2014

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ARTICLES

TAKING ON WATER: LOCAL GOVERNMENT, EMINENT DOMAIN, AND THE FORECLOSURE CRISIS

Brian Cullin

Introduction

The 2008 Financial Crisis and the ensuing Great Recession sent shockwaves throughout the U.S. and global economy, wreaking havoc from Wall Street to Main Street. The Crisis harkened economic contraction, high unemployment, and elevated rates of home foreclosure. While the financial industry recovered, spelling an end to one crisis, another continues – the Foreclosure Crisis. The rate of home foreclosure, already ominously on the rise before 2008 and growing in intensity and breadth in the aftermath of the Financial Crisis, provides the foundation for this paper. This article examines an innovative public-private partnership between a private firm, Mortgage Resolution Partners (MRP), and local governments concerned with the negative side effects of foreclosure on local communities. The MRP – local government Proposal (“Proposal”) is aimed at preventing future home foreclosures. Under the Proposal, local governments will seize distressed home loans and mortgages from the private trusts currently owning them. After seizure, the local government will renegotiate new mortgage loans with the homeowners to reduce the amount of principal owed. While the modern causes of foreclosure are no doubt complex, the Proposal centers on local government’s use of a power predating American Independence – eminent domain.

Part I provides a brief history of the events that precipitated the increased incidence of foreclosure from 2006 to the present and identifies the forces that continue to fuel it. Part II summarizes the mechanics of the Proposal and provides a synopsis of the arguments forwarded by the Proposal’s supporters to justify its use over alternative policy options. Part II concludes with a summary of past attempts to utilize the Proposal and the status of current attempts, as well as a

1. See infra Part I.
2. See infra Part I.
3. See infra Part II.a-b.
brief history of the eminent domain power. Part III analyzes the fed­
eral and state constitutional, statutory, and practical obstacles faced by
local governments choosing to adopt the Proposal. Analysis will pay
special attention to the Proposal's propriety in light of federal and state “public use” and “just compensation” requirements for taking
property. Additional legal issues, such as the constitutionality of the
Proposal under the dormant Commerce Clause and the Contracts
Clause, along with thorny jurisdictional matters, are not addressed,
but are worthy of future exploration.

I. Causes of the Foreclosure Crisis

General consensus identifies the formation of a housing bubble and its subsequent burst, which began in 2006, when home value
growth began to slow and then decline, as contributing to the largest
decline for housing values in American history and a historically high
percentage of home loans seriously delinquent or in foreclosure. The
dramatic decline in home values experienced from 2006 to present
created the high levels of negative home equity that largely fueled increasing rates of foreclosure. There is a strong association between negative home equity and the likelihood of foreclosure, as negative home equity prevents a homeowner from being able to sell the home or refinance to a more affordable mortgage when the current payment
becomes unmanageable. The initial foreclosures, during 2006 and

4. See infra Part II.c-d.
5. See infra Part III.
6. See Jeff Holt, A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper, 8 J. Bus. Inquiry 120, 120-26 (2009). A combination of government policies, such as sustained periods of low mortgage interest rates and short term interest rates; lender and financial industry practices, such as securitization of mortgages and relaxed lending standards, typified by the explosion of sub-prime lending from the late 1990’s to the mid 2000’s; and irrational speculation by lenders, borrowers, regulators, and investors that housing prices would continue to rise, were the primary causes of a rapid growth in home values, culminating in a bubble which burst in 2006. Id.
9. See Neil Bhutta et al., THE DEPTH OF NEGATIVE EQUITY AND MORTGAGE DEFAULT DECISIONS, Federal Reserve Board of Governors 2 (2010). (A home with negative equity is often described as being “underwater.” Negative home equity occurs when a homeowner owes more money to repay a home loan than the home’s market value. The market value of the home and the size of the mortgage determine the level of negative equity.)
10. See U.S. DEP’T OF HOUS. & URBAN DEV., supra note 8, at 16; see also Bhutta, supra note 9, at 1.
2007, were overwhelmingly non-prime mortgage loans.12 This first wave of foreclosures, along with the oversupply of housing it created, depressed housing values even further. In a vicious cycle, the lower housing values created more negative equity for other homeowners.13 The period of macroeconomic weakness and contraction that followed, marked by increasing unemployment, contributed to additional foreclosures of even prime, fixed rate mortgages.14 These foreclosures further lead to more negative equity for homeowners and more foreclosures, which further depressed housing values.15

