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The Price of Crisis: Eminent Domain, Local Governments, and the Value of Underwater Mortgages

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Abstract

Governments at all levels in the U.S. have deployed a range of tactics to address some of the most pernicious effects of the Financial Crisis of 2008: namely, a loss of trillions in homeowner equity as well as the growth of the prevalence of underwater mortgages, where the outstanding principals on the mortgages exceed the value of the underlying properties. Among other tactics for addressing such impacts, local governments have begun to explore whether it is wise and legal to use the power of eminent domain to seize distressed home mortgages. This Article attempts to situate this approach to such mortgages within the larger economic, legal and policy context to determine whether this approach has a sound basis in law and policy. To do this, we deploy the tools of Comparative Institutional Analysis to assess the potential viability of using eminent domain to seize underwater mortgages. In doing so, we review the wide-ranging efforts of governments at all levels in the United States to deal with the economic effects of the Financial Crisis of 2008. We look at the relative success of these different tactics used by these governmental entities—from *ex ante* regulatory approaches to *ex post* law enforcement and civil litigation strategies—to assess the most effective tools available to remedy the economic and social problems posed by distressed mortgages. We then determine whether the use of eminent domain by localities is consistent with those governmental responses to the fallout of the Financial Crisis that have proven effective in responding to some of its worst impacts: here, the loss of homeowners' equity in their homes and the prevalence of underwater mortgages.

In carrying out this analysis we ask, and attempt to answer, five key questions. First, are local governments appropriate actors to address the lingering problem of underwater mortgages? Second, what has been the relative success of the range of tactics that governments at all levels have used to address underwater mortgages, including law enforcement strategies and legislative and regulatory measures? Third, assuming local governments are appropriate actors to address this problem, how should localities and, if necessary, courts, value underwater mortgages in the context of condemnation proceedings: i.e., what is the appropriate amount of compensation that localities should pay mortgagees and other lienholders when seizing underwater mortgages? Fourth, what are some strategies local governments can use to find the

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resources necessary to finance a program that would seize underwater mortgages and, in effect, purchase them from mortgage holders? Finally, what are some potential down-side risks to local governments taking these actions? This review concludes not only that local governments are appropriate actors to address underwater mortgages, but also that *ex post* legal tools—such as eminent domain—are appropriate and effective techniques to use to address the fallout from the Financial Crisis of 2008, particularly its impact on homeowners. It also finds that the just compensation due holders of distressed, underwater mortgages, should governments seek to seize them by eminent domain, should be roughly sixty percent of the unpaid principal balance on those mortgages.

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The Price of Crisis: Eminent Domain, Local Governments, and the Value of Underwater Mortgages.

Raymond H. Brescia[†]

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In September of 2013, the city council of the City of Richmond, California—a city located near San Francisco with a population of approximately 105,000 people[1]—became the first municipal legislative body in the United States to approve a plan to use that government's power of eminent domain to seize "underwater" mortgages: i.e., mortgages where the value of the outstanding debt held against the property exceeded the value of the underlying property itself.[2] Through such a plan, the city would seize underwater mortgages on such properties, pay fair market value for those mortgages, and then negotiate with the residents to write new mortgages on the properties.[3]

Other localities have considered taking this dramatic step, and advocates and scholars have argued that they should, saying that the use of eminent domain in this way is not just legal, but wise. According to the proponents of such an approach, the use of a locality's eminent domain power in this manner would help keep

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[1] Steve Stanek, *California City Okays Eminent Domain to Seize Underwater Mortgages*, HEARTLANDER. (Sept. 11, 2013), http://news.heartland.org/newspaper-article/2013/09/11/california-city-okays-eminent-domain-seize-underwater-mortgages.

[2] *See*, *e.g.*, Steve Stanek, *California City Okays Eminent Domain to Seize Underwater Mortgages*, HEARTLANDER. (Sept. 11, 2013), http://news.heartland.org/newspaper-article/2013/09/11/california-city-okays-eminent-domain-seize-underwater-mortgages; *California City Oks Plan to Seize Underwater Mortgages Using Eminent Domain*, NBC NEWS (Sept. 11, 2013, 11:00 AM), http://www.nbcnews.com/business/california-city-oks-plan-seize-underwater-mortgages-using-eminent-domain-8C11128804; *Richmond, California Backs Plan to Use Eminent Domain to Help Underwater Borrowers*, THE HUFFINGTON POST (Sept. 11, 2013, 8:14 AM), http://www.huffingtonpost.com/2013/09/11/richmond-california-eminent-domain_n_3905885.html.

[3] *Id*.

property owners in their homes and prevent foreclosures. In turn, such an approach may help the local economy by reducing the number of properties entering foreclosure, combatting neighborhood blight and maintaining property values for neighboring homes.[4] Critics argue—among other things—that mortgage interest rates would rise as a result of this approach, particularly if it were adopted widely, and that this course of action would increase litigation risk, as mortgagees challenged the takings in court.[5] Such costs would create a drag on economic development and impose significant burdens on local governments adopting this approach.[6] Opponents also argue that using eminent domain in this way constitutes an illegal use of that power, and that it "arguably violates the Contract Clause [of the U.S. Constitution[7]] because it entirely obliterates mortgage-based contract rights, including in connection with mortgage-backed securities."[8] Regardless of the opposition, the City of Richmond became the first in the nation to approve this arguably unorthodox use of the eminent domain power, and other municipalities across the country appear poised to follow this path as well.[9]

This Article attempts to situate this approach to underwater mortgages within the larger and lingering foreclosure crisis and asks—and attempts to answer—five interrelated questions that this use of eminent domain by localities raises. First, are local governments appropriate actors to address the lingering problem of underwater mortgages? Second, what has been the relative success of the range of tactics that governments at all levels have used to address underwater mortgages, including law enforcement

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[4] Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt*, FEDERAL RESERVE BANK OF NEW YORK, 19 CURRENT ISSUES IN ECONOMICS AND FINANCE (5) (June 10, 2013), *available at* http://www.newyorkfed.org/research/current_issues/ci19-5.pdf.
[5] Edward Burg, *Seizing Underwater Mortgages: An Idea That's All Wet*, AMERICAN BANKER (August 15, 2013), *available at* http://www.americanbanker.com/bankthink/seizing-underwater-mortgages-an-idea-that-is-all-wet-1061357-1.html.
[6] *Richmond, California Backs Plan to Use Eminent Domain to Help Underwater Borrowers*, THE HUFFINGTON POST (Sept. 11, 2013, 8:14 AM), *available at* http://www.huffingtonpost.com/2013/09/11/richmond-california-eminent-domain_n_3905885.html.
[7] U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .").
[8] *They Can't Do That, Can They? Constitutional Limitations on the Seizure of Underwater Mortgages*, JONES DAY (June 2012), *available at* http://www.jonesday.com/they_cant_do_that/.
[9] *See* Carrie Bay, *Eminent Domain Takes Root in Areas with High Unemployment, Poverty*, DSNEWS (Dec. 2, 2013), *available at* http://www.dsnews.com/articles/eminent-domain-takes-root-in-areas-with-high-unemployment-poverty-2013-12-02.

strategies and legislative and regulatory measures? Third, assuming local governments are appropriate actors to address this problem, how should localities and, if necessary, courts, value underwater mortgages in the context of condemnation proceedings: i.e., what is the appropriate amount of compensation that localities should pay mortgagees and other lienholders when seizing underwater mortgages? Fourth, what are some strategies local governments can use to find the resources necessary to finance a program that would seize underwater mortgages and, in effect, purchase them from mortgage holders? Finally, what are some potential down-side risks to local governments taking these actions?

To address these questions, this paper proceeds as follows. In Part I, we review the scope and causes of the Financial Crisis of 2008 (which we will call, simply, the Financial Crisis) and the ongoing foreclosure crisis embedded within it. In Part II, we address the role that governments at all levels—and each branch of those governments—have played and can play in addressing the lingering financial effects of these twin crises. We will pay particular attention to two interrelated consequences of the Financial Crisis: namely, the loss of homeowner equity as a result of the Crisis and the large number of underwater mortgages that have arisen as a result of this loss of equity. In this review, we emphasize the role of litigation and other legal actions to address these consequences of the Crisis. In this section, utilizing the tools of Comparative Institutional Analysis, we will attempt to address the first two questions posed above: i.e., what is the role of localities in addressing the fallout from the Crisis and what are some tactics that have proven effective in addressing the problem of underwater mortgages.

In Part III, we offer a brief overview of the government's power of eminent domain, explaining how the process works in many jurisdictions. We emphasize how the New York constitution and New York law in particular provide for this authority, and compare this state's eminent domain regime to that of California. While we discuss mostly how the constitutions and laws of these two states deal with the issue of eminent domain, we identify some of the key areas within the law of eminent domain where states are likely to agree, and where there may be state-level variations. We also discuss constitutional and statutory authority, as well as case law interpreting both, to identify the types of property subject to the power of eminent domain. In this Part, we return to the third of the two questions posed above: how to value underwater mortgages in the eminent domain process.

In Part IV, we address the question of how to fund an eminent domain program directed at underwater mortgages. Finally, in Part V, we address some potential negative consequences of localities adopting such a program.

I. The Course of the Financial Crisis.

Unlike the old adage about success having many parents while failure is an orphan, the causes of the Financial Crisis are legion, spanning many decades and unfolding over time from many different sectors: legislative bodies, financial institutions, homeowners, courts, and regulators. For our purposes, a brief overview of some of the causes of the Financial Crisis is warranted, though we do not wish to get too deep in the weeds on the topic; we will let others do that, and many have.[10]

In the 1980s and 1990s, a wave of deregulation created the legal infrastructure that made subprime mortgage products possible.[11] Mortgage lenders found ways to automate the

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10. For background on and overview of the financial crisis, see, generally, EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 9–35 (2007) (providing analysis of trends in homeownership from the 1940s to the 2000s); JOHN BELLAMY FOSTER & FRED MAGDOFF, THE GREAT FINANCIAL CRISIS: CAUSES AND CONSEQUENCES (2009); RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION (2009); ROBERT J. SHILLER, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT 29–38, 87–113 (2008) (attributing the subprime mortgage crisis to irrational expansion of housing values); MARK ZANDI, FINANCIAL SHOCK: A 360º LOOK AT THE SUBPRIME MORTGAGE IMPLOSION, AND HOW TO AVOID THE NEXT FINANCIAL CRISIS (2009) (reviewing origins of the financial crisis). Over the last two years, a raft of new works provide information about the deliberations of financial institutions and their regulators in the lead up to and immediate aftermath of the Financial Crisis, or provide outsider critiques of the government response to the crisis. These books include: SHEILA BAIR, BULL BY THE HORNS: FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF (2012); NEIL BAROFSKY, BAILOUT: HOW WASHINGTON ABANDONED MAIN STREET WHILE RESCUING WALL STREET (2012); JEFF CONNAUGHTON, THE PAYOFF: WHY WALL STREET ALWAYS WINS (2012); ANAT ADMATI & MARTIN HELLWIG, THE BANKERS' NEW CLOTHES: WHAT'S WRONG WITH BANKING AND WHAT TO DO ABOUT IT (2013); BEN S. BERNANKE, THE FEDERAL RESERVE AND THE FINANCIAL CRISIS (2013); ALAN S. BLINDER, AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD (2013); TIMOTHY F. GEITHNER, STRESS TEST: REFLECTIONS ON FINANCIAL CRISES (2014); and JENNIFER TAUB, OTHER PEOPLE'S HOUSES: HOW DECADES OF BAILOUTS, CAPTIVE REGULATORS AND TOXIC BANKERS MADE HOME MORTGAGES A THRILLING BUSINESS (2014).

