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

Raymond H Brescia, *Albany Law School*
Nicholas Martin, *Albany Law School*

Raymond H. Brescia,
Associate Professor of Law and Director of the Government Law Center, Albany Law School.

Nicholas Martin
J.D. 2015 (Anticipated), Albany Law School

Word Count: 14,053 (Including Footnotes)

Abstract

In response to the lingering fallout from the Financial Crisis of 2008, 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 and asks three key questions. First, are local governments appropriate actors to address the lingering problem of underwater mortgages? Second, assuming they 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? Third, what are some strategies local governments can use to find the resources necessary to capitalize a program that would seize underwater mortgages and purchase them from mortgage holders? Finally, what are some potential down-side risks to local governments taking these actions? This Article attempts to address these questions, using through the use of comparative institutional analysis. It reviews the efforts of governments at all levels in the United States to deal with the economic effects of the Financial Crisis of 2008. It also looks at the success of 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 at remedying the economic and social problems posed by distressed mortgages. 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.
# Table of Contents

I. *The Course of the Crisis.* ........................................................ 3

II. *Government Actors, the Crisis and the Tools at Their Disposal to Address the Fallout from the Financial Crisis.* .......... 6
   A. *Federal Government.* ............................................................. 7
   B. *State Governments.* ............................................................. 9
   C. *Local Governments.* ............................................................. 10
   D. *Using a “Mass Torts” Approach in Response to the Lasting Effects of the Financial Crisis.* ............................. 13
      1. Financial Crisis Products: More Toxic than Asbestos. 13
      2. Localities as Litigants ......................................................... 16
      3. Eminent Domain as a Potential Response to the Underwater Mortgage Problem ............................................. 18

III. *Valuing Underwater Properties in Eminent Domain Proceedings.* ................................. 19
   A. *The Eminent Domain Process.* ........................................ 19
   B. *Seizing Intangible Property.* ........................................... 21
   C. *Valuing Underwater Mortgages.* ........................................ 25

IV. *Finding the Money.* ............................................................ 31

V. *Anticipated Down-Side Risks.* ............................................... 33

Raymond H. Brescia†

Nicholas Martin∗

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—became the first municipal legislative body in the United States to approve a plan to use of that government’s constitutional 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. Through such a plan, the city would seize underwater mortgages on such properties, paying fair market value for those mortgages based on the value of the underlying property, and then negotiate with the residents to write a new mortgage, based on the value of the property set through the exercise of the eminent domain power.

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, the use of a locality’s eminent domain power in this manner would help keep property owners in

† Associate Professor of Law and Director of the Government Law Center, Albany Law School; J.D., Yale Law School (1992); B.A., Fordham University (1989); formerly the Associate Director of the Urban Justice Center in New York City, a Skadden Fellow at The Legal Aid Society of New York, law clerk to the Honorable Constance Baker Motley, and staff attorney at New Haven Legal Assistance Association.

∗ J.D. Candidate 2015, Albany Law School; B.A., Siena College (2012).


3 Id.
their homes and prevent foreclosures. In turn, this may help the economy and reduce the number of properties entering foreclosure, reducing neighborhood blight and maintaining property values for neighboring homes. 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. Such cost would create a drag on economic development and impose significant burdens on local governments adopting this approach. 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] because it entirely obliterates mortgage-based contract rights, including in connection with mortgage-backed securities.” 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 it is entirely possible that other municipalities across the country may follow this path as well.

This Article attempts to situate this approach to underwater mortgages within the larger crisis and asks three key questions. First, are local governments appropriate actors to address the lingering problem of underwater mortgages? Second, assuming they 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

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7 U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .”).
mortgagees and other lienholders when seizing underwater mortgages? Third, what are some strategies local governments can use to find the resources necessary to capitalize a program that would seize underwater mortgages and 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 will review the scope and causes of the Financial Crisis of 2008 and the lingering foreclosure crisis embedded within it (which we will refer to simply as the Financial Crisis). In Part II, we will address the role that governments at all levels—and each branch of those governments—have played and can play in addressing these crises’ lingering financial effects, with particular emphasis on the role of litigation and other legal actions to address some of the most harmful effects of the fallout from the financial crisis. In this section, utilizing the tools of comparative institutional analysis, we will attempt to address the first of the two questions posed above: i.e., the role of localities in addressing the fallout from the Financial Crisis. In Part III, we will offer a brief overview of the government’s power of eminent domain, explaining how the process works in many jurisdictions. We will emphasize how New York law in particular provides for this authority, and compare this state’s law to that of California. We will 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 will return to the second of the two questions posed above: how to value underwater mortgages in the eminent domain process. In Part IV, we will address the question of how to fund an eminent domain program directed at underwater mortgages. Finally, in Part V, we will address some potential negative consequences of localities adopting such a program.