II. The Eminent Domain Proposal

a. Mechanics of the Proposal

The Proposal centers on the use of eminent domain by local governments to seize home loans and mortgages corresponding to “underwater”16 homes located within their respective jurisdictions. Both performing and non-performing17 underwater loans are subject to the Proposal.18 Under the Proposal, only underwater home loans currently held in private securitization trusts would be targeted by local governments.19 Private investors hold interests in these private securitization trusts and would be the parties to receive eminent domain compensation.20 Underwater mortgages held in trusts created by government sponsored entities, such as Fannie Mae and Freddie Mac, would not be included in the Proposal.21 The distinction stems from research that identified home loans in private trusts as more toxic and more likely to end in foreclosure.22 Additionally, the unique obstacles

12. See id at 8.
13. See id. at 18.
14. See Bhutta, supra note 9, at 3. A major trend in the literature on causes of home foreclosure is the “double trigger” theory that negative income shocks, such as loss of employment, extended sickness, or divorce, when combined with even low levels of negative home equity, lead to foreclosure. Id.
16. See Bhutta, supra note 9, at 2 (“underwater” is the vernacular phrase to describe a home with negative equity).
17. Stephen M. Frost The Bank Analyst’s Handbook: Money, Risk, and Conjuring Tricks 379 (John Wiley & Sons, Ltd. 2004). Non-performing loans are loans for which scheduled repayment is more than 90 days past due.
19. See id. at 2.
21. See Defendants’ Opposition to Motion for Preliminary Injunction, supra note 18, at 1-2.
22. See id. at 2.
to renegotiation posed by private trusts and the Proposal's perceived ability to address these specific obstacles are additional reasons for the distinction.23

First, the Proposal advocates for local governments to attempt a voluntary purchase with the current home loan owner. If the local government's offer is rejected, the local government must approve the use of eminent domain to seize selected home loans and mortgages.24 Second, the local government will proceed through eminent domain procedures established under state law to acquire the home loans and mortgages. MRP will use capital raised from private investors to fund the local government's condemnation awards.25 This feature avoids the use of any local taxpayer dollars.26 The Proposal calls for compensating the current loan holders at approximately 75 to 80 percent of the current fair market value of the home.27 The percentage reflects what MRP deems a "foreclosure discount," which reflects "the market's recognition of the cost in time, money and effort to foreclose on the homeowner and thereafter to maintain and sell the property."28 Implicitly, the compensation amount reflects an assumption that every individual home loan in eminent domain proceedings under the Proposal, regardless of how underwater it is, will enter into foreclosure.29 Following eminent domain proceedings, the local government and MRP will enter into negotiations with individual homeowners to originate a new home loan and mortgage. The two sides will negotiate with an eye toward reducing the principal amount owed to approximately 95 percent of the current fair market value of the home, in order to relieve negative equity and make monthly payments more afforda-

24. See infra notes 39-40, 42 and accompanying text.
25. See MORTGAGE RESOLUTION PARTNERS, supra note 20.
28. See MORTGAGE RESOLUTION PARTNERS, supra note 20.
ble.\textsuperscript{30} The new loan and mortgage will then be resold to new investors, with the proceeds devoted to repaying the investors who fronted the eminent domain award, MRP, and the local government. The local government would extinguish the seized home loan and mortgage.

\textit{b. The Proposal’s Advantages: Removing Market Impediments to Principal Reduction}

Proposal supporters cite attributes of the private mortgage backed securities market that make the Proposal preferable to other policy options aimed at reducing and eliminating foreclosure. A first mover problem in the mortgage loan industry prevents individual mortgage loan holders from renegotiating and lowering principal.\textsuperscript{31} As Professor Robert Hockett explains,

\begin{quote}
Everyone else’s revaluing eliminates debt overhang, [and] thereby lowers aggregate default risk, and so raises property prices. That in turn lessens the degree to which any last mortgage remains underwater – indeed it will probably lift it above water. Every mortgagee therefore has reason to wish to be last . . . All accordingly wait for the others to act.\textsuperscript{32}
\end{quote}