11. Cathy Lesser Mansfield, *The Road to Subprime "Hel" was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity*

mortgage underwriting process, this allowed them to increase the volume of mortgages they could write.[12] They also created new mortgage products, products that became increasingly exotic and permitted lenders to increase the number of eligible borrowers by, in effect, lowering underwriting standards.[13] They accomplished this by offering products that would attract a wider pool of applicants, regardless of their ultimate ability to repay their mortgages.[14] These developments, coupled with innovation in mortgage financing (namely, the ability to securitize mortgages), meant the mortgage market could convert future income streams from mortgagor payments under a mortgage into liquid assets which would, in turn, fuel more mortgage underwriting.[15] Mortgage lenders and the brokers that assisted them in identifying prospective borrowers created compensation schemes that encouraged them to pursue loan volume over loan quality, using an "originate-to-securitize model": one crafted on what would ultimately be a Ponzi-like scheme.[16] Also in pursuit of fees, credit ratings agencies assessed and blessed these financial products with little regard for their ultimate value or viability.[17]

All of this happened at a time of easy credit: monetary policy that reduced bank borrowing costs so that they could, in turn, make more capital available to lend.[18] Such lowered borrowing costs, which were the product of lowered returns on Treasury bills, meant investors seeking higher rates of return were looking for investment opportunities, precisely at a time when home mortgage lending was starting to increase, through both new mortgage originations and mortgage refinancing.[19] Investment banks, seeing the soaring profits of subprime lenders and heeding the call of investors for more mortgage-backed securities, pushed lenders to generate more mortgages that the investment banks

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Market, 51 S.C. L. REV. 473, 492 (2000)

[12] Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 21-22 (2009).

[13] FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT, AUTHORIZED EDITION: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, xxiii (2011)(hereinafter, FCIC Report).

[14] KATHLEEN ENGEL & PATRICIA MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS, 1262 (2011).

[15.] *Id.* at 32–33.

[16] *See*, FCIC Report, *supra* note 13, at 8, citation omitted.

[17.] DANIEL GROSS, DUMB MONEY: HOW OUR GREATEST FINANCIAL MINDS BANKRUPTED THE NATION 50 (2009).

[18] Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 3-5 (2008)(identifying the ready availability of subprime mortgage credit as one of the causes of the Financial Crisis).

[19] *See* GROSS, *supra* note 17, at 13-20;

could package into securities and sell to eager investors.[20] In an effort to meet the demand of these investors for mortgage-backed securities, mortgage lenders sought new borrowers once they had reached as many viable—or "prime"—borrowers as they could. Mortgage brokers armed with exotic mortgage products, which they marketed aggressively, saddled less creditworthy borrowers with subprime loans.[21] The loans written for these borrowers would turn toxic, creating shocks throughout the finance chain.[22]

New sources of capital, new mortgage products, and lowered underwriting criteria pumped more capital into the home mortgage market; these forces ultimately created an asset bubble, one which would pop, fueling a dramatic drop in home values, rate shock (as adjustable rate mortgages became more onerous), and a credit freeze (meaning borrowers could not refinance their onerous mortgages). In a game of financial musical chairs, when the music stopped, there were no more chairs for banks and borrowers alike. At the risk of mixing metaphors, and in the words of one of this article's co-authors, "[w]ith so much riding on the strength of both the housing market and the underlying mortgages, the toxins from [faulty loans] entered the global financial bloodstream, setting off the current crisis."[23]

II. Government Actors, the Crisis and the Tools at Their Disposal to Address the Fallout from the Financial Crisis.

This review of some of the factors that helped bring about the crisis skated over, to a certain extent, the role that government might have played in the Crisis. For some, the implied government subsidies to the government-sponsored entities—Fannie Mae and Freddie Mac—helped to inflate the real estate bubble.[24] For others, lax enforcement of laws against predatory lending, and the pre-emption of many of those state laws by federal

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[20] Moran, *supra* note 12, at 24-25.
[21] Engel & McCoy, *supra* note 14, at 32.
[22] Moran, *supra* note 12, at 30–31.
[23] Raymond H. Brescia, *Tainted Loans: The Value of a Mass Torts Approach in Subprime Mortgage Litigation*, 78 CINC. L. REV. 1, 8 (2009).
[24] U.S. House of Representatives, Hearings Before the Committee on Financial Services, Subcommitee on Capital Markets and Government Sponsored Entities (Testimony of John L. Ligon, How Government Housing Policy Led to the Financial Crisis)(March 6, 2013). For an overview of federal intervention in the U.S. housing market, *see* Douglas J. Elliott, *The Federal Role in Housing Finance: Principal Issues and Policy Proposals*, in THE FUTURE OF HOUSING FINANCE: RESTRUCTURING THE U.S. RESIDENTIAL MORTGAGE MARKET (Martin Neil Baily, ed., 2011).

regulators, helped to unleash predatory lenders.[25] A full review of the different roles of government actors in helping to cause the crisis is beyond the scope of this review. Instead, what we hope to address is the potential role different government actors might play, moving forward, in addressing those elements we have chosen to focus on here: i.e., the lingering fallout from the crisis as it has impacted homeowners most directly, through the loss of homeowner equity and the corresponding growth of underwater mortgages.

For this discussion, we will utilize the tools of Comparative Institutional Analysis (CIA) to assess the role that governments at all levels can assume in addressing the lingering effects of the Crisis, and the relative effectiveness of the tools at their disposal for doing so.[26] CIA is a method of analysis that "asks which institution or combination of institutions is best suited to resolve" a public policy problem.[27] While the definition of the term "institution" may vary for some CIA scholars,[28] Komesar describes institutions as "large-scale social decision-making processes," which he outlines as "markets, political processes, communities, and courts."[29] He further divides institutions into "jurisdictional size": local, state and federal.[30] Of course, local, state, and federal governments have embedded within them executive, legislative and judicial branches, each with a different role to play in the larger institutions outlined by Komesar. For example, a state executive branch official, like a state attorney general, might bring litigation in a state or federal court. In this way, she may be embedded within a political process yet utilize adjudicative functions through the courts to attempt to resolve a pressing issue or dispute.

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[25] On federal preemption of state anti-predatory lending laws, *see* Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. Cin. L. Rev. 1303 (2016).
[26] The literature on comparative institutional analysis is legion. For a representative example of this scholarship, *see* NEIL K. KOMESAR, LAW'S LIMITS: THE RULE OF LAW AND THE SUPPLY AND DEMAND OF RIGHTS (2001).
[27] Christopher R. Edgar, *The "Traditional State Function" Doctrine: A Comparative Institutional Perspective*, NYU JOURNAL OF L. & LIBERTY 857, 871 (2005).
[28] For an overview of some of the varying definitions of the term institution in CIA, see Daniel H. Cole, *The Varieties of Comparative Institutional Analysis*, 2013 WISC. L. REV. 383 (2013). For example, Douglass North defines institutions as the "rules of the game." DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 3 (1990).
[29] KOMESAR, *supra* note 26, at 31.
[30] *Id.*, at 29.

In this Article, we will attempt to assess the relative effectiveness of different institutions, different branches of government, and different levels of government at achieving select public policy goals that have arisen in the wake of the Financial Crisis: namely, loss of homeowner equity due to the reduction in the value of their homes resulting from the Financial Crisis and the ongoing foreclosure crisis that has followed, as well as the overhang of mortgage debt that has produced a large number of underwater mortgages: one in six U.S. mortgages, or seventeen percent, by one recent count.[31]

In addition, our analysis will also go deeper into the tactics utilized by different levels and branches of government to solve these policy problems caused by the Financial Crisis. We will pay close attention to the use of *ex ante* statutes and regulations generated by political processes as well as litigation and other law enforcement mechanisms utilized by executive branches of government to address these problems.

This analysis will then situate the use of eminent domain to address the problems of underwater mortgages and lost homeowner equity within this larger context. We will refer to the use of eminent domain as an executive action. Admittedly, when an individual whose property has been seized by eminent domain wishes to challenge that action, that dispute is resolved in the courts. Nevertheless, for the purposes of a discussion about institutional choices and the effectiveness of institutional tactics, we will consider eminent domain a quintessentially executive action.

What follows is a discussion regarding the role of different institutional actors and tactics in addressing the economic and legal fallout from the Financial Crisis. As we have already stated, one of the main political, economic and policy problems created by the Financial Crisis and its aftermath, and one which we shall focus on here, is the problem of underwater mortgages: where a borrower owes more on her mortgage than the home securing the mortgage is worth. The problem of underwater mortgages threatens the health of the housing market as such mortgages are more likely to go into foreclosure, and they are a bellwether, generally, of the strength of that market.[32] The following discussion will thus focus

[31] ZILLOW REAL ESTATE RESEARCH, NEGATIVE EQUITY CAUSING HOUSING GRIDLOCK, EVEN AS IT SLOWLY RECEDES (August 25, 2014) *available at* http://www.zillow.com/research/2014-q2-negative-equity-report-7465/

[32] Contrary to what neo-classical economic theory says, however, despite a large number of borrowers being underwater, they have not "walked away" from their

on the relative success of different governmental institutions and institutional tactics in addressing the problem of underwater mortgages.

While a comparative institutional analysis of the ability of the market—as one of Komesar's institutions—to address underwater mortgages on its own might be appropriate to begin our discussion, such an analysis is beyond the scope of this Article. For our purposes, we wish to focus here on the potential role government can play in addressing the fallout from the Financial Crisis. Moreover, since the Financial Crisis was, in the words of Judge Richard Posner, a "failure of capitalism," it is hard to look simply to market forces to help restore financial order.[33]

A. The Federal Government.

The federal government has a central role to play in overseeing the financial system. Whether it is guaranteeing home mortgage loans, regulating monetary policy, or enforcing federal anti-trust and consumer protection laws, federal actors—regulatory agencies, Congress, the federal courts—are at the forefront of regulating financial institutions. Congress re-entered the fray in 2009-2010 in drafting the Dodd-Frank Act,[34] and, through that Act, created the Consumer Financial Protection Bureau.[35] In so doing, it took measures to prevent future crises. At the same time, it has not made great strides in taking action to rectify the problems caused by the Financial Crisis, however. Admittedly, while Dodd-Frank might help prevent the next crisis, it has done little to remedy the crisis-induced foreclosure tsunami, or the problem of negative homeowner equity. While some members of Congress promoted an effort to grant underwater homeowners the power to seek modifications of their mortgages in bankruptcy court—the so-called mortgage "cramdown" option—that effort failed in the

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mortgages—and their homes—in large numbers. For a discussion of this phenomenon, *see* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 2010 WAKE FOREST L. REV. 972 (2010).

[33] POSNER, *supra* note 10.

[34] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[35] *Id*., at Title X. For a discussion of the creation of the Consumer Financial Protection Bureau, see,Michael B. Mierzewski, *et al., The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection as the Primary Regulator of Consumer Financial Products and Services*, 127 BANKING L.J. 722 (2010).

Senate when sixty senators would not vote to bring the legislation creating this mechanism to a vote.[36]

Similarly, it would appear that federal regulatory agencies—at least those not shuttered after the Financial Crisis because they were so clearly captured by agency interests as to have helped banks engage in excessively risky actions (namely, the Office of Thrift Supervision)—have little role to play in addressing the fallout from the Crisis. While several of the regulatory agencies responsible for overseeing financial institutions have agreed that they will take into account the extent to which banks are assisting homeowners in mortgage relief programs when considering those banks' performance under the Community Reinvestment Act,[37] regulators, historically, have not used that law's regulatory framework to punish banks by any measure.[38] While there is much that regulatory agencies can do to oversee bank conduct moving forward, they have shown little appetite for taking action to ensure banks rectify the damage done to average consumers in the lead up to the Financial Crisis, and in the years that have followed, and it is not clear they are willing to take a strong position to do so now.

