

INDUSTRY MEMBERS' PERSPECTIVES

Misusing Eminent Domain

By Danielle Fagre Arlowe,
American Financial Services Association (AFSA)

From the perspective of mortgage lenders, the increased use of eminent domain to seize mortgages is baffling and a cause for deep concern.

Eminent domain laws allow the state to take private property for public use. Lately, we have seen some municipalities, in partnership with a commercial enterprise, develop programs that use eminent domain to restructure mortgage obligations. The apparent intent behind this is to use eminent domain as a form of principal forgiveness for borrowers who are struggling to make their monthly payments.

We believe that this approach is chronically flawed, which is a view that is increasingly widespread. Some municipalities have already withdrawn attempts to use eminent domain in this way, as they have become informed of the challenges it would create. The Federal Housing Finance Administration has indicated that it could order Fannie Mae and Freddie Mac to cease doing business in areas “employing eminent domain to restructure mortgage loan contracts” and the Obama administration has announced that it is not clear whether mortgages seized by eminent domain would qualify for FHA financing. Considering FHA, Fannie Mae and Freddie Mac represent up to 90 percent of all new loans, it’s increasingly hard to make the case for using eminent domain to restructure mortgages.

There are other serious problems with these programs. Prime amongst them is that many of the loans marked for seizure are not delinquent. This makes a mockery of the programs’ declared aims to prevent foreclosure and blight, and leaves municipalities open to accusations that they are merely cherry picking good loans to refinance them (which makes a handsome profit for certain commercial enterprises). It also creates enormous extra risk for lenders, which face the prospect of having paying mortgages seized. This incentivizes lenders to abandon markets and increase prices.

Lender risk is significantly increased when one considers that these programs appear to depend on compensating lenders for seized loans at less than fair market value. As well as leaving municipalities on the hook for legal fees when investors challenge these valuations, this is an unconscionable interference in the marketplace.

The legal risk to the municipalities themselves is immense. We assume that these programs are intended to enhance local economies by reducing homeowners’ debt, but the Takings Clause of the Fifth Amendment wouldn’t appear to permit a government to seize a mortgage and redistribute it for the general purpose of improving conditions. And that’s exactly what this is about—using eminent domain to seize a mortgage, not the real property itself.

Since 2008, mortgage lenders, which typically lose money in foreclosure, have put significant resources into foreclosure prevention—supporting federal government initiatives, hiring new staff, and developing new methods for reaching out to borrowers. Eminent domain programs should be dropped in favor of support for these existing programs. Otherwise, the alternative is a great deal of legal wrangling that is unlikely to result in any real relief for those struggling to pay their mortgages. ■

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