I. The Course of the 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: legislators, 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.\textsuperscript{10} In the 1980s and 1990s, a wave of deregulation created the legal infrastructure that made subprime mortgage products possible.\textsuperscript{11} Mortgage lenders found ways to automate the mortgage underwriting process which allowed them to increase the volume of mortgages they could write.\textsuperscript{12} They also created new mortgage products, products that became increasingly exotic, designed to increase the number of eligible borrowers by, in effect, lowering underwriting standards.\textsuperscript{13} This was accomplished by offering products that would attract a wider pool of applicants, regardless of their ultimate ability to repay their mortgages.\textsuperscript{14} These developments, coupled with innovation in mortgage financing (namely, the ability to securitize mortgages), meant the mortgage market was able to convert future income streams from mortgagor payments under a

\textsuperscript{10} For background on and overview of the financial crisis, see, generally, \textsc{Edward M. Gramlich}, \textsc{Subprime Mortgages: America’s Latest Boom and Bust} 9–35 (2007) (providing analysis of trends in homeownership from the 1940s to the 2000s); \textsc{John Bellamy Foster & Fred Magdoff}, \textsc{The Great Financial Crisis: Causes and Consequences} (2009); \textsc{Daniel Gross}, \textsc{Dumb Money: How Our Greatest Financial Minds Bankrupted the Nation} (2009); \textsc{Richard A. Posner}, \textsc{A Failure of Capitalism: The Crisis of ’08 and the Descent into Depression} (2009); \textsc{Robert J. Shiller}, \textsc{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); \textsc{Mark Zandi}, \textsc{Financial Shock: A 360° Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis} (2009) (reviewing origins of the financial crisis). A raft of new books have been released over the last two years that provide information about internal financial institutions deliberations during the crisis, or provide outsider critiques of the government response to the crisis. These books include: \textsc{Sheila Bair}, \textsc{Bull by the Horns: Fighting to Save Main Street from Wall Street and Wall Street from Itself} (2012); \textsc{Neil Barofsky}, \textsc{Bailout: How Washington Abandoned Main Street While Rescuing Wall Street} (2012); \textsc{Jeff Connaughton}, \textsc{The Payoff: Why Wall Street Always Wins} (2012); \textsc{Anat Admati & Martin Hellwig}, \textsc{The Bankers’ New Clothes: What’s Wrong with Banking and What to Do About It} (2013); \textsc{Ben S. Bernanke}, \textsc{The Federal Reserve and the Financial Crisis} (2013); \textsc{Alan S. Blinder}, \textsc{After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead} (2013); and \textsc{Timothy F. Geithner}, \textsc{Stress Test: Reflections on Financial Crises} (2014).

\textsuperscript{11} Cathy Lesser Mansfield, \textsc{The Road to Subprime “Hel” was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market}, 51 S.C. L. Rev. 473, 492 (2000)

\textsuperscript{12} Eamonn K. Moran, \textsc{Wall Street Meets Main Street: Understanding the Financial Crisis}, 13 N.C. Banking Inst. 5, 21-22 (2009).


\textsuperscript{14} \textsc{Kathleen Engel & Patricia McCoy}, \textsc{The Subprime Virus: Reckless Credit, Regulatory Failure, and Next Steps}, 1262 (2011).
mortgage into liquid assets which could, in turn, fuel more mortgage underwriting.\textsuperscript{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.\textsuperscript{16} Also in pursuit of fees, credit ratings agencies assessed and blessed these financial products with little regard for their ultimate value or viability.\textsuperscript{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.\textsuperscript{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 take off.\textsuperscript{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 could be packaged into securities and sold to eager investors.\textsuperscript{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. Aggressive outreach by brokers armed with exotic mortgage products was able to saddle less creditworthy borrowers with subprime loans.\textsuperscript{21} The loans written for these borrowers would turn toxic, creating shocks throughout the finance chain.\textsuperscript{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). When the music stopped—to borrow an oft-used