One executive branch agency taking steps to mitigate the crisis is the Treasury Department, through its array of programs designed to facilitate communication between homeowners in arrears on their mortgages and their loan servicers. The purpose of this communication is to encourage the two sides to come to some mutually beneficial resolution to disputes over mortgage arrears. The most prominent of such programs is the Home Affordable Modification Program: HAMP. As promoted by President Obama, it was believed that HAMP would serve as many as four million homeowners reach forbearance agreements with respect to their mortgages. HAMP has reached just a fraction of these homeowners, and very few homeowners have entered into agreements that actually realigned their mortgage debt with the value of the home that secures the mortgage.[39] In other words,

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[36] Maurna Desmond, *Cramdown Bill Fails in Senate*, FORBES, (April 20, 2009).
[37] 12 U.S.C. §2901, *et seq.* (2006). For background on judicial interpretation of the Bankruptcy Code regarding modification of mortgages, *see* Taub, *supra* note 10, at 108-118.
[38] For an overview of the Community Reinvestment Act and the role of regulators in using bank performance in modifying mortgages, *see* Raymond H. Brescia, *The Community Reinvestment Act: Guilty, but Not as Charged*, 88 ST. JOHN'S LAW REVIEW ___ (2014)(forthcoming), *available at*: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2227520.
[39] For an overview of the effectiveness of the HAMP program in meeting its stated goals, see SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET

HAMP may have helped some people delay their mortgage payments, but it has done little to generate actual mortgage modifications that included principal reduction.[40]

The executive branch can still play a role in ensuring that consumers who have suffered from predatory bank behavior are made whole by the entities that harmed them. Here, the Justice Department has played a lead role in pressuring banks to pay large fines in an attempt to make up for some of the harm caused to other federal and quasi-federal agencies (like the GSEs), investors, and, yes, homeowners. Some might argue that the sum total of the funds raised using Justice Department authority pales in comparison to the fallout from the Financial Crisis. Indeed, as described below, while the estimates of the losses in homeowner equity as a result of the Financial Crisis is estimated at over $9 trillion,[41] to date, Justice Department and other agency advocacy has resulted in more than $100 billion in fines and compensation.[42] Nevertheless, this executive branch agency has played a central role in getting banks to the negotiating table, even while it has been loathe to bring criminal action against bank actors, and the banks themselves.[43] Thus, the power of the Justice Department to bring litigation, and to threaten litigation, seems to have been one tool that has proven effective—at least when compared to the success of other efforts—in addressing some of the greatest impacts of the Crisis. We will return to these matters shortly.

B. State Governments.

Many states have been hard hit by the Financial Crisis. States have seen a reduction in sales tax revenue because of lower economic activity. Others, like New York, are dependent on the financial sector for income tax revenue, and the loss in revenue in

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RELIEF PROGRAM, RISING REDEFAULTS OF HAMP MORTGAGE MODIFICATIONS HURT HOMEOWNERS, COMMUNITIES & TAXPAYERS (July 24, 2013) *available at* http://www.sigtarp.gov/Audit%20Reports/Rising_Redefaults_of_HAMP_Mortgage_Modifications.pdf.

[40] For some of the critiques of the HAMP program's implementation, see Murrey Jacobson, *Obama's Foreclosure Program Slammed Anew for Ineffectiveness*, PBS NEWSHOUR: THE RUNDOWN (March 21, 2011), *available at* http://www.pbs.org/newshour/rundown/obamas-foreclosure-prevention-program-has-bullet-on-its-back/

[41] U.S. GOVERNMENT ACCOUNTABILITY OFFICE: REPORT TO CONGRESSIONAL REQUESTERS, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT, 21 (2013).

[42] *See, infra.,* text accompanying notes 65 through 73.

[43] See, Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted*, NEW YORK REVIEW OF BOOKS, (January 9, 2014).

that sector meant a reduction in government funds available for social services, education, and other programs generally provided by a state like New York.[44]

In terms of *ex ante* actions that might have prevented the Crisis, at the legislative level, states that had passed robust anti-predatory lending laws were pre-empted from applying them to certain types of federally regulated financial institutions.[45] After the fact, states—both legislatively and through attorneys general—have tried to find budget support for homeowner assistance, like legal services, housing counseling and financial aid.[46] As with federal intervention, states, often acting through attorneys general, have also used law enforcement strategies to bring banks to the table to resolve claims of predatory and discriminatory lending. Moreover, in a landmark settlement, forty-nine attorneys general and the Justice Department settled claims that five mortgage servicers—from some of the nation's largest banks—were responsible for the practice that came to be known as "robo-signing": i.e., fabricating court documents in mortgage foreclosure actions.[47] This settlement netted tens of billions of dollars in fines and a degree of financial relief for some homeowners affected by the practice.[48] The combined forces of the U.S. Justice Department and 49 state attorneys general reached this settlement with the banks without filing any legal actions; they simply negotiated these agreements after the mere threat of legal action.[49]

In addition, years before the Financial Crisis unfolded, New York's then-Attorney General Eliot Spitzer sought the authority to bring fraud investigations against certain federally regulated institutions, and his successor, then-Attorney General Andrew

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[44] MOODY'S INVESTOR SERVICES, RATINGS UPDATE: MOODY'S UPGRADES NEW YORK STATE GO AND PIT BONDS TO AA1, OUTLOOK STABLE (June 16, 2014)(noting New York State's dependence on revenue from the financial services sector) *available at* http://comptroller.nyc.gov/wp-content/uploads/2014/06/NYS-upgrade-6-16-142.pdf.
[45] Julia Patterson Forrester, *supra* note 25.
[46] THE PEW CHARITABLE TRUSTS, DEFAULTING ON THE DREAM: STATES RESPOND TO AMERICA'S FORECLOSURE CRISIS (April 2008), available at http://www.pewtrusts.org/~/media/legacy/uploadedfiles/wwwpewtrustsorg/reports/subprime_mortgages/defaultingonthedreampdf.pdf.
[47] For a description of robo-signing practices, see CONG. OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT, EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE MITIGATION 25 (Nov. 16, 2010), *available at* http://cop.senate.gov/documents/cop-111610-report.pdf.
[48] Alan J. Heavens, *$25 Billion Robo-Signing Settlement Reached with 5 Banks*, PHILADELPHIA INQUIRER (February 9, 2012).
[49] Joe Nocera, *Two Cheers for the Settlement*, NEW YORK TIMES, Feb. 17, 2012 (describing the robo-sign settlement as a "product of negotiation").

Cuomo, in a case that went to the U.S. Supreme Court, was successful in doing so. Although these actions did not prevent any improper conduct, the Court affirmed that the state attorneys general had authority to engage in oversight of federally regulated institutions in those areas commonly reserved to state government oversight, like fraud and discrimination.[50]

States have thus had some success in using litigation and law enforcement tactics to bring *ex post* actions to try to help alleviate some of the harshest economic consequences of the Financial Crisis and its aftermath. Once again, as is the case with federal government activities, it has been law enforcement and litigation tactics—not *ex ante* regulatory measures or executive actions designed to provide other forms of relief to homeowners—that seem to have had the greatest impact when it comes to remedying illegal conduct after it occurred.

C. Local Governments.

In terms of the Financial Crisis's impact on governments at different levels, local governments appear to have borne the brunt of the Financial Crisis. This impact starts at local property values, which are tied, inextricably, to local government revenues. As property values fall, and mortgagors fall behind on their mortgage payments, local coffers shrink.[51] A reduction in property values means that homeowners may pay less in property taxes. If they are not paying their mortgages, they are likely not paying their real estate taxes either. All of this starts with property values. And foreclosures are death on property values, as the following discussion shows.

A number of studies have attempted to assess the financial impact of foreclosures on neighboring property values. One study in Chicago in the late 1990s found that the value of single family homes within one-eighth of a mile of a foreclosed home fell by 0.9% to 1.136% for each foreclosure.[52] Indeed, with each foreclosure, the loss in value of neighboring homes—and thus the amount of wealth lost in a community due to each foreclosure—

[50] Cuomo v. Clearing House Association, LLC, 557 U.S. 519 (2009).
[51] For a discussion of the impact of foreclosures on local property tax revenue, *see* Joseph Alm, *et al.*, *How Do Foreclosures Affect Property Values and Property Taxes*, LAND LINES (January 2014).
[52] DAN IMMERGLUCK & GEOFF SMITH, WOODSTOCK INST., THERE GOES THE NEIGHBORHOOD: THE EFFECT OF SINGLE-FAMILY MORTGAGE FORECLOSURES ON PROPERTY VALUES 9 (2005), *available at* http://www.nw.org/foreclosuresolutions/reports/documents/ TGTN_Report.pdf.

amounted to between $159,000 and $371,000 per foreclosure.[53] The Federal Reserve Bank of Atlanta found that property values in the late 2000s, on average, were reduced by up to 1% due to nearby foreclosures; this reduction was, in part, the result of disinvestment in properties in foreclosure and delays in the foreclosure process.[54]

In the aggregate, as a result of these forces, the General Accounting Office estimates that American homeowners lost $9.1 trillion in home equity as a result of the Financial Crisis.[55] In addition, at least one study has shown that African-American and Latino communities have suffered a disproportionate loss in wealth, especially in more segregated communities.[56]

This loss in wealth impacts local governments—heavily dependent on property taxes, often one of their main sources of income—disproportionately. As property values decline, homeowners can typically petition their local governments to reduce the appraised value of their homes, and, in turn, their property tax bill. When homes go into foreclosure, property taxes often go unpaid. When homes stand vacant and abandoned, it is rare for a responsible party—whether the former homeowner, the bank, or some other entity—to pay the taxes. Indeed, it is often difficult for a local government to even find a responsible party, let alone collect taxes from him or her.[57]

Although local governments bear the brunt of much of the economic fallout from the Financial Crisis, particularly its impact on home property values, there are limited resources at their disposal to address this fallout. Some localities have instituted property registration requirements, so that servicers need to identify when they have taken ownership over a property through

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[53] *Id.* at 11.

[54] KRISTOPHER GERARDI, *ET AL.*, FORECLOSURE EXTERNALITIES: SOME NEW EVIDENCE, Federal Reserve Bank of Atlanta, Working Paper Series, 2012-11 (August 2012), *available at* http://www.frbatlanta.org/documents/pubs/wp/wp1211.pdf.

[55] U.S. GENERAL ACCOUNTING OFFICE, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT, REPORT TO CONGRESSIONAL REQUESTERS, 21 (January 2013), *available at* http://www.gao.gov/assets/660/651322.pdf.

[56] Jacob S. Rugh & Douglas S. Massey, *Racial Segregation and the American Foreclosure Crisis*, 75 AMER. SOCIOLOGICAL REV. 629, 644-646 (2010).

[57] U.S. CONFERENCE OF MAYORS, COMBATING PROBLEMS OF VACANT AND ABANDONED PROPERTIES: BEST PRACTICES IN 27 CITIES (June 2006) *available at* http://www.usmayors.org/bestpractices/vacantproperties06.pdf.

foreclosure.[58] Others have taken to engaging in demolition of vacant properties, or seizing them through tax foreclosure and trying to rehabilitate them, or to convince non-profit developers to do so, sometimes with financial incentives, sometimes without.[59] In any event, regulatory fixes, like property registration requirements, may do little to address the financial impacts of the Crisis on homeowners, and, in turn, local governments.

Other cities are exploring the adoption of so-called Responsible Lending Ordinances, a tactic that has been used by a small number of cities for some time, but that has gained some traction of late. These ordinances have taken different shape, but, typically, they involve a local legislative body imposing certain requirements or benchmarks on the banks with which that local government does business. By doing so, these legislatures are trying to use the power of the purse to channel financial institution behavior in ways that will have positive effects on those communities. Prior to the Crisis, these ordinances were only in effect in two cities—Cleveland and Philadelphia—and neither seemed to shield these cities from the impacts of the Financial Crisis. Except where cities have built metrics into their ordinances that address the fallout of the Financial Crisis (like the extent to which such institutions do or do not engage in mortgage modification practices), cities that have adopted such ordinances more recently may improve financial institution behavior within city limits in the future, but they will do little to address the most troubling aspect of the Financial Crisis for local governments: foreclosures.[60]

As with federal and state governments though, some intrepid local governments have taken action in the courts to rectify some of the most nefarious acts of the subprime mortgage frenzy, namely race-based, reverse redlining: targeting communities of color for loans on unfair terms. The discussion below lays out in greater detail the success of these efforts.

