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September 7, 2012

**SENT VIA EMAILTO:** eminentdomainOGC@fhfa.gov

Alfred Pollard, Esq.
Office of the General Counsel
Federal Housing Finance Agency
400 Seventh Street SW., Eighth Floor
Washington, DC 20024

Re: Comments on use of Eminent Domain to Restructure Performing Loans
Our Client: United Trustees Association

Dear Mr. Pollard:

This letter is written on behalf of the United Trustees Association ("UTA"). UTA's members include trustees under deeds of trust or mortgages, who provide reconveyance and nonjudicial foreclosure services for all types of lenders. In addition to providing education and legal updates to their members, UTA has been actively involved in legislative changes and in filing amicus curiae briefs before state and federal appellate courts. UTA is very concerned about the proposals to use the government's power of eminent domain to restructure performing mortgages on over-encumbered properties (i.e., "underwater properties"). UTA has joined with an industry coalition ("Industry Coalition")[1] opposing the use of eminent domain to acquire performing, underwater private mortgages and then to refinance and sell the mortgages to new private investors (i.e., resecuritizing loans). UTA adopts the comments of the Industry Coalition filed with the FHFA on September 7, 2012 and the legal opinion of Walter Dellinger et al, O'Melveny and Meyers LLP ("O&M Opinion") attached to the Industry Coalition Comments.[2] Therefore, our comments supplement the Industry Coalition's

[1] The coalition is comprised of American Bankers Association; American Council of Life Insurers; American Insurance Association; American Securitization Forum; Association of California Life and Health Insurance Companies; Association of Financial Guaranty Insurers; Association of Mortgage Investors; California Bankers Association; California Escrow Association; California Mortgage Association; California Mortgage Bankers Association; California Land Title Association; Community Mortgage Banking Project; Consumer Bankers Association; Consumer Mortgage Coalition; Inland Valleys Association of Realtors; Investment Company Institute; Mortgage Bankers Association; Residential Servicing Coalition; Securities Industry and Financial Markets Association; The California Alliance to Protect Private Property Rights; and the United Trustees Association.

[2] Hereinafter referred to as to the "Coalition Letter".

comments and will primarily, but not exclusively, focus on the practical problems that impact UTA members.

As we understand it, a private investment group called Mortgage Resolution Partners ("MRP") would provide or arrange funding for a government entity (like the County of San Bernardino) to seize by eminent domain performing, underwater mortgages where the current secured obligation exceeds the fair market value of the real property security (i.e., "MRP Proposal"). Recently, the MRP proposal has been expanded to include loans in default. MRP would administer the resecuritization of the loans and receive a fee for each loan. Under MRP's Proposal, the underwater mortgages would be condemned and "fair value" would be paid to purchase the underwater mortgages. MRP presumes that fair value would be approximately 75% - 80% of the value of the home. This discount is allegedly based upon the increased risk of default, the costs of foreclosure as well as other data. The secured property would then be refinanced by other private lenders or investors potentially at lower interest rates.

Even assuming that the MRP Proposal could be found to be constitutional, which we seriously doubt, condemning performing, underwater mortgages has numerous adverse consequences for current lenders or fund/pool securities holders (big and small); loan servicers; those providing default services; and for the public at large. Because of the miscalculation on the potential costs and risks of the MRP Proposal, any government entity adopting the MRP Proposal will undoubtedly increase the burden on its taxpayers.

**Impact on the Consumer Home Loan Financial Market.**

Borrowers, when purchasing property, generally receive the benefit of asset appreciation and take the risk of depreciation. Over time, most properties that have lost value begin to appreciate again. Most loans are for longer than 7 years. The MRP Proposal interrupts the normal loan life cycle and the opportunity for the value of the security to increase over time. Of course, any owner of real property would jump at the chance to enjoy the benefits of appreciation of the secured property while avoiding the consequences of depreciation in value. For borrowers who would qualify for the MRP proposed eminent domain program, the same result could be achieved by extending to a larger class of borrowers programs such as HARP 2 and applying such programs to loans held by private lenders. These programs better distinguish between borrowers who really need help as opposed to those who do not.

When making a loan to a borrower, many lenders consider both the value of the security and the "quality" of the borrower. The "quality" of the borrower is often determined by factors such as the borrower's credit scores, ability to pay, assets, default history, prior bankruptcies or even a lender's prior history with the same borrower. As such, the quality of the borrower increases the likelihood of payment even if the security depreciates or if it is foreclosed. If the only salient factor in whether a loan is paid off were the value of security, there would be no unsecured loans. However, a mortgage note is a contract between a borrower and a lender. Some people just honor their contracts even when they do not turn out well for them. Other borrowers honor their

contract because there are consequences of doing so beyond foreclosure of the collateral (i.e., impairment to credit or potential liability on the note). Many refinance loans or equity loans still pose the risk that a borrower may be subject to a deficiency judgment should he or she fail to perform.[3] This right of the lender to collect on the note where the security has been foreclosed or to obtain a deficiency judgment where the security is worth less than the secured obligation will be effectively lost if performing; underwater mortgages are allowed to be taken by eminent domain at discounted valuations. While deficiency judgments are rarely used in California, the removal of the lender's ability to resort to additional assets or income of the borrower will destroy many of the factors considered when determining the quality of the borrower. The use of eminent domain on performing, underwater mortgages deprives the lender (condemnee) of the potential of recovering on its loan (i.e., its contract) from other assets or income of the borrower other than those specifically hypothecated.