\textsuperscript{15} Id. at 32–33.
\textsuperscript{16} See, FCIC Report, supra n. 13, at 8, citation omitted.
\textsuperscript{17} DANIEL GROSS, DUMB MONEY: HOW OUR GREATEST FINANCIAL MINDS BANKRUPTED THE NATION 50 (2009).
\textsuperscript{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).
\textsuperscript{19} See GROSS, supra note 17, at 13-20;
\textsuperscript{20} Moran, supra n. 12, at 24-25.
\textsuperscript{21} Engel & McCoy, supra n. 14, at 32.
\textsuperscript{22} Moran, supra n. 12, at 30–31.
phrase—banks and borrowers were both left without chairs to sit in. In the words of one 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.”

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. For others, lax enforcement of laws against predatory lending, and the pre-emption of many of those state laws by federal regulators, helped to unleash predatory lenders. 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 in addressing the lingering fallout from the crisis moving forward. For this discussion, we will utilize the tools of comparative institutional analysis for assessing the role that governments at all levels can take in addressing the lingering effects of the Crisis, and the relative effectiveness of the tools at their disposal. For levels of government, we will look at federal, state, and local governments. For the tools, we will look at ex-ante regulations and oversight, as well as ex post executive and legislative actions, litigation, and other law enforcement mechanisms. One tool in particular that we will review is the power of eminent domain:

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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).
what we will refer to here as an executive action. Of course, when an individual whose property has been seized by eminent domain wishes to challenge that action, that challenge is resolved in the courts. For the purposes of this discussion, however, we will consider this an executive action.

A. 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,\(^\text{27}\) and, through that Act, created the Consumer Financial Protection Bureau. In so doing, it took measures to prevent future crises; it has not made great strides in taking action to rectify the problems caused by the Financial Crisis, however. Admittedly, while Dodd-Frank that might help stave off the next crisis, it has done little to remedy the crisis-induced foreclosure tsunami. While some members of Congress promoted an effort to permit underwater homeowners the power to seek modifications of their mortgages in bankruptcy court—the so-called mortgage “cramdown” option—that effort failed in the Senate when sixty senators would not vote to bring the legislation permitting this mechanism to a vote.\(^\text{28}\)

Similarly, 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 may be assisting homeowners in mortgage relief programs when considering those banks’ performance under the Community Reinvestment Act,\(^\text{29}\) regulators, historically, have not used that law’s regulatory framework to punish banks by any measure.\(^\text{30}\) While there is much

\(^{30}\) 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.
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 in a strong position to do so.

One executive branch agency taking steps to mitigate the crisis is the Treasury Department, and 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 facilitate the two sides coming to some mutually beneficial resolution to these types of disputes. 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. In other words, HAMP may have helped some people delay their mortgage payments, but it has done little to generate actual mortgage modifications that included principal reduction.  

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—to the tune of over one hundred billion dollars—to make up for the harm caused 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 $9 trillion.  

To date, Justice Department and other agency advocacy

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31 For some of the critiques of the HAMP program’s implementation, see Murray 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/

has resulted in roughly $100 billion in fines and compensation.\textsuperscript{33} Nevertheless, this executive branch agency has played a central role in getting banks to the negotiating table, even while it has been loath to bring criminal action against bank actors, and the banks themselves.\textsuperscript{34} 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 fallout from the Crisis. We will return to these matters shortly.

\textbf{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 that sector meant a reduction in government funds available for social services, education, and other programs provided by the states. 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.\textsuperscript{35} 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.\textsuperscript{36} 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.\textsuperscript{37} This settlement netted tens of billions of dollars in fines

\textsuperscript{33} The Economist, \textit{Mortgage-Related Bank Fines: Payback Time for Subprime} (October 16, 2013).
\textsuperscript{34} See, Jed S. Rakoff, \textit{The Financial Crisis: Why Have No High-Level Executives Been Prosecuted,} NEW YORK REVIEW OF BOOKS, (January 9, 2014).
\textsuperscript{35} Julia Patterson Forrester, \textit{supra} n. 25.
\textsuperscript{37} For a description of robo-signing practices, see \textit{CONG. OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT, EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE}
and a degree of financial relief for some homeowners affected by the practice.\textsuperscript{38}

In addition, years before the Financial Crisis unfolded, then-Attorney General Eliot Spitzer sought the authority to bring fraud investigations against certain federally regulated institutions, and his successor, then-Attorney General Andrew 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.\textsuperscript{39}

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 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. A reduction in property values mean 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. 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—amounted to between $159,000 and $371,000 per foreclosure. 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.