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[58] Federal Reserve Bank of Atlanta, The Evolution of Vacant Property Registration Ordinances across the United States (Podcast Transcript) *available at* http://www.frbatlanta.org/podcasts/transcripts/perspectivesonrealestate/121205_immergluck.cfm (describing property registration programs).
[59] *See*, U.S. Conference of Mayors, *supra* note 57.
[60] For an overview of responsible banking ordinances, see, Raymond H. Brescia & Sonia Steinway, *Scoring the Banks: Building a Behaviorally Informed Community Impact Report Card for Financial Institutions*, 18 FORD. J. OF CORP. & FIN. L. 339, 353-358 (2013).

D. Using a "Mass Torts" Approach in Response to the Lasting Effects of the Financial Crisis.

As the previous discussion shows, the tactics that seem to have had the most purchase in terms of addressing, *ex post*, the problem of underwater mortgages spawned by the Financial Crisis seems to be litigation and law enforcement efforts: both the bringing of lawsuits and creating pressure through investigations and the threat of lawsuits. As has been argued elsewhere by one of the co-authors of this Article,[61] the cases governments are filing and the investigations they are commencing and resolving possess features that are commonly referred to as "mass torts." In a mass torts context, litigation (or similar tactics) can effectuate sweeping relief to a wide range of victims through procedural mechanisms that lead to global settlements of complex social disputes. According to Deborah Hensler, some of the key features of this category of cases are as follows: numerosity, commonality, interdependence of case values, controversy over causation, emotional or political heat, and higher than average claim rate.[62] Mass torts litigation can also involve the use of techniques to adjudicate questions of liability, causation, damages, and compensation in the aggregate.[63] As the following discussion shows, the successful outcomes of many Financial Crisis cases and investigations, the size of the settlements, and the manner in which litigants and the courts are dealing with them, suggest that they deserve classification as mass torts.

1. Financial Crisis Products: More Toxic than Asbestos.

Asbestos litigation holds a special place in the pantheon of mass torts.[64] A 2005 study by the RAND Corporation estimated the cost of roughly thirty years of asbestos litigation to have reached seventy billion at that time.[65] Yet just seven years of

[61] See, Raymond H. Brescia, *Tainted Loans: the Value of a Mass Torts Approach in Subprime Mortgage Litigation*, 78 U. CIN. L. REV. 1 (2009).
[62] Deborah R. Hensler, *A Glass Half Full, a Glass Half Empty: The Use of Alternative Dispute Resolution in Mass Personal Injury Litigation*, 73 TEX. L. REV. 1587, 1596 (1995) (footnotes omitted).
[63] For a discussion of such techniques, see Judith Resnik, *From "Cases" to "Litigation,"* 54 LAW & CONTEMP. PROBS. 5, 25–40 (1991).
[64] *See, e.g.,* Gerald W. Boston, *A Mass Exposure Model of Toxic Causation: The Content of Scientific Proof and the Regulatory Experience*, 18 COLUM. J. ENVTL. L. 181, 196 (1993)(referring to asbestos litigation as the "quintessential 'mass' tort").
[65] STEPHEN J. CARROLL, *ET AL.*, ASBESTOS LITIGATION, Rand Institute for Civil Justice (2005).

litigation over practices in the lead up to the Financial Crisis has exceeded that amount. Indeed, a study by *The Economist* tallies the cost of financial litigation in the wake of the financial crisis, as of the end of 2013, at nearly $100 billion,[66] and there have been several high-profile actions in recent months, which add another $20 billion to the price tag. Although some expect the cost of asbestos litigation to continue to climb over the coming decades, and reach an estimated $200 billion, pending mortgage litigation could outpace that figure in just the next year.

In November 2013, the Justice Department and other government entities reached a $13 billion settlement with JPMorgan Chase for claims of faulty disclosures related to mortgage-backed securities.[67] That same month a jury in Manhattan found Bank of America (BofA) liable for the conduct of its subsidiary, Countrywide, for misconduct in the waning days of the mortgage frenzy, and the federal government, which first asked the judge in that case to penalize BofA $864 million following that verdict, later increased its request to over $2 billion.[68] This amount is relatively small compared to the nearly $50 billion BofA alone has paid out over the last few years, mostly for the misconduct of Countrywide Financial and its affiliates.[69] BofA purchased Countrywide during the peak of the subprime market, and now it is being held responsible for a range of practices exhibited by that mortgage lender during the market's expansion. But that verdict would be followed by yet another BofA settlement; the BofA $50 billion price tag in Financial Crisis litigation increased over 30% in August of 2014, as it agreed to settle with the Justice Department for more than $16 billion to resolve outstanding Financial Crisis legal claims.[70]

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[66] The Economist, *Mortgage-Related Bank Fines: Payback Time for Subprime* (October 16, 2013).
[67] U.S. Department of Justice Press Release, *Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages* (November 19, 2013), *available at* http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html.
[68] Halah Touryalai, *Change of Heart: DOJ Wants $2 Billion Instead of $864 Million in BofA Fraud Case*, FORBES, January 30, 2014, *available at* http://www.forbes.com/sites/halahtouryalai/2014/01/30/change-of-heart-doj-wants-2b-instead-of-864m-in-bofa-fraud-case/
[69] The Economist, *supra* note 66.
[70] Press Release, U.S. Department of Justice, *Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis* (August 21, 2014), available at: http://www.justice.gov/opa/pr/2014/August/14-ag-884.html

In addition, as discussed above, five of the biggest banks settled for $25 billion to resolve potential claims in the so-called "robo-sign" scandal in which low-level bank officials fabricated documents in the course of foreclosure litigation. In July 2014, the Department of Justice settled with Citigroup to resolve claims similar to those levied against JPMorgan Chase and BofA; the price tag for that settlement: $7 billion.[71] Finally, at the time of this writing, the Department of Justice is using these settlements to pressure other banks to enter into a new round of talks to attempt to resolve outstanding mortgage claims.[72]

In addition to the threat of additional litigation against other banks, the Federal Housing Finance Administration (FHFA) still has pending actions against several banks. FHFA had originally filed claims against seventeen banks seeking nearly $200 billion in damages.[73] While some of the settlements described above were the product of these cases, and FHFA has settled with several more banks, including a $3.5 billion settlement with Goldman Sachs, also in August 2014, there are still actions pending against a small number of banks,[74] which, if they are resolved as well, would increase even more the payout from Financial Crisis litigation.

In the mass torts context, litigants pursue sweeping claims and often resolve them through broad and far-reaching settlements. The goals of mass torts litigation can vary, but by using mass torts techniques, litigants—plaintiffs and defendants alike—can bring about meaningful relief to victims and financial peace for defendants. Through such techniques, litigants can avoid the unpredictability and cost of case-by-case adjudication. They are able to resolve cases in ways that they manage, ways that often allow defendants to get meaningful relief to victims through mechanisms that resolve claims along pre-determined metrics. Many of the settlements described above have included claims

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[71] Anthony Narula & Philip R. Stein, *Citigroup Settles with DOJ for $7 Billion*, NATIONAL LAW JOURNAL (July 23, 2004), *available at* http://www.natlawreview.com/article/citigroup-settles-doj-7-billion.

[72] Aruna Viswanatha & Karen Freifeld, *U.S. Using JPMorgan Penalty to Speed Cases against Other Banks*, REUTERS (June 11, 2014), *available at* http://www.reuters.com/article/2014/06/11/us-us-mortgage-banks-investigation-idUSKBN0EM29820140611.

[73] Augustino Fontevecchia, *FHFA Sues 17 Banks over Massive Mortgage Losses at Fannie and Freddie*, FORBES, (September 2, 2011), *available at* http://www.forbes.com/sites/afontevecchia/2011/09/02/fhfa-sues-17-banks-over-massive-mortgage-losses-at-fannie-and-freddie/.

[74] Nathanial Popper, *Goldman to Pay $3.15 Billion to Settle Mortgage Claims*, NEW YORK TIMES (August 22, 2014) *available at*: http://dealbook.nytimes.com/2014/08/22/goldman-to-pay-3-15-billion-to-settle-mortgage-claims/.

facilities: systems through which individual victims of bank abuse could pursue relief along pre-determined paths.

Trials in Financial Crisis litigation have been rare, with the BofA verdict from last November being one of those exceptions. Indeed, most of the roughly $120 billion in claims that financial institutions have agreed to pay have come in the form of settlements, and through these settlements, banks are distributing a portion of these funds to victims of mortgage abuses.[75] Because of this, Financial Crisis litigation appears to bear the hallmarks of toxic tort litigation. Banks are entering into broad-ranging settlements in an effort to resolve sweeping claims and deliver financial benefits to a large number of beneficiaries through aggregated claims facilities.

2. Localities as Litigants

It is not just the Department of Justice and some state attorneys general that are engaged in mass tort litigation in the wake of the Financial Crisis. Cities are getting in on the act as well. Since early English common law, local governments have used their power to bring nuisance litigation to prevent harmful actions, from unsafe driving of horses, to the pollution of streams and wells.[76] Long before the advent of zoning and building codes, local governments used the power of the courts to curtail harmful practices that affected resident quality of life, like the operation of a slaughterhouse in a residential neighborhood, or a factory releasing too much smoke or dust.[77] In modern times, local governments have attempted to use the courts, with varying degrees of success, to fight the proliferation of illegal handguns, to combat climate change, and to counter predatory lending.[78] In this last arena, several localities are now using the nation's fair lending laws to recoup some of the losses from bank actions that they have claimed constitute reverse redlining.

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[75] Admittedly, the authors are under no illusion that homeowners have received over $120 billion in relief in the wake of these settlements, far from it. For just one critique of the settlements and their impact on homeowners, see, Vauhini Vara, *Overselling the Settlement*, THE NEW YORKER (August 25, 2014).

[76] *See, e.g.,* Restatement (Second) of Torts, §821B com. a. (1979) (describing historical scope of nuisance actions).

[77] For an overview of the history of nuisance law in American jurisprudence, Jeff Lewin, *Boomer and the American Law of Nuisance: Past, Present, and Future*, 54 ALB. L. REV. 189 (1990).

[78] For an overview of modern trends in nuisance litigation, *see* Raymond H. Brescia, *On Public Plaintiffs and Private Harms: The Standing of Municipalities in Climate Change, Firearms and Financial Crisis Litigation*, 24 NOTRE DAME J. OF L. ETHICS & PUB. POL'Y 7 (2010).

In two such cases, the first filed by the Mayor and City Council of Baltimore, Maryland, and the second, filed jointly by the City of Memphis and the surrounding Shelby County, Tennessee, these local governments charged Wells Fargo bank as having engaged in reverse redlining. As a result of these practices, the plaintiffs alleged, the cities suffered because of diminished property values and increased blight.[79]

Of course, these allegations are not unique to these cities. A Federal Reserve study[80] of mortgage lending in 2006 shows that African-American borrowers were nearly three times as likely in that year to enter into a subprime loan as compared to Whites. Even controlling for many borrower characteristics, including income, African-American borrowers were still twice as likely as Whites to take out a subprime loan. This pattern occurred more frequently in middle-income, African-American communities. A study[81] conducted by the *New York Times* of lending in the New York City region found that middle-income African-Americans were roughly six times as likely to take out a subprime loan as Whites of similar, or even lower, incomes. Research conducted by one of the co-authors of this Article revealed a connection between African-American median incomes and foreclosure rates; the higher the African-American median income in a state, among other factors, tended to correspond with a higher foreclosure rate.[82] These last findings suggest that predatory lending was more prevalent in states with a larger and wealthier African-American middle class.

