra* note 148 and accompanying text.

[287] *See* Gottlieb & Kim, *supra* note 20, at 6.

[288] *See* Goodman et al., *supra* note 15, at 29; Hockett, *supra* note 16, at 154–55.

[289] *Why Foreclosure Happens, supra* note 43; *see* Goodman et al., *supra* note 15, at 29.

[290] *See* Goodman et al., *supra* note 15, at 29; *Why Foreclosure Happens, supra* note 43.

Negative equity greatly increases the odds that these mortgages will end in foreclosure and decreases the value of the mortgages.[291] Furthermore, even though strategic default is not currently common, the fear remains that it will occur more often as information spreads and the stigma attached to foreclosure begins to fade.[292] Accordingly, even before any precipice of defaults occurs, the fear of this cascade of defaults could lower the value of the mortgages.[293]

Advocates on both sides of the debate will likely offer evidence to demonstrate why their valuation of just compensation is accurate, but in this economy it could be difficult for the trier of fact to determine a fair amount.[294] Advocates for the Plan claim that the value can be calculated at below the fair market value of the home by using the valuation methodologies used by Fannie Mae and Freddie Mac—quasi-government entities that oversee the mortgage industry.[295] Opponents, however, have highlighted that because performing loans generally continue to perform, many of these mortgages would be sold for significantly more than the fair market value of the underlying home.[296] With such systemic dysfunction in the marketplace it could be difficult to find a truly accurate value for a pool of underwater mortgages.[297]

The correct valuation is likely between the advocates' proposed fire-sale price and the lenders' proposed full principal plus interest.[298] Though there are legitimate arguments for using either valuation, the true value is likely somewhere in the middle.[299] If a court determines just compensation to be below the fair market value of the home, even if not 20–25% below, the Plan could still potentially eliminate negative equity.[300] Unfortunately for proponents of the Plan, if just compensation is valued at anything above the fair market value of the home, the

---

[291] *See* Goodman et al., *supra* note 15, at 29; *Why Foreclosure Happens*, *supra* note 43.

[292] *See* Crespi, *supra* note 14, at 179; Wilkinson-Ryan, *supra* note 45, at 1575; *see also* Hockett, *supra* note 16, at 134 (discussing real estate analysts' estimates that between 7.4 million and 9.4 million additional homes are at serious risk of default in the coming six years).

[293] *See* Crespi, *supra* note 14, at 179; Wilkinson-Ryan, *supra* note 45, at 1575.

[294] *See* Hockett, *supra* note 16, at 134; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7; *cf.* Jaconetty, *supra* note 69, at 235 (discussing the difficulty in finding an accurate valuation of home prices in the current real estate market).

[295] MRP Comment Letter, *supra* note 119, at 1–2.

[296] Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[297] *Cf.* Jaconetty, *supra* note 69, at 235.

[298] *See* Hockett, *supra* note 16, at 134; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[299] *See* Hockett, *supra* note 16, at 134; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[300] *See* Gottlieb & Kim, *supra* note 20, at 4.

Plan would be unable to get homeowners fully out of negative equity without additional funding.[301] Though modifying the principal down, even if not below fair market value, would provide some relief to the homeowners, it would likely remain insufficient to alleviate the fear of foreclosure.[302] Ironically, until strategic default becomes more common, which would further decrease the value of underwater mortgages, the just compensation for these mortgages will likely remain above the fair market value of the property thereby making principal reductions through the use of eminent domain economically impossible.[303]

Even if it would be impossible to use eminent domain to reduce principal without taxpayer money, the threat of it alone might be enough.[304] Currently, loan servicer incentives and pure inertia have prevented restructuring of these mortgages.[305] This has occurred despite the significant value in lowering principal of these mortgages to reduce the risk of default.[306] Perhaps the expense of litigation challenging the Plan will be enough to bring about mediation between the lenders and borrowers to come to an agreement on the fair value of these loans—hopefully preventing foreclosures while saving both parties ample time and money.[307]

Conclusion

With the federal government offering little help to families still struggling from the housing crisis, people are starting to look for alternative solutions. The Plan first proposed by Robert Hockett offers one such solution: using eminent domain to condemn mortgages with neg-

---

[301] *See id.*; *supra* note 148 and accompanying text.

[302] *See* MRP Comment Letter, *supra* note 119, at 3; Husing, *supra* note 120. It could be argued that the potential benefits of the Plan would no longer be attainable if the relief was merely that homeowners still remained underwater—albeit with less negative equity. *See* MRP Comment Letter, *supra* note 119, at 3; Husing, *supra* note 120. More problematic, however, is that such a modification to the Plan could, in effect, render the Plan no longer constitutional under the public use prong. *See Kelo*, 545 U.S at 491 (Kennedy, J., concurring) (discussing that the public benefit must be paramount in order to satisfy the public use prong).

[303] *See* White, *supra* note 6, at 971–72; Memorandum from Dellinger et al. to SIFMA, *supra* note 21, at 6–7.

[304] *See Don't Condemn Underwater Mortgages. Renegotiate.*, Bloomberg (Aug. 9, 2013, 12:06 PM), http://www.bloomberg.com/news/2013-08-09/don-t-condemn-underwater-mortgages-renegotiate-.html.

[305] *See id.*

[306] *See id.*; *supra* notes 79–81 and accompanying text (describing the incentives for lenders to modify loans).

[307] *See Don't Condemn Underwater Mortgages. Renegotiate.*, *supra* note 304.

ative equity. Under the Plan, municipalities would pay lenders 20–25% less than the current fair market value of the home to condemn the underwater mortgages. Municipalities would then adjust the principal on these mortgages to current market rates, thereby eliminating the homeowner's negative equity. This Plan has the potential to prevent foreclosures, reduce blight, and bring stability to the housing markets.

Despite the benefits of the Plan, the Plan most likely runs afoul of the just compensation prong of the Fifth Amendment's Takings Clause. To satisfy the just compensation requirement, the Plan would have to be amended to increase the amount of compensation provided to lenders. Increasing the amount of compensation is impossible, however, without requiring municipalities—and the taxpayers that they represent—to bear the burden of the Plan. As such, the increase would make the Plan politically and economically infeasible both because municipalities would lack the resources to contribute these additional funds and because taxpayers would object to this use. Instead, one can hope that the mere possibility that the Plan may be enacted—however unlikely that possibility may be—is enough to encourage banks and lenders to renegotiate and modify loans in an effort to save underwater homeowners from continuing to drown in their negative equity.

Andrew Peace