In the aggregate, as a result of these forces, the General Accounting Office estimates that American homeowners $9.1 trillion in home equity as a result of the Financial Crisis. 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.

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.

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41 Id. at 11.
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 foreclosure. 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. 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.

As with federal and state governments though, some intrepid local governments have taken action in the courts to rectify some

47 See, U.S. Conference of Mayors, supra n. 45.
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.

**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 mass foreclosures 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, 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 the following: numerosity, commonality, interdependence of case values, controversy over causation, emotional or political heat, and higher than average claim rate. Mass torts litigation can also involve the use of techniques to adjudicate questions of liability, causation, damages, and compensation in the aggregate. 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. A 2005 study by the RAND Corporation estimated the cost of roughly thirty years of asbestos litigation to have reached

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seventy billion at that time. Yet just seven years of litigation over practices in the lead up to the Financial Crisis has exceeded that amount. Indeed, a study by The Economist tallies the cost, as of the end of 2013, of financial litigation in the wake of the financial crisis to reach nearly $100 billion, 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. 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. 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. BofA had 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. 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; the price tag for

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53 The Economist, supra n. 33.
56 The Economist, supra n. 33.
that settlement: $7 billion.\textsuperscript{57} Finally, at the time of this writing, the Department of Justice is using these settlements to pressure other banks, like BofA, to enter into a new round of talks over resolving outstanding mortgage claims.\textsuperscript{58}

In addition to the threat of additional litigation against BofA, the Federal Housing Finance Administration (FHFA) has more than a dozen pending against a host of banks. They have originally filed claims against seventeen banks seeking nearly $200 billion in damages.\textsuperscript{59} While some of these cases have settled quietly, were FHFA to settle the remaining claims—or obtain judgments—for even half the amount sought in its complaints, it would still double 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 bring about 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 predictable ways, 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 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 $100 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 good portion of these funds to victims of mortgage abuses. 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. From early English common law, local governments have used their power to bring nuisance actions to prevent harmful actions, from unsafe driving of horses, to the pollution of streams and wells. 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 a slaughterhouse being operated in a residential neighborhood, or a factory releasing too much smoke or dust. 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. 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.

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 cities have alleged, the cities have suffered as a result of diminished property values and increased blight.

Of course, these allegations are not unique to these cities. A Federal Reserve study of mortgage lending in 2006 shows that

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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 was even more likely to occur in middle-income, African American communities. A study 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 were 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. These last findings suggest that predatory lending was more prevalent in states where the African-American middle class was wealthier and larger.

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 subprime loans as “ghetto loans” and borrowers of color as “mud people.”

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. Wells reached also reached an agreement with Baltimore which will

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bring over $7 million in lending assistance to homeowners in that city.\(^6\)

Reverse redlining litigation has not been relegated to solely municipal or county litigants. In late December, 2011, the Justice Department and the Attorney General of the State of Illinois settled reverse redlining lawsuits against Countrywide. 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.\(^6\) 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.\(^7\)

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

Litigation, investigations, and the threat of both have resulted in over $100 billion in settlements with 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. One more arrow seems available to governments: the use of eminent domain to seize distressed mortgages.

In the early days of the Financial Crisis, Howell Jackson first raised the prospect that the federal government might step into the breach to 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.\(^7\) 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.”

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


A. The Eminent Domain Process.

The Fifth Amendment of the United States Constitution provides, “[N]or shall private property be taken for public use, without just compensation.” This constitutional provision gives the federal government the right to condemn private property as long as it is for the public use, provided that “just compensation” is paid to the owner. State governments are not prohibited from taking property through eminent domain power under the Due

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72 Hockett, supra n. 4, at 3.  
74 U.S. CONST. amend. V.
Process Clause of the Fourteenth Amendment, provided they provide an appropriate process for doing so. The power itself is codified in the Constitution of each State, one of the powers reserved by the states through the 10th Amendment to the U.S. Constitution. 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.