Apart from mere statistics, the plaintiffs in the Baltimore and Memphis/Shelby County cases produced affidavits from former Wells employees as evidence of discrimination at the bank. These affidavits alleged that officials at the bank referred to

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[79] For a description of the allegations in the Memphis/Shelby County and Baltimore litigation, *see* Michael Powell, *Memphis Accuses Wells Fargo of Discriminating against Blacks*, NEW YORK TIMES (December 30, 2009) *available at* http://www.nytimes.com/2009/12/31/us/31wells.html.

[80] Robert B. Avery, et al., The 2006 HMDA Data (December 2007), available at http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf

[81] Michael Powell & Janet Roberts, *Minorities Affected Most as New York Foreclosures Rise*, NEW YORK TIMES (May 15, 2009) *available at* http://www.nytimes.com/2009/05/16/nyregion/16foreclose.html

[82] Raymond H. Brescia, *The Cost of Inequality: Social Distance, Predatory Conduct, and the Financial Crisis*, 66 N.Y.U. ANNUAL SURVEY OF AMERICAN LAW 641 (2010) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1661746

subprime loans as "ghetto loans" and borrowers of color as "mud people."[83]

In May of 2012, Wells Fargo agreed to settle the claims filed by Baltimore and Memphis and Shelby County. Wells has committed to making hundreds of millions of dollars in loans available in Memphis and surrounding Shelby County, a portion of which will go to low- and moderate-income borrowers.[84] Wells also reached an agreement with Baltimore that will bring over $7 million in lending assistance to homeowners in that city.[85]

Municipal and county litigants are not the only ones pursuing reverse redlining litigation. In late December, 2011, the Justice Department and the Attorney General of the State of Illinois settled reverse redlining lawsuits against Countrywide and BofA. That settlement set up a fund of $335 million to be used to compensate borrowers of color illegally steered into subprime loans when they could have qualified for loans on better terms.[86] The DOJ also resolved an investigation of practices at SunTrust bank's mortgage unit; to resolve that investigation, SunTrust agreed to set up a $12 million fund to compensate victims.[87]

3. Eminent Domain as a Potential Response to the Underwater Mortgage Problem.

As we show above, the use of litigation and law enforcement tactics, and even the threat of such action, has likely had the most relative success of any tactic deployed by any governmental actor in addressing the problem of underwater mortgages and homeowner loss of mortgage equity. Government

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[83] Michael Powell, *Bank Accused of Pushing Mortgage Deals on Blacks*, NEW YORK TIMES (June 6, 2009), *available at* http://www.nytimes.com/2009/06/07/us/07baltimore.html?pagewanted=all.

[84] Dakin Campbell, *Wells Fargo Pledges Investment to End Memphis Lawsuit*, BLOOMBERG (May 29, 2012), *available at* http://www.bloomberg.com/news/2012-05-29/wells-fargo-promises-more-than-435-million-to-end-memphis-suit.html.

[85] Relman, Dane & Colfax PLLC Press Release, *Baltimore Settles Landmark Fair Lending Case Against Wells Fargo*, *available at* http://www.relmanlaw.com/civil-rights-litigation/cases/baltimore-settles.php (last visited, July 23, 2014).

[86] CBSnews.com, *Bank of America Settles Discrimination Suit for $335M* (December 21, 2011) *available at* http://www.cbsnews.com/news/bank-of-america-settles-discrimination-suit-for-335m/.

[87] Department of Justice Press Release, *Justice Department Reaches $21 Million Settlement to Resolve Allegations of Lending Discrimination by Suntrust Mortgage* (May 31, 2012), *available at http://www.justice.gov/opa/pr/2012/May/12-crt-695.html.*

actors at all levels appear to have utilized such tactics, from the Department of Justice and the Securities and Exchange Commission, to state attorneys general and local government entities, like the City of Baltimore, MD, and Shelby County, TN. From the multi-billion dollar settlements with the biggest banks to smaller agreements with banks like SunTrust, government actors have had some success using litigation and law enforcement tactics, like conducting governmental investigations, to address the economic problems still plaguing many homeowners as a result of the Financial Crisis. Now, local governments throughout the country are considering deploying a new legal tactic to help address the problem of underwater mortgages; they are considering using eminent domain to seize underwater mortgages, compensate the mortgagees, and repackage those mortgages to bring them in line with the current value of the underlying mortgage. It is to this approach that we now turn.

In the early days of the Financial Crisis, Howell Jackson first raised the prospect that the federal government might seize underwater mortgages through eminent domain and then rewrite them, realigning the value of the mortgage with the underlying property values, and entering into a new mortgage with the homeowner on fair terms.[88] A major benefit of using eminent domain in this way is not simply the re-alignment of property values with mortgage values, but this tool helps to cut the Gordian knot of mortgage securitization, pooling and servicing agreements, servicer incentives, and the existence of second liens that all make voluntary mortgage modifications with principal reductions difficult to impossible. Indeed, the barriers created by the transaction costs associated with negotiating with all interested parties—which can number in the hundreds with respect to a single mortgage—are practically insurmountable. Even though it may be in the best interests of both mortgagor and mortgagee to help the homeowner stay in his or her home, through forbearance or principal reduction, it is often difficult to bring all of the parties together to execute an effective mortgage modification. This problem is particularly acute with securitized mortgages. As Robert Hockett points out: "While it would be no less rational or beneficial to write these loans down, certain structural features of the loans—features that now act as market failures—prevent the rational thing from being done."[89]

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[88] Howell E. Jackson, *Build a Better Bailout*, CHRISTIAN SCIENCE MONITOR (September 25, 2008), *available at* http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html.
[89] Hockett, *supra* note 4, at 3.

Given the relative success of other legal approaches to help deliver some modicum of relief to distressed homeowners, is eminent domain a tactic governmental institutions can use to improve homeowner outcomes in the wake of Financial Crisis fallout? As the discussion in the previous section shows, litigation, investigations, and the threat of both have resulted in over $120 billion in settlements to resolve Financial Crisis-related claims against large banks. Agencies and law enforcement officials have used an array of legal tools—claims of fraud, criminal conduct, discrimination, and violation of securities laws—to use the law as leverage to exact these settlements. As has been seen with other tactics, like civil litigation and criminal prosecutions, that might help institutions address the economic problems created by the Financial Crisis, perhaps the specter of eminent domain actions, whether a government actor goes through with them, might be enough to help bring about effective responses to the problem of underwater mortgages.

Since the political winds in Washington do not seem to favor an eminent domain program instituted by the federal government, Robert Hockett has called for localities to step in where the federal government has not to use eminent domain to seize and repackage underwater mortgages.[90] The following Parts of this Article address some of the possibilities such a plan opens up and some of its potential ramifications.

III. Valuing Underwater Properties in Eminent Domain Proceedings.

A. The Eminent Domain Process.

The Fifth Amendment of the United States Constitution provides that private property shall not "be taken for public use, without just compensation."[91] This constitutional provision gives the federal government the right to condemn private property as long as it is to benefit the public, and provided "just compensation" is paid to the owner.[92] State governments are not prohibited from

[90] Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery."* 18 STANFORD J. OF L., BUS., AND FIN. 121 (2012):
[91] U.S. CONST. amend. V.
[92] In *Kelo v. City of New London*, the U.S. Supreme Court validated two elements of the takings power that come into play in the use of the power to seize underwater mortgages: whether blight reduction is a legitimate "public

taking property through the eminent domain power under the Fourteenth Amendment, as long as they provide an appropriate process for doing so.[93] The power itself is codified in the constitutions or statutes of most states,[94] and is one of the powers reserved by the states through the 10th Amendment to the U.S. Constitution.[95] The power of eminent domain can be delegated to local governments by the state in which they are located, either through the express terms of a state constitution or by statute.[96]

The amount the government entity (the condemnor) must pay to the condemnee—the "just compensation" required by the law—is generally measured by the fair market value of the property at the time of the taking through eminent domain.[97] The

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use" of the power and whether a public entity can transfer seized properties to private entities. 545 U.S. 469 (2005). While forty-two states have passed *post-Kelo* legislation to reign in what some state legislators saw as the excesses of *Kelo*, it is not clear that such legislation, barring Florida's, would appear to limit the power of local and state governments to transfer properties to private entities, if that is what a condemning government does once it condemns a distressed mortgage. *See, e.g.* Fla. Stat. §73.013 (may only "be conveyed by the condemning authority or any other entity to a natural person or private entity, by lease or otherwise" in very limited circumstances). For a review of *post-Kelo* legislation, *see* Andrew P. Morriss, *Symbol or Substance? An Empirical Assessment of State Responses to* Kelo, 17 SUP. CT. ECON. REV. 237 (2009).

[93] U.S. CONST. amend. XIV, § 1 ("[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . . .").

[94] *E.g.*, N.Y. CONST. art. I, § 7 ("Private property shall not be taken for public use without just compensation.); Cal. CONST. art. I, § 19 ("Private property may be taken or damaged for a public use and only when just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner."). For a description of state eminent domain provisions in constitutions and statutes, *see* 1 NICHOLS ON EMINENT DOMAIN § 1.3, at 1-95 (3d ed. 2004).

[95] U.S. CONST. amend. X.

[96] *E.g.*, N.Y. CONST. art. IX, § 1 ("Local governments shall have the power to take by eminent domain private property within their boundaries for public use . . . ."). *See* N.Y. GEN. MUN. LAW § 74 ("A municipal corporation authorized by law to take and hold real property for the uses and purposes of the corporation, may, if it is unable to agree with the owners for the purchase thereof, acquire title to such property by condemnation."). *See also* Kohlasch v. New York State Thruway Authority, 482 F.Supp. 721, 723 (S.D. N.Y. 1980) ("The power to condemn is a sovereign, not municipal function. However, in New York that power has long been delegated to cities and to municipalities.").

[97] *See, e.g.,* School Dist. #13 of Town of Huntington v. Wicks, 227 N.Y.S.2d 768, 771 (Sup. Ct. 1962); Application of Westchester County, 127 N.Y.S.2d 24, 34 (Sup. Ct. 1953). *See also* 4 NICHOLS ON EMINENT DOMAIN § 12.01 ("The 'just compensation' to which such owner is entitled has been held to be the *value* of the property at the time it is acquired . . . ."). *But see id.* ([I]t also has been judicially recognized that the use of market value as a measure is not constitutionally mandated. . . .") In certain situations, where there may not be an ascertainable market, courts can award just compensation based on a property's actual or intrinsic value. *See*, *e.g.*, Keator v. State, 23 N.Y.2d 337, 339–40 (1968) (stating in cases where there is no ascertainable market nor testimony as

policy behind paying the owner fair market value for his or her property is to put the person in the same relative position as if the taking had not occurred: i.e., if he or she had to sell the property on the open market at the time of the taking.[98] It is the duty of the condemnor to determine and provide just compensation to property owners whose property the condemnor wishes to seize through eminent domain.[99]

While a review of the particular processes utilized to complete a constitutional taking in those states in which eminent domain is permitted is beyond the scope of this Article, we will look at how one state, New York, handles the exercise of the eminent domain power to provide a basic overview of one state's process. While there are, indeed, state-by-state differences in the manner in which eminent domain proceedings are undertaken, this overview helps to highlight some of the key components of the process in most states. We will use New York's statutorily defined process as a lens through which to view the process generally, with the understanding that the details of each state's approach might differ in small or large ways from New York's process. As we describe New York's process, we will attempt to highlight some of the areas where other states may diverge from New York's approach.