The Proposal provides the “combined orchestration” that removes the rational impulse to await others’ revaluing first.\textsuperscript{33} A second impediment is the structural characteristics of private securitization trusts that currently hold the home loans and mortgages. The fragmented ownership of the trusts between thousands of investors presents a coordinated action problem, as there are significant barriers to these investors locating each other and acting together to modify the loans in the trust.\textsuperscript{34} Additional barriers to renegotiation include, first, conflicts between investors who sit in different tranches, and thus, have different incentives regarding the timing of renegotiation, and second, the contractual agreements between trust servicers and investors that prohibit or greatly limit\textsuperscript{35} the servicers’ ability to modify or sell loans in a trust.\textsuperscript{36} Proponents argue current federal programs, such as Home Affordable Refinance Program (HARP) and Home Affordable Mortgage Program (HAMP), are not capable of overcoming the aforementioned coordination problems and achieve their limited success at significant taxpayer expense.\textsuperscript{37} In contrast, the Proposal “is de-
signed specifically to sidestep all of the unnecessary impediments that presently block meaningful debt revaluation.\textsuperscript{38}

c. Current Status of the Proposal

To date, no local government has exercised eminent domain pursuant to the Proposal. Collections of government leaders in prominent cities, such as, New York, have publicly expressed support for the Proposal.\textsuperscript{39} Several local governments studied the Proposal, only to abandon it.\textsuperscript{40} Several are in varying stages of study.\textsuperscript{41} Two cities, Richmond, California and Irvington, New Jersey, have advanced furthest by formally adopting the Proposal by a 4-3 and 6-1 vote of their respective councils.\textsuperscript{42} In Richmond, however, the Proposal still faces a substantial obstacle posed by a state law that requires a two-thirds supermajority of the Council to approve individual exercises of eminent domain.\textsuperscript{43} A possible end around the supermajority requirement is to partner with other local governments to implement the Proposal.

\textsuperscript{38} Id. at 28.

\textsuperscript{39} See Ben Lane, \textit{Is Eminent Domain Coming to New York City?}, \textit{Housing Wire} (June 25, 2014), http://www.housingwire.com/articles/30447-is-eminent-domain-coming-to-new-york-city (reporting support of the Proposal by four New York City council members).


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via a Joint Powers Authority (JPA). Only a simple majority of the City Council is required to enter into a JPA. A supermajority of the JPA would be required to condemn any home loan and mortgage using eminent domain. The Richmond City Council approved a plan to seek partners for a JPA. Despite Richmond not having condemned a single home loan or mortgage to date, private trust servicers brought suit against Richmond in federal court challenging the legality of the Proposal. The federal court dismissed the claims as unripe. Trust servicers subsequently withdrew appeals of the district court ruling, citing that the seizure of mortgages had not materialized. The outcome of Richmond's 2014 municipal election, which has the potential to shift the makeup of the city council, will likely determine the near-term trajectory of the Proposal.

d. History and Nature of Eminent Domain

Eminent domain is “the power of the sovereign to take property for public use without the owner's consent.” The power to take private property for public use has a long history, dating back as far as the Romans. The American Colonies exercised a power resembling eminent domain, although not using the name. The power continued

44. See CAL. GOV'T CODE § 6502 (2014).
48. See id. (order granting motion to dismiss).
49. See Sam Forgione, Investors Withdraw Appeals Against California Eminent Domain Plan, REUTERS (May 16, 2014, 8:29 PM), http://www.reuters.com/article/2014/05/17/us-mortgages-investing-eminentdomain-idUSBREA4G00A20140517 (stating that appeal would be "immediately re-filed" if Richmond took steps to further the Proposal).
51. JULIUS L. SACKMAN NICHOLS ON EMINENT DOMAIN § 1.11, 1-5 (Matthew Bender ed., 3d ed. 2014).
52. See id. at § 1.12, 1-14 (noting, however, that “it was not until after the close of the Middle Ages that the taking of property for public use as a distinct branch of governmental power began to be discussed”).
53. See id. at § 1.22(1), 1-78-1-99 (the system of exercising eminent domain in the American Colonies was influenced by the English practice of inquest by jury).
in the early United States, as several original state constitutions recognized and limited the power to take property for public use.\textsuperscript{54}