“Just compensation” is generally measured by the fair market value of the property at the time of the taking. Though it may not be a completely accurate method of valuation, courts often use the fair market value of the property at the date of the condemnation proceeding to satisfy the requirement of just compensation. The policy behind paying the owner fair market value for their 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. It is the duty of the condemnor to determine and provide just compensation to property owners.

While a review of the processes for all 50 states is beyond the scope of this Article, we will look at how our state, New York, handles eminent domain proceedings to provide a basic overview of that state’s process. There are, indeed, differences state-by-state, this overview helps to highlight some of the key components of the process.

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75 U.S. CONST. amend. XIV, § 1 (“[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . . .”).
76 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.”).
77 U.S. CONST. amend. X.
78 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.”).
81 See, e.g., J.W. Clement Co., 28 N.Y.2d at 258.
In New York, condemners—either the state or local government—must adhere to certain requirements when they attempt to take land for the public use. First, prior to the acquisition, the condemnor must hold a public hearing in order to inform the public of its intention of seizing the property through eminent domain. The purpose of this public hearing is to review the purported public use of the proposed taking. Also, the location of the hearing must be “reasonably proximate” to the property that is subject to the eminent domain proceeding.\(^82\) 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 than thirty, days prior to such hearing by publishing this information in at least five successive issues of an official daily newspaper.\(^83\) Within ninety days after the conclusion of the hearings, the condemnor must publish its determinations and findings in at least two successive issues of an official 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.”\(^84\) 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.\(^85\)

**B. Seizing Intangible Property.**

Generally, governments in New York State have used their power of eminent domain to condemn real, tangible property.\(^86\) Real property consists of, among other things, land as well as structures that are attached to the land.\(^87\) Land includes anything that has a permanent nature along the surface or below the surface.\(^88\) Tangible property is any sort of physical thing that can

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\(^{82}\) N.Y. EM. DOM. PROC. LAW § 201.
\(^{83}\) N.Y. EM. DOM. PROC. LAW § 202.
\(^{84}\) N.Y. EM. DOM. PROC. LAW § 204.
\(^{85}\) N.Y. EM. DOM. PROC. LAW § 207.
\(^{86}\) See, e.g., N.Y. CONST. art. 1, § 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).
\(^{88}\) Id.
be felt or touched. 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 touched. Examples of intangible property include, among other things, stocks, copyrights, and bonds.

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. The statute reads, “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.” 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. “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.”

In addition, for our purposes in this discussion, New York’s eminent domain law provides that mortgages are defined as “real property,” which helps sidestep the issue of whether government entities in the state may seize underwater mortgages as intangible property. 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,

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90 Id.
91 Id.
92 See N.Y. EM. DOM. PROC. LAW § 708.
93 Id.
94 See 51 N.Y. JUR. 2d Eminent Domain § 36.
95 Id.
legal or equitable, in lands or water, and right, interest, privilege, easement and franchise relating to the same, including terms for years and liens by way of mortgage or otherwise.96

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 intangible 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.97 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.98 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 intangible property in New York at both the state and local level.

This governmental power to seize intangible property 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.99 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.”100 The Constitutional 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

96 See N.Y. EM. DOM. PROC. LAW § 103(F)(emphasis supplied).
97 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).
98 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”).
99 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).
100 Id.
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. 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 . . . .” The statute specifically permits the government to take any interest in property, which includes intangible property.

The taking of intangible property in California has been cited in case law. 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. 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. 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.

In City of Glendale v. Superior Court, an appellate court cited City of Oakland, stating that the governmental power of eminent domain applies to both tangible and intangible property. Contracts are an example of intangible property subject to

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101 CAL. CIV. PROC. CODE § 1240.110.
102 Id.
103 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).
104 City of Oakland v. Oakland Raiders, 32 Cal. 3d 60, 68 (1982).
105 Id. at 76.
106 Id. at 68.
107 23 Cal. Rptr. 2d 305 (1993).
108 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.
appropriation in the State of California. 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. Both City of Oakland and City of Glendale illustrate how intangible property may be condemned in the State of California, likely as a result of California’s constitutional provision on eminent domain that fails to specify exactly what type of private property is subject to appropriation.