In New York, condemnors—either the state or local government—must adhere to certain requirements when they attempt to take land for public use. First, prior to the acquisition, the condemnor must hold a public hearing in order to inform the public of its intention to seize the property through eminent domain. One of the purposes of this public hearing is to review the purported public use of the proposed taking. The location of the hearing must be "reasonably proximate" to the property that is subject to the eminent domain proceeding.[100] When there is a public hearing, the condemnor must notify the public of the purpose, time, and location of the hearing at least ten, but no more

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to a fair market price of a piece of property, courts may base an award on actual or intrinsic value; that is, the current cost of reproduction of the property, less depreciation); Albany Country Club v. State, 37 Misc. 2d 134, 142 (N.Y. Ct. Cl. 1962) (stating that courts may base awards on actual or intrinsic value where the market value of the property cannot be determined).

[98] *See, e.g.,* City of Buffalo v. J.W. Clement Co., 28 N.Y.2d 241, 258 (1971); Rose v. State, 24 N.Y.2d 81, 87 (1969). *See also* 4 NICHOLS ON EMINENT DOMAIN § 12.01 ("[V]aluation must be based upon the concept that the owner of the property is to be left pecuniarily in the same position as he would have been had the property not been taken . . . .").

[99] *See, e.g.*, *J.W. Clement Co.*, 28 N.Y.2d at 258.

[100] N.Y. EM. DOM. PROC. LAW § 201.

than thirty, days prior to such hearing by publishing this information in at least five successive issues of a recognized daily newspaper.[101] Within ninety days after the conclusion of the hearings, the condemnor must publish its determinations and findings in at least two successive issues of a recognized newspaper in the locality of the property that is subject to eminent domain. These findings must specify the public use or purpose of the proposed project, the reasons for selecting the particular property, the effect the taking will have on the environment and the residents of the community, and "such other factors as it considers relevant."[102] Finally, any persons who are "aggrieved" by the condemnor's determination and findings may request judicial review by the appellate division of the state's supreme court—the mid-level appeals court in New York—within thirty days after the publication of the determination and findings.[103]

B. Seizing Intangible Property.

One question raised by seizing underwater mortgages through eminent domain is whether this form of property is considered tangible or intangible property under a particular state's takings law and jurisprudence. Generally, governments in New York State have used their power of eminent domain to condemn real, tangible property.[104] Real property consists of, among other things, land as well as structures that are attached to the land.[105] The term "land" under New York's eminent domain jurisprudence includes anything that has a permanent nature along the surface or below the surface.[106] Tangible property is any sort of physical thing that can be felt or touched.[107] Examples of real, tangible property include houses, buildings, and other fixtures.

Unlike tangible property, intangible property consists of property in which a person has an ownership interest, yet has no physical substance; that is, it is something that cannot be felt or

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[101] N.Y. EM. DOM. PROC. LAW § 202.
[102] N.Y. EM. DOM. PROC. LAW § 204.
[103] N.Y. EM. DOM. PROC. LAW § 207.
[104] *See*, *e.g.*, N.Y. CONST. art. I, § 7 (stating that private property cannot be taken without just compensation); N.Y. EM. DOM. PROC. LAW § 101 (stating the purpose of using the power of eminent domain).
[105] *Real Property*, LEGAL INFORMATION INST., http://www.law.cornell.edu/wex/real_property (last visited Feb. 10, 2014).
[106] *Id.*
[107] *See, e.g.,* Kazi v. State Farm Fire * Cas. Co., 15 P.3d 223, 229 (Cal. 2001) (holding that "'tangible property' refers to things that can be touched, seen, and smelled")(citation omitted).

touched.[108] Examples of intangible property include, among other things, stocks, copyrights, and bonds.[109]

In New York State, though the governmental power of eminent domain has traditionally been used to condemn real property, statutory language provides that eminent domain may be used to acquire intangible property as well. Under New York's Eminent Domain Procedure Law, the government is permitted to use its eminent domain power to seize both tangible and intangible property.[110] The statute reads as follows: "Whenever any condemnor is authorized to acquire for a public use, title to property other than real property, the acquisition of such property shall be in the manner and procedure prescribed for the acquisition of real property under this chapter."[111] The statute specifically provides that property "other than real property" may be acquired for the public use. This means the power of eminent domain is not limited to the acquisition of tangible property; the government may appropriate intangible property as well.[112] As one New York treatise explains: "The power of eminent domain is not restricted to tangible property or realty but also extends to intangibles and personal effects . . . . Intangible rights, as well as incorporeal rights, may be taken by the exercise of such power."[113]

Despite the fact that the applicable statute provides that condemnors can use the eminent domain power with respect to intangible property, for our purposes in this discussion, New York's eminent domain law actually defines mortgages as "real property." This helps sidestep the issue of whether government entities in the state may seize underwater mortgages as intangible property. Specifically, the statute provides as follows:

> "Real property" includes all land and improvements, lands under water, waterfront property, the water of any lake, pond or stream, all easements and hereditaments, corporeal or incorporeal, and every estate, interest and right, legal or equitable, in lands or water, and right, interest, privilege, easement and franchise relating

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[108] For an overview of the treatment of intangible property in eminent domain jurisprudence, *see* David A. Dana & Thomas W. Merrill, Property: Takings 228-253 (2002).
[109] *Id.*
[110] *See* N.Y. EM. DOM. PROC. LAW § 708.
[111] *Id.*
[112] *See* 51 N.Y. JUR. 2D *Eminent Domain* § 36.
[113] *Id.*

> to the same, *including terms for years and liens by way of mortgage or otherwise*.[114]

While some may quibble with this definition, and even if one considers mortgages intangible property, statutory language in New York clearly provides that the government has the power to seize mortgages, and to seize them as tangible property.

Admittedly, however, case law in New York dealing directly with this issue is scarce. In fact, many cases merely mention that the state or a municipality *may* take intangible property, yet those cases themselves deal only with the issue of appropriating real property.[115] At the same time, at least one court in New York has found that the public use or public purpose for which private property is taken is defined very broadly as anything that may give the public a benefit.[116] It seems plausible that, given this broad interpretation of a public use or purpose under New York case law, coupled with statutory language and other case precedent, governments may seize mortgages in New York State, whether they are treated as real property, as the statute provides, or they are seen by a court as intangible property, despite this statutory language. Thus, New York's eminent domain law does not appear to create a barrier to the condemnation of underwater mortgages.

This governmental power to seize mortgages as property—whether tangible or intangible—is not exclusive to New York. For example, California law does not limit the governmental power of eminent domain to apply solely to real, tangible property.[117] As stated in the text of the California Constitution, "Private property may be taken or damaged for a public use and only when just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner."[118] The constitutional

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[114] *See* N.Y. EM. DOM. PROC. LAW § 103(F)(emphasis supplied).
[115] *See*, *e.g.*, People v. Adirondack Ry. Co., 160 N.Y. 225 (1899) (stating that governmental power to appropriate private property for the public use extends to both tangible and intangible property); Bronx Chamber of Commerce v. Fullen, 21 N.Y.S.2d 474 (N.Y. Sup. Ct. 1940) (stating the government may take all private property through the power of eminent domain, both tangible and intangible).
[116] *See* Goldstein v. New York State Urban Development Corp., 879 N.Y.S.2d 524, 533 (N.Y. App. Div. 2009) (stating that a public use or public purpose under the state constitution is "broadly defined as encompassing virtually any project that may confer upon the public a benefit, utility or advantage").
[117] *See* CAL. CONST. art. I, § 19 (stating simply that private property may be taken for the public use, without specifically stating the type of property subject to appropriation).
[118] *Id.*

provision does not specify what exactly constitutes "private property"; that is, it does not specify exactly what property is subject to condemnation. An argument can be made that intangible property could be subject to the governmental power of eminent domain from a reading of this provision.

Aside from California's constitutional provision, statutory language arguably provides for the taking of intangible property. According to California's Code of Civil Procedure, the government is permitted to acquire a broad category of property for the public use or purpose.[119] The statute reads: "[A]ny person authorized to acquire property for a particular use by eminent domain may exercise the power of eminent domain to acquire any interest in property necessary for that use . . . ."[120] The statute specifically permits the government to take any interest in property, which includes intangible property.

Courts in California have endorsed the taking of intangible property in that state.[121] In *City of Oakland v. Oakland Raiders*, 32 Cal. 3d 60 (1982), the Supreme Court of California noted that because the State Law Revision Commission made a recommendation to define property subject to condemnation in a broad fashion, intangible property could therefore be subject to the power of eminent domain.[122] While the courts of California may not have the authority to determine what type of property a government entity may seize in an eminent domain proceeding, nevertheless, the state legislature has provided that a city or municipality can acquire any property it deems necessary to carry out its functions.[123] As a result, the court in *City of Oakland* stated that the municipality could use its power of eminent domain to attain all property rights linked with ownership of the Oakland Raiders.[124]

Similarly, in *City of Glendale v. Superior Court*,[125] an appellate court cited *City of Oakland*, when it found that the governmental power of eminent domain applies to both tangible

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[119] CAL. CIV. PROC. CODE § 1240.110.
[120] *Id*.
[121] *See* Syngenta Crop Protection, Inc. v. Helliker, 42 Cal. Rptr. 3d 191, 214 (Cal. Ct. App. 2006) (stating the takings clause contained in the United States Constitution as well as the California Constitution applies not only to tangible property, but to intangible trade secret rights as well).
[122] City of Oakland v. Oakland Raiders, 32 Cal. 3d 60, 68 (1982).
[123] *Id*. at 76.
[124] *Id*. at 68.
[125] 23 Cal. Rptr. 2d 305 (1993).

and intangible property.[126] Contracts are an example of intangible property subject to appropriation in the State of California.[127] Thus, in this case, the court stated that every contract—whether between a person and the government or simply between two individuals—is subject to appropriation for the public use through eminent domain.[128] Both *City of Oakland* and *City of Glendale* illustrate how governmental entities in California may condemn intangible property, although it may be for no other reason tthat California's constitutional provision on eminent domain fails to specify exactly what type of private property is subject to appropriation.

New York and California appear to have similar constitutional and statutory provisions, providing a broad category of property subject to appropriation through state and local government's use within those jurisdictions of their eminent domain power. Case law in California appears to deal directly with the issue of taking intangible property rights, whereas New York case law merely makes mention of the state and local governments' ability to condemn such property rights, a power recognized in state law. Regardless, there is sufficient authority in both states to conclude that tangible and intangible property is subject to governmental appropriation. Of course, not every state will, like New York, state explicitly that mortgages constitute real property subject to condemnation, or have broad definitions of property, like California, where courts have interpreted such a definition as authorizing state and local governments there to seize intangible as well as tangible property. When a state or local government considers whether it will utilize the power of eminent domain to seize underwater mortgages, it must determine, under the relevant statutory or constitutional scheme, whether it is authorized to seize such property through eminent domain. In some states, that scheme permits the condemnation of mortgages as tangible property, as in New York, or, in others, the grant of authority is so broad, as in California, that the condemnor may seize such mortgages as intangible property. It is, of course, entirely possible that neither will be the case: that is, a particular state may define—through statute, constitution, or case law—the type of property subject to the eminent domain power so narrowly that mortgages are not included in that definition. In such states, a strategy designed to seize underwater mortgages will have no basis in law, and thus, will fail. To date, the authors are

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[126] City of Glendale v. Superior Court, 23 Cal. Rptr. 2d 305, 313 (Cal. Ct. App. 1993), citing *City of Oakland*, 32 Cal. 3d at 69–70.
[127] *Id.*
[128] *Id.*

aware of no state in which localities have appeared to consider such a plan and yet the state scheme did not permit it.

C. Valuing Underwater Mortgages.

Regardless of whether mortgages are considered tangible or intangible property, assuming a state's eminent domain scheme permits the taking of such mortgages as property in some form, the next question a locality that seeks to condemn underwater mortgages through eminent domain must answer is how to value such property. In other words, what is the price localities should pay for distressed, underwater mortgages?

While each state's laws may vary on the issue of valuing these mortgages, and some of that will hinge on whether the state law in which the locality is found considers a mortgage as either tangible or intangible property, the question of valuing property generally in condemnation proceedings is a relatively straightforward one, and one to which we will return shortly.