The current financial crisis in the housing market has already significantly reduced borrowers' access to financing, and the MRP Proposal will only exacerbate the problem. If the use of eminent domain to restructure mortgages becomes widespread, current lenders will be discouraged from making financing available to purchase or refinance residential housing. In addition, even where loans are available, it is likely that adoption of the MRP Proposal will depress loan-to-value ratios, making it even more difficult for consumers to purchase or refinance homes, thus dragging down the market even further. The use of low loan-to-value government insured or guaranteed loans would simple shift risk to the taxpayers.

The greatest harm will likely arise from removing performing loans from lenders' loan portfolios, leaving a larger percentage of non-performing loans on lenders' books. When combined with new state and federal laws imposing even more stringent "ability to pay" provisions, the lowering of the percentage of performing loans in a lender's or a lending pool's loan portfolio will substantially reduce the funds available for the purchase and refinancing of residential properties. The clients of UTA members include large and small lenders, mortgage pools and private investors whose loans are arranged by licensed real estate brokers. Many of these loans are funded by main street investors including pension plans, 401ks, small mortgage pools and or by retired investors. Any plan that focuses upon performing underwater loans will impact all loans portfolios but will have an inordinately large impact on small portfolios that could be decimated if the MRP Proposal extends to performing, underwater mortgages. While the eminent domain proposal would help the income stream for borrower participants, it will do just the opposite for pension plans and retired investors who rely on the income stream from the performing loans in their portfolio. If, as suggested recently, the MRP proposal were expanded to non-performing loans, it would deprive the investors of sharing in appreciation of the security over time, shifting losses from borrowers to many retired investors, pension plans and 401ks.

[3] Cal. Code of Civ. Proc. § 580b, 580d and 726.

**"Just Compensation": The Valuation Problem.**

Under both state and federal constitutions, the condemnee (mortgage holder) is entitled to "just compensation"[4] While the "taking" cannot be contested generally as long as it is for a "public purpose", the determination of "just compensation" is often challenged. In some states, such as California[5], the condemnee is entitled to a jury trial which, if not exercised, significantly increases the costs of trial and the likelihood of different results in similar cases. In addition, if the condemnee agrees to arbitration, the costs of arbitration must be paid by the condemnor (i.e., the government).[6] In California, the government must pay for up to $5,000.00 for the condemnee to obtain an independent appraisal.[7] These costs will tend to be near the maximum due to the dual appraisal necessary (i.e., discussed below).

The standard for just compensation is the "fair market value" of the property taken.[8] The eminent domain proposal suggests that potentially heavy discounts could be applied to existing loans that are condemned because of the greater risk of default. While there is certainly some increased risk of default when a property is over-encumbered, "quality" borrowers (i.e., those with good credit, other assets and sufficient income) with a history of paying his/her mortgage have a relatively low risk of default.

Assuming that the use of eminent domain could pass constitutional scrutiny, which seems highly unlikely, lenders will have the right to contest the valuation of the mortgage. As has happened with the use of eminent domain relating to real property (as opposed to mortgages), this will encourage a large number of lawyers to provide services to lenders to challenge overly aggressive lower valuations. In addition to the government having to pay for its appraisal, it will have to pay up to $5,000.00 to the lender or investor for independent valuations. Valuations will necessarily be complex, as they will involve two components or appraisals. Each property and each borrower is unique. While there is substantial experience in valuing real property, valuing the loan will be very problematic. Each loan will be unique depending on the credit history, assets, and payment history of the particular borrower. Many borrowers may be shown to have little or no risk of default. How will borrower information be obtained? MRP assumes that a standard formula can be used for every private mortgage. We doubt such an assumption will be adopted by courts.

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[4] U.S. Constitution 5th and Article 1, § 19.

[5] We use the California Eminent Domain Law (Cal. Code of Civ. Proc. §§ 1230.10 et seq.) as the example of state eminent domain laws due to the fact that many of the proposals for condemnation of mortgages have originated in California and because a large percentage of loans which would be subject to the proposal are California loans.

[6] Cal. Code of Civ. Proc. § 1273.010.

[7] Cal. Code of Civ. Proc. § 1263.025.

[8] Cal. Code of Civ. Proc. § 1273.310.

As in California, if a lender prevails on the valuation issue (i.e., is able to show the value is greater than the value provided by the government appraiser), the condemning party may be required to pay the condemnee his reasonable litigation expenses.[9] If in fact valuations of 75-80% as suggested in the MRP Proposal are used, lenders and investors will face substantial loan write-downs because these valuations do not represent "fair market value" of the loan. Undoubtedly, a huge number of cases will be filed by lenders and by investors challenging the government's valuations. Since a condemnee who successfully challenges the government's valuation may recover costs of litigation, many of these actions will be filed and lawyers will flock to represent lenders and investors in these type of actions (possibly on contingency agreements). The condemning entity invariably will have to increase its valuations for mortgage loans or risk further depletion of the state's valuable funds.

**Conclusion**

UTA believes that there is little good that can come from the MRP Proposal. The Proposal is basically the transfer of wealth or income from one private individual to another (i.e., from the lender/investor to the borrower). The impact on loan portfolios held by UTA members would be devastating particularly where performing (not defaulting) loans would be plucked from their loan servicing and loan portfolios. The consequences of the MRP Proposal will be lower loan-to-value ratios on non-government guaranteed or insured loans; taxpayer risk where the loans are government guaranteed or insured and reduced access to credit for borrowers seeking to buy or refinance a residential property. Ultimately, the costs of condemnation and of litigation that is sure to come will make the use of eminent domain a boondoggle for the government entities adopting the MRP Proposal (or similar proposals) and it will increase the burden on already over-burdened tax payers.

Very truly yours,

ADLESON, HESS & KELLY, APC

By: _____
Phillip M. Adleson

PMA/tlc

[9] Cal. Code of Civ. Proc. §§ 1250.410(b) & 1268.610.