New York State and California appear to have similar constitutional and statutory provisions, providing a broad category of property subject to appropriation through the government’s use of its eminent domain power. California appears to have some case law dealing 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. Regardless, there is sufficient authority in both states to conclude that tangible and intangible property is subject to governmental appropriation.

C. Valuing Underwater Mortgages.

Given the state of the law in New York and some other jurisdictions, could states like New York, when they appear to have the power to seize mortgages (either because they are defined as real property or because government entities in New York appear to have the power to seize intangible property as well), implement a plan similar to that enacted in Richmond, California? Because a mortgage is technically considered real property in the State of New York, it is clearly a right subject to appropriation through the power of eminent domain. It follows, therefore, that the state and municipal governments in this state, and others that have similar powers, have the power to take underwater mortgages for the public use.

For the law of eminent domain as it relates to the valuation of property, we turn to the leading treatise on the subject, Nichols on Eminent Domain. The 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

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109 Id.
110 Id.
111 NICHOLS ON EMINENT DOMAIN (Julius L. Sackman ed., rev. 3d ed. 2007).
held to be the value of the property at the time it is acquired.”

When assessing property in an eminent domain proceeding, “[a]ll elements of value inherent in the property merit consideration.”

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.

The New York Court of Appeals followed this approach in *In re Huie*, 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, 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.’

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112 Id., at § 12.01 (emphasis supplied).
113 Id.
114 Id.
115 2 N.Y.2d 168 (1956)(citation omitted).
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.”\textsuperscript{116} 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.”\textsuperscript{117} 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.”\textsuperscript{118} This rule is articulated in \textit{Yoder v. Sarasota County}.\textsuperscript{119} 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 \textit{at the time of the lawful appropriation}.”\textsuperscript{120} The U.S. Supreme Court in \textit{Campbell v. United States}\textsuperscript{121} held, 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.”\textsuperscript{122}

This then begs the question: 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. But that is not the price at which distressed mortgages are being sold on the open market. According to one source, “Delinquent loans are trading at around 65 percent to almost 80 percent of the current property values.”\textsuperscript{123} 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.”\textsuperscript{124} At the height of the Financial Crisis, in 2008, some distressed mortgages were selling for as little as ten percent of their face value.

\textsuperscript{116} Nichols, §12.02.  
\textsuperscript{117} \textit{Id.}  
\textsuperscript{118} \textit{Id.} at § 12A.01  
\textsuperscript{119} 81 So.2d 219 (Fla. 1955).  
\textsuperscript{120} 81 So.2d at 220–21 (emphasis supplied).  
\textsuperscript{121} 266 U.S. 368 (1924).  
\textsuperscript{122} 266 U.S. at 370.  
Even if mortgages were not considered real property but rather intangible property, case law in New York has developed for valuing intangible property. 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.\footnote{125} 

The notion of valuing intangible assets into the computation of just compensation is by no means a revolutionary concept. The issue often arises where business interests are destroyed after a condemnor seizes the land upon which such interests are established.\footnote{126} 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.\footnote{127} 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.'"\footnote{128} 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.'"\footnote{129} 

Though it may seem fair to consider goodwill and going concern into the valuation of just compensation, the government has not historically taken these factors into account, though this appears to be changing. 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.\footnote{130} This rule unfortunately does not account for 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

\begin{footnotes}
\item[125] 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.
\item[127] Id. at 284.
\item[128] Id. at 287.
\item[129] Id. at 288.
\item[130] Id. at 286.
\end{footnotes}
the losses that most directly reflect the inherent value of the business."\textsuperscript{131}

Many scholarly critics have attacked 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.\textsuperscript{132} 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.”\textsuperscript{133} 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.