First, however, we will address what might appear to be a thornier question: should condemnors and courts value intangible property differently than they do tangible property. We will see that, in the end, when addressing either type of property, the same basic standard applies; the property—whatever its nature, either tangible or intangible—is valued at the amount the property will obtain at sale on the open market. Once again, we turn to New York law to show how that state deals with this question.

Over time, courts in New York have developed methods for valuing both tangible and intangible property.[129] Indeed, the notion of valuing intangible assets in the eminent domain context is by no means a revolutionary concept. The issue often arises where business interests are jeopardized when a condemnor seizes the land upon which such interests are realized.[130]

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[129] If the government considers the value of intangible assets in providing just compensation to a property owner upon condemnation of real property, it stands to reason that the state and local governments in New York can condemn intangible property interests as well. As noted in Part III, there exists statutory authority in New York for the government to take "property other than real property . . . ." N.Y. EM. DOM. PROC. LAW § 708. The taking of intangible property has also been noted in a State legal encyclopedia. *See* 51 N.Y. JUR. 2D *Eminent Domain* § 36.

[130] Lynda J. Oswald, *Goodwill and Going-Concern Value: Emerging Factors in the Just Compensation Equation*, 32 B.C. L. REV. 283, 283 (1991).

As the following discussion shows, case law appears to be evolving to the point that if a condemnor takes the land where a business has been established, the condemnor may have to compensate the condemnee for the "goodwill" or "going concern value" of the property.[131] Goodwill is the "'value which inheres in the fixed and favorable considerations of customers, arising from an established and well-known and well-conducted business.'"[132] Unlike goodwill, going-concern value "refers to 'the many advantages inherent in acquiring an operating business as compared to starting a new business with only land, buildings and equipment in place.'"[133]

Though it may seem fair to consider goodwill and going concern into the valuation of just compensation, the condemning governments have not historically taken these factors into account, though it appears the case law is evolving on this point. For example, according to the "business losses rule," the condemnee has been entitled only to the recovery of the value of the real property and the fixtures that were seized.[134] Traditionally, this approach has not taken into account losses of certain intangible assets of these businesses, including, among other things, goodwill and going concern value. As one commentator argues: "[p]erhaps the most troublesome losses, at least in terms of condemnation law, are loss of goodwill and loss of going-concern value, for these are the losses that most directly reflect the inherent value of the business."[135]

Many scholars have criticized the business losses rule, arguing that the government should provide compensation to a property owner for the business interests that are seized along with the real property.[136] This idea of factoring such intangible business assets into the computation of just compensation appears to be gaining favor in the legal system, as "[a] number of state courts and legislatures have begun to recognize that losses of goodwill, going-concern value, or profits are real losses for which the property owners should be compensated."[137] New York is one such state that has factored the value of intangible assets—such as going-concern value—in providing just compensation to a property owner.

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[131] *Id.* at 284.
[132] *Id.* at 287.
[133] *Id.* at 288.
[134] *Id.* at 286.
[135] *Id.* at 287.
[136] *See id.* at 283 n. 1.
[137] *Id.* at 284.

In *In re Fifth Avenue Coach Lines, Inc.*,[138] the New York Court of Appeals addressed the issue of factoring certain intangible assets into the total valuation for the taking of real property. The case involved New York City using its power of eminent domain to condemn certain parcels of property belonging to two bus companies, Fifth Avenue Coach Lines, Inc., and Surface Transit, Inc.[139] At issue in the appeal was how to assess the propriety of the condemnation awards given to the bus companies, taking into account both the "tangible and intangible going concern assets of these enterprises."[140]

After the value of the real, tangible property had been confirmed,[141] the court looked at a variety of intangible assets to factor into the total condemnation award for the bus companies. Included in this list of intangible assets was compensation provided to the companies for the taking of routes,[142] since there was a value in the taking of a transportation system that involved "73 bus routes covering 46,000,000 passenger miles and providing virtually all the surface transportation in Manhattan and the Bronx with some additional routes in Queens."[143] The court also included operating systems and records, [144] franchise agreements, [145] and the value of trained employees at the companies[146] in the list of intangible assets factored into the computation of just compensation. The court took into account the various intangible assets to determine the total condemnation award for the bus companies.

Similarly, in *In re Park Street (Lido Boulevard), Town of Hempstead*,[147] the court addressed the proper award of damages for the condemnee of a business, taking into account certain intangible assets. In this case, the condemnor—Nassau County—used its power of eminent domain to seize a profitable beach club, and the county continued to operate the club in a similar manner as it had been operated by the condemnee.[148] The condemnor therefore took the land as well as the business.[149] The court stated that the

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[138] In re Fifth Avenue Coach Lines, Inc., 22 N.Y.2d 613 (1968).
[139] *Id*. at 618.
[140] *Id*.
[141] *Id*.
[142] *Id*. at 621–24.
[143] *Id*. at 621.
[144] *See id*. at 624–26.
[145] *See id*. at 625–26.
[146] *See id*. at 627.
[147] In re Park St. (Lido Boulevard), Town of Hempstead, 336 N.Y.S.2d 566 (N.Y. Sup. Ct. 1972).
[148] *Id*. at 575–76.
[149] *Id*. at 576.

"going concern value" was an "asset for which just compensation must be paid . . . ."[150] The court explained, "[g]oing concern value is predicated upon an estimate of future profits and relates to the superior productiveness of a well-operated, successful business or plant and its sound future potential."[151]

The court ultimately assessed the going concern value and factored it into the compensation award for the taking of the beach club.[152] This was mainly because the county acquired this club that was operating at a profit, and continued to operate it in virtually the same fashion.[153] The court made clear that the condemnee must provide the property owner just compensation for the going concern value of the business, a value that the court deemed "measurable."[154] The court stated:

> Certainly, the Condemnee has a right to be compensated for the value of this business as well as the land and improvements. It is not unreasonable to find that a purchaser would pay more for this property with a successful going business than if there were no business at all.[155]

Both *Fifth Avenue* and *Park Street* are instances where New York courts factor intangible property assets into the valuation of real property seized through eminent domain. As previously noted, even though New York law mentions how the government may use its power of eminent domain to take both tangible and intangible property,[156] there is scarce case law in the state dealing solely with seizure of intangible property. Nevertheless, New York is one state where courts weigh broad factors when assessing the appropriate and "just" compensation due a condemnee in the takings context.

Since this discussion reveals that courts in New York are willing to consider a range of factors to assess the value of intangible property, we return to the original question addressed in

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[150] *Id*. at 577.
[151] *Id*.
[152] *See id*. at 579.
[153] *See id.* at 575–76. Although the county discontinued certain practices after acquiring the beach club, it continued to operate, among other things: swimming pools; tennis courts; the beach; the snack bar; and a day camp. As a result, the condemnee argued that he was due compensation for the loss of the going concern value of his business. *Id.*
[154] *Id.* at 577.
[155] *Id.*
[156] *See* text accompanying notes 94-96, *supra*.

this section: what is the method most commonly used to determine the appropriate level of compensation in a condemnation proceeding, regardless of the type of property, either tangible or intangible.

The leading treatise on the subject is *Nichols on Eminent Domain.*[157] This treatment of the issue of valuation of properties in eminent domain proceedings provides that "[t]he 'just compensation' to which [a property] owner is entitled has been held to be the *value* of the property at the time it is acquired."[158] When assessing property in an eminent domain proceeding, "[a]ll elements of value inherent in the property merit consideration."[159] Indeed, anything that "affects value and which would influence a prudent purchaser should be considered." And property should be assessed on a case-by-case basis, to render the compensation "just":

> Irrespective of the method adopted for the ascertainment of such value, it is incumbent on the condemnor to endeavor to reach a result that is truly 'just compensation,' that is, fair to the public as well as to the owner of the property taken. The criteria for determining compensation and the elements that command consideration have not become unalterably fixed, and consideration must be given to the nature of the property affected and the extent of the interest acquired.[160]

The New York Court of Appeals followed this approach in *In re Huie*,[161] when it described the process for assessing property values, stressing the discretion available to those making the assessments:

> The [New York] Constitution provides only that the owner receive 'just compensation' for the property taken . . . . In the determination of that just compensation, there is no single element which is controlling, and it is competent for the commissioners of appraisal to consider all factors indicative of the value of the property, such as its fair market values as of the date of appropriation,

[157] NICHOLS ON EMINENT DOMAIN (Julius L. Sackman ed., rev. 3d ed. 2007).
[158] *Id*., at § 12.01 (emphasis supplied).
[159] *Id.*
[160] *Id.*
[161] 2 N.Y.2d 168 (1956)(citation omitted).

> the reproduction cost of improvements less depreciation sales of similar property income highest suitable use and consequential damages to property not taken but affected by the condemnor's use. 'Omission of an attempt to enumerate all is of no consequence here. It would be a difficult and unsatisfactory venture. No single element standing alone here is decisive.'

Returning to *Nichols*, it is clear that just compensation means simply "fair market value at the time of the taking": "[i]t is well settled that when a parcel of land is taken for public use by the exercise of the power of eminent domain, the measure of compensation is the fair market value of the land."[162] Fair market value is "the amount of money which a purchaser willing, but not obliged, to buy the property would pay to an owner willing, but not obliged, to sell it, taking into consideration all uses for which the land was suited and might be applied."[163] That value is set at the time the property is taken by the government: "The general rule is that value is fixed at the time the property is actually appropriated."[164] This rule is articulated in *Yoder v. Sarasota County*.[165] There, Florida's highest court found as follows: "We have consistently ruled that the amount of compensation to be awarded to a property owner when his property is sought to be taken in an eminent domain proceeding is the value of the land taken *at the time of the lawful appropriation*."[166] The U.S. Supreme Court, in *Campbell v. United States*[167] has held that just compensation is "such a sum as would put [the owner] in as good a position pecuniarily as he would have been if his property had not been taken."[168]

Of course, returning to the issue of distressed mortgages, the question of just compensation in such settings is as follows: what is the value of a distressed mortgage? A lender might say the value is the "face value" of the mortgage: i.e., the value of the outstanding principal of the loan. As we have discussed, where a state can take both tangible and intangible property, it is conceivable also that a government entity seeking to take

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[162] Nichols, §12.02.
[163] *Id.*
[164] *Id.* at § 12A.01
[165] 81 So.2d 219 (Fla. 1955).
[166] 81 So.2d at 220–21 (emphasis supplied).
[167] 266 U.S. 368 (1924).
[168] 266 U.S. at 370. For a discussion of Supreme Court jurisprudence on just compensation, *see*, Clynn S. Lunney, Jr., *Compensation for Takings: How Much is Just?*, 42 CATH. U. L. REV. 721 (1993).

distressed mortgages might have to factor into the compensation calculation the extent to which a mortgage might have what some might call both tangible and intangible elements to it. In a recent article in the *Urban Lawyer*, author Joel Langdon posits that condemnors will have to factor in the cost of not just the mortgage debt but also such things as the value of the right to a deficiency judgment in the event the sale price of the mortgage is less than the value of the home at foreclosure sale.[169]

Since the value of property taken through eminent domain is generally set at the value of that property on the open market, the question of what value to set for a distressed mortgage is simply the price at which distressed mortgages are being sold on the open market. Such sales necessarily factor in the value of such arguable intangible elements of the mortgage, like the right to a deficiency judgment or the right to foreclose on the underlying property, because the transfer of the mortgage brings with it those powers. Fortunately, since creditors have sold distressed mortgages since the beginning of the Financial Crisis, the market is sending a signal of the value of such mortgages.

According to one source, "[d]elinquent loans are trading at around 65 percent to almost 80 percent of the current property values."[170] In 2011, another source stated that non-performing residential loans "were trading in the range of 50 to 65 percent of the current market value of the underlying property."[171] At the height of the Financial Crisis, in 2008, some distressed mortgage bonds were selling for, in the words of the *New York Times*, "pennies on the dollar."[172]

A recent report from the U.S. Department of Housing & Urban Development (HUD), details the amount that the federal government is receiving for its sale of distressed mortgages. In that report, HUD points out that, in 2012, the government sold

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[169] Joel Langdon, *The Importance of a Promise: Underwater Mortgages and a Municipal Rescue Attempt through Eminent Domain*, 45 URB. LAWYER 571, 591-594 (2013).

[170] Heather Perlberg and John Gittelsohn, *Wall Street Landlords Buy Bad Loans for Cheaper Homes*, BLOOMBERG (Feb. 21, 2014, 5:08 PM), *available at* http://www.bloomberg.com/news/2014-02-21/wall-street-landlords-buy-bad-loans-for-cheaper-homes-mortgages.html.

[171] George Ostendorf, *Distressed Mortgages for Sale*, SHELTERFORCE (2011), *available at* http://www.shelterforce.org/article/2633/distressed_mortgages_for_sale/P0/.

[172] Louise Story, *Investors Stalk the Wounded of Wall Street*, NEW YORK TIMES (April 4, 2008), *available at:* http://www.nytimes.com/2008/04/04/business/04vultures.html?pagewanted=print&_r=0.

these mortgages for the equivalent of forty percent of the unpaid principal balance of such mortgages.[173] Today, they are being sold for roughly sixty percent of unpaid principal balance, or, sixty cents on the dollar.[174]

The eminent domain process that compensates condemnees for the value of their condemned property at what the market will bear for the sale of that property would thus value underwater mortgages at the price they will obtain on the open market at the time of the condemnation. As the previous discussion shows, we have a number of data points from which to assess that value. It appears that such purchasers of distressed properties are paying roughly sixty percent of the outstanding principal balance of the mortgage. And it is this price that localities, seeking to condemn such mortgages, should likely have to pay in the event they were to condemn them through eminent domain. It is important to note, however, that the sale price of such mortgages appears to bear no relation to the price or value of the underlying property securing the distressed mortgage. Instead, these prices reflect the outstanding principal balance on the loan.

While local market forces might vary depending on the location of the property securing the mortgage, its condition, etc., state and local governments, as condemnors, and courts that may review their actions, can factor in such local variances when assessing the fair market value of the mortgages.

IV. Finding the Money.

If local governments instituted plans to seize underwater mortgages, they would need to find financing to carry out such plans. It has been suggested that local governments could find investors who could make money available for the purchase of distressed mortgages. In turn, once those mortgages are, in effect, re-written, those investors would receive the income streams from the new mortgages. Hockett explains this process as follows:

> [I]nvestors, including current bondholders and perhaps federal agencies, convey[] funds to eminent domain trusts operated by the states or their sub-

[173] U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT AND THE FEDERAL HOUSING ADMINISTRATION, QUARTERLY REPORT ON FHA SINGLE FAMILY LOAN SALES, DATA AS OF MAY 30, 2014 2 (August 28, 2014), *available at*: http://portal.hud.gov/hudportal/documents/huddoc?id=report082814.pdf.
[174] *Id.*

> units. These eminent domain trusts then purchase deeply underwater ("bad") loans from private-label securitization trusts. The states or their sub-units, in most cases probably advised or otherwise assisted by financial professionals, then work with homeowners to write new mortgages, replacing the negative equity loans with modestly positive equity loans—probably thirty-year fixed-rate mortgages in all cases. Finally, the new ("good") loans are conveyed to the first-mentioned trusts, which convey the resultant funds to the first-mentioned investors.[175]

Such a process requires a fairly large infusion of funds to get started, however. A different, less costly, process might resemble that used by the Home Owners' Loan Corporation (HOLC), which intervened in the mortgage crisis that unfolded during the Great Depression. The Roosevelt Administration promoted and Congress created the HOLC through an original stock issuance of $200 million, purchased by the U.S. Treasury. This capital infusion served as HOLC's initial operating funds (over $3.5 billion in 2014 dollars).[176] HOLC was authorized to issue debt in the form of bonds. At its peak, HOLC issued bonds for the purposes of purchasing mortgages from lenders in the amount of roughly $3.1 billion.[177]

Today, the size of the mortgaged residential real estate in the United States is ten times its size in 1933.[178] An equivalent bond issuance relative to today's mortgage market, and at 2014 dollars, could exceed $560 billion.[179] What HOLC did, however, was exchange these bonds, and the promise to pay a dividend to

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[175] Hockett, *supra* note 4, at 5.

[176] HOME LOAN BANK BOARD, FINAL REPORT TO THE CONGRESS OF THE UNITED STATES RELATING TO THE HOME OWNERS' LOAN CORPORATION, 1933-1951 4 (1952)(hereinafter Report to Congress) available at http://fraser.stlouisfed.org/publications/holc/issue/3028/download/41076/hlc_final_report_1952_pt3.pdf. On the creation of the HOLC, see Robert Hockett, *A Jeffersonian Republic by Hamiltonian Means: Values, Constraints and Finance in the Design of a Comprehensive and Contemporary American "Ownership Society,"* 79 S. CAL. L REV. 49, 107-108 (2005).

[177] Report to Congress, *supra* note 176, at 16; C. LOWELL HARRISS, HISTORY AND POLICIES OF THE HOME OWNERS' LOAN CORPORATION 16 (1951).

[178] The number of mortgaged residential units in the United States at present is 51 million. In 1930, it is estimated that there less than 5 million mortgaged residential units. C. Lowell Harriss, History and Policies of the Home Owners' Loan Corporation, 16 (1951).

[179] To calculate a figure in present dollars, the U.S. Bureau of Labor Statistics website: http://www.bls.gov/data/inflation_calculator.htm

the bondholders, with the banks that held the distressed mortgages. It then issued new mortgages to borrowers and used those mortgage proceeds to pay off the bond debt. There was a "spread" of roughly one percent: the bond holders were paid four percent interest and the borrowers, for the most part, paid five percent interest. There was built-in principal reduction and equity restoration: HOLC could only refinance a property at eighty percent of its appraised value.[180] HOLC could not purchase the mortgage on a property where the appraised value exceeded $20,000 ($367,000 in 2014), and loans could not exceed $14,000 on any property ($257,00 today).[181] Exchanging non-performing loans for government-issued bonds helped the banks stabilize their balance sheets, and they could exchange the bonds for cash on the secondary market, as investors were eager to hold them.[182] While there was an initial infusion of funds into HOLC, a similar program designed to support eminent domain actions could result in a swap of bonds for mortgages. This would be far less expensive than an outright purchase of those mortgages.

Whether bond holders would have a direct relationship with mortgagors, as in the Hockett plan, or localities opted to issue bonds and serve as an intermediary between bondholders and mortgagors, would depend on the ability of the locality to manage such exchanges. If a similar interest rate spread were offered investors as was offered in the 1930s by the HOLC, it might generate funds to have a private entity administer the program, not unlike the role servicers often play today in the home mortgage context. Given the low interest rates offered on the bond market of 2014, creating a spread that generates sufficient income should not be difficult. Given these factors, it would seem that, with an initial infusion of funds, either from investors, a governmental entity (FHFA perhaps), or through penalties emanating from large bank settlements, localities might be able to institute an eminent domain program designed to seize distressed mortgages.

V. Anticipated Down-Side Risks.

Of course, no program such as this is without potential pitfalls. And no comparative institutional analysis is complete without an attempt to identify the potential risks inherent in any course of action or the defects inherent in any institution. One of the main concerns with the use of eminent domain by localities to seize underwater mortgages is that it might have a negative effect

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[180] Harriss, *supra* note 177, at 25.
[181] Report to Congress, *supra* note 176, at 16.
[182] Harriss, *supra* note 177, at 20-21.

on the primary and secondary mortgage market in a particular community. Where localities vote or threaten to institute an eminent domain program for underwater mortgages, financial institutions may take action in the market to signal their displeasure with such a plan, by not underwriting mortgages in those communities, or refusing to purchase their municipal bonds.[183] It is possible, also, that mortgages underwritten in such communities would be less valuable on the secondary mortgage market, or large players, like FHFA, might reject such mortgages out-of-hand. As another example of the type of pressure FHFA can exert on the market, under previous leadership, FHFA threatened to raise the fees the GSEs charge for guaranteeing home mortgages loans in certain states where, in the opinion of FHFA leadership, the foreclosure process took too long.[184]

It is clear that the financial sector—both the public and private elements of it—is extremely resistant to localities using eminent domain to seize distressed mortgages and compensate the holders of such mortgages based on the fair market value of the underlying property. Financial institutions express fears that such actions will affect their bottom line and impose steep losses on their balance sheets. While it may be true that such a program would likely have an adverse effect on the balance sheets of financial institutions holding distressed mortgages, holding distressed mortgages has that same effect as well. Letting homeowners spiral down even further in arrears, and allowing more mortgages to go into foreclosure, will only continue to create a drag on home values of all properties, even those not in distress. And banks hold those mortgages too.

Financial institutions have been claiming since the beginning of the Financial Crisis that aggressive legal action against the banks would create a vicious cycle, one that would destabilize the banks and have deep ripple effects throughout the economy. Critics claim that it is these fears that have caused some law enforcement officials at all levels of government to treat the

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[183] After Richmond, CA, voted to approve an eminent domain plan, it had trouble refinancing its municipal bonds, which some said was a response of investors to the plan to seize underwater mortgages. *See*, Carolyn Said, *Eminent Domain Plan May Have Spooked Investors*, SAN FRANCISCO CHRONICLE (August 29, 2013) *available at* http://www.sfgate.com/realestate/article/Eminent-domain-plan-may-have-spooked-investors-4773720.php.

[184] This plan was later delayed by new leadership at FHFA. Clea Benson, *Fannie Mae Fee Increases to be Delayed by FHFA Under Watt*, BLOOMBERG (December 21, 2013), *available at* http://www.bloomberg.com/news/2013-12-21/fannie-mae-fee-increases-to-be-delayed-by-fhfa-under-watt.html.

banks with kid gloves. Some have called this the "Too Big To Jail" phenomenon: that law enforcement officials have internalized the fears of financial institutions and do not wish to use the full extent of their law enforcement tools to bring bankers to justice for the illegal actions that led to the Financial Crisis.

Yet, as described above, financial institutions have weathered the fallout of the legal actions taken by the Justice Department and others and most large financial institutions are still standing. While some may have fallen in the depths of the Financial Crisis, their failure was not the result of aggressive law enforcement action, rather, it was the banks' own risky bets. In fact, it has been the mere threat of legal action that has brought about some of the largest cash settlements described above. For example, the robo-sign scandal was resolved at a price tag of $25 billion (with just five banks) without the Justice Department or any of the forty-nine attorneys general who signed on to that agreement firing a single legal shot. Perhaps the leverage the localities have is to raise the threat that they might institute eminent domain proceedings as a way to bring mortgagees to the table to enter into voluntary loan modifications, ones that reduce mortgage principal and help realign mortgage principal with the value of the underlying property.

Conclusion

At the time that we write this Article, no locality has yet to take action to seize an underwater mortgage by eminent domain. Whether the lingering effects of the Financial Crisis will continue to justify the need to do so remains to be seen. While the housing recovery has been incremental at best in certain markets, many localities are still reeling from the fallout from the Financial Crisis. As the preceding discussion shows, it has been *ex post* legal action designed to remedy the effects of the Financial Crisis that seems to have had the most success in bringing some modicum of relief to homeowners who were illegally foreclosed upon, were saddled with subprime loans on unfair terms, or were discriminated against based on their race or ethnicity. As the preceding discussion shows, in many jurisdictions, to the extent localities are able to utilize eminent domain as one arrow in their legal quiver, this might give them the leverage they need to help realign mortgage values with property values and bring some relief to homeowners still struggling under the lingering effects of the Financial Crisis of 2008 and its aftermath.