In \textit{In re Fifth Avenue Coach Lines, Inc.},\textsuperscript{134} 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.\textsuperscript{135} At issue in the appeal was how to properly value the condemnation awards to the bus companies, taking into account both the “tangible and intangible going concern assets of these enterprises.”\textsuperscript{136}

After the value of the real, tangible property had been confirmed,\textsuperscript{137} 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,\textsuperscript{138} 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.”\textsuperscript{139} Also included in the list of intangible assets factored into the computation of just

\begin{itemize}
  \item \textsuperscript{131} \textit{Id.} at 287.
  \item \textsuperscript{132} \textit{See id.} at 283 n. 1.
  \item \textsuperscript{133} \textit{Id.} at 284.
  \item \textsuperscript{134} \textit{In re Fifth Avenue Coach Lines, Inc.}, 22 N.Y.2d 613 (1968).
  \item \textsuperscript{135} \textit{Id.} at 618.
  \item \textsuperscript{136} \textit{Id.}
  \item \textsuperscript{137} \textit{Id.}
  \item \textsuperscript{138} \textit{Id.} at 621–24.
  \item \textsuperscript{139} \textit{Id.} at 621.
\end{itemize}
compensation were operating systems and records, franchise agreements, and the value of trained employees at the companies. The court factored in 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, 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. The condemnor therefore took the land as well as the business. The court stated that the “going concern value” was an “asset for which just compensation must be paid . . . .” The court explained, “Going 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.”

The court ultimately measured the going concern value and factored it into the award for just compensation for the taking of the beach club. 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. The court was adamant in stating 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.” 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

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140 See id. at 624–26.
141 See id. at 625–26.
142 See id. at 627.
144 Id. at 575–76.
145 Id. at 576.
146 Id. at 577.
147 Id.
148 See id. at 579.
149 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.
150 Id. at 577.
more for this property with a successful going business than if there were no business at all.\textsuperscript{151}

Both \textit{Fifth Avenue} and \textit{Park Street} are examples of New York case law that 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,\textsuperscript{152} there is scarce case law in the state dealing solely with seizure of intangible property. Nevertheless, New York seems to be one state that is permitting the weighing of broad factors in reaching a conclusion as to the appropriate and “just” compensation due a condemnee in the takings context.

\textbf{IV. Finding the Money.}

Were local governments to institute a plan of seizing underwater mortgages, they would need to find financing to carry it out. 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:

\textit{[I]nvestors, including current bondholders and perhaps federal agencies, conveying funds to eminent domain trusts operated by the states or their sub-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.}\textsuperscript{153}

\textsuperscript{151} \textit{Id.}
\textsuperscript{152} \textit{See} text accompanying notes 94-96, \textit{supra.}
\textsuperscript{153} Hockett, \textit{supra} n. 4, at 5.
Such a process would 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).\textsuperscript{154} 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.\textsuperscript{155} Today, the size of the mortgaged residential real estate in the United States is ten times its size in 1933.\textsuperscript{156} An equivalent bond issuance relative to today’s mortgage market, and at 2014 dollars, would exceed $560 billion.\textsuperscript{157} HOLC exchanged these bonds, and the promise to pay a dividend to 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.\textsuperscript{158} 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).\textsuperscript{159} 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.\textsuperscript{160}


\textsuperscript{155} Report to Congress, supra n. 154, at 16; C. LOWELL HARRISS, HISTORY AND POLICIES OF THE HOME OWNERS’ LOAN CORPORATION 16 (1951).

\textsuperscript{156} 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).

\textsuperscript{157} To calculate a figure in present dollars, the U.S. Bureau of Labor Statistics website: http://www.bls.gov/data/inflation_calculator.htm

\textsuperscript{158} Harriss, supra n. 156, at 25.

\textsuperscript{159} Report to Congress, supra n. 154, at 16.

\textsuperscript{160} Harriss, supra n. 156, at 20-21.
Whether bond holders would have a direct relationship with mortgagors, as in the Hockett plan, or localities opted to issue bonds and serve as a sort of 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 or a governmental entity (FHFA perhaps), 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 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.161 It is possible, also, that mortgages underwritten in such communities would be more costly to purchase on the secondary mortgage market, or large players, like FHFA, might reject such mortgages out-of-hand. 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, it had determined, the foreclosure process takes too long.162

161 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.

162 This plan was later delayed by new leadership at FHFA. Clea Benson, Fannie Mae Fee Increases to be Delayed by FHFA Under Watt, BLOOMBERG
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 have 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 at all levels of government to treat the 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.

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, localities are likely able to utilize eminent domain as one arrow in their legal quiver that 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.