The U.S. Constitution addresses the eminent domain power in the Takings Clause of the Fifth Amendment.\textsuperscript{55} The clause places limitations on the exercise of eminent domain by the federal government, requiring the exercise be for a "public use" and that "just compensation" be paid to the owner of the condemned property.\textsuperscript{56} The U.S. Supreme Court incorporated the requirements of the Takings Clause against the states via the Fourteenth Amendment in the late 19th Century.\textsuperscript{57} All States currently impose independent limitations on eminent domain via state constitution and statute.\textsuperscript{58} The philosophical underpinnings of the source of the eminent domain power—a inherent power of sovereignty not requiring recognition by constitutional provision, but pre-existing in an absolute and unlimited form\textsuperscript{59}—shaped the federal and state provisions addressing eminent domain, which function as express limitations on the power.\textsuperscript{60} The federal and state governments possess the power as a function of their sovereign status.\textsuperscript{61} Political subdivisions of states, which are not sovereigns, do not inherently possess the power of eminent domain.\textsuperscript{62} Political subdivisions can only exercise eminent domain through a delegation of the power from the state via statute.\textsuperscript{63}

III. Legal Issues

The Proposal must satisfy both federal and state constitutional and statutory standards related to eminent domain. The Takings Clause establishes the minimum requirements to be observed by federal, state, and local governments in the course of taking private property.

\textsuperscript{54} See id. at § 1.12(2), 1-16.
\textsuperscript{55} See U.S. Const. amend. V ("[N]or shall private property be taken for public use, without just compensation.").
\textsuperscript{56} Id.
\textsuperscript{57} See Chicago B. & Q.R. Co. v. City of Chicago, 166 U.S. 226, 239 (1897).
\textsuperscript{58} See Sackman, supra note 51, at § 1.3, 1-92.
\textsuperscript{59} See id. at §1.14(2), 1-23, 1-27.
\textsuperscript{60} See id. at §1.14(2), 1-29.
\textsuperscript{61} See Cnty. of San Mateo v. Coburn, 130 Cal. 631, 634 (1900) ("The right of the state to appropriate private property for public use is an element of sovereignty ... "). See also Lore v. Bd. of Pub. Works, 277 Md. 356, 358 (1976) ("[T]he power of eminent domain adheres to sovereignty and requires no constitutional authority for its existence.").
\textsuperscript{62} See City of Oakland v. Oakland Raiders, 646 P.2d 835, 838 (Cal. 1982) ("In contrast to the broad powers of general government ... 'a municipal corporation has no inherent power of eminent domain and can exercise it only when expressly authorized by law.' ").
\textsuperscript{63} See generally Boswell v. Prince George's Cnty., 330 A.2d 663, 668 (Md. 1975) ("However, 'when property is to be taken for local public purpose the power is usually delegated to the municipal corporation or other governmental subdivision of the state ... such delegation is unquestionably within the power of the legislature.' ").
States are free to adopt more robust protections of property from eminent domain in their respective state constitutions or statutes, and many states have done so. Therefore, in many instances, satisfying the federal constitutional standard is only the first hurdle to clear.

In recognition of this reality, different state level requirements will be explored. State level focus is important given the vast state by state variation in foreclosure rates, and even large county by county variation within the same state. The localized concentrations of foreclosures make the Proposal especially attractive to a limited universe of local governments. Special focus will be paid to differential public use and compensation requirements present in five states currently facing the highest rates of home foreclosure – California, Nevada, Illinois, Florida, and Maryland.

The Takings Clause of the U.S. Constitution, which establishes “nor shall private property be taken for public use, without just compensation,” limits the exercise of eminent domain by the federal and state governments by imposing substantive requirements that the taking be for a “public use,” rather than a purely private use, and that the government entity adequately and monetarily compensate the property owner for the property taken. Before the contours of the federal and state public use and just compensation requirements are explored, it is first important to investigate whether the home loans – essentially contracts entitling the current holder to repayment – and the mortgage security interests that are seized are even considered “property” under the Takings Clause.

a. **Eminent Domain and Intangible Property: Federal Standard**

Intangible property, as well as tangible property, is subject to taking via eminent domain. The U.S. Supreme Court rejects this distinction

64. See Kelo v. City of New London, 545 U.S. 469, 489 (2005) ("Nothing in our opinion precludes any State from placing further restrictions on... the takings power. Indeed, many States already impose 'public use' requirements that are stricter than the federal baseline. Some of these requirements have been established as a matter of state constitutional law.

65. See U.S. Dep’t of Hous. & Urban Dev., supra note 8, at 9-12 (identifying at one extreme, a group of four states with a foreclosure rate more than double the national average, and at the other extreme, a group of four states where the foreclosure rate is at the historic average).”

66. See Brad Heath, Most Foreclosures Pack Into a Few Counties, USA TODAY (Mar. 6, 2009), http://usatoday30.usatoday.com/money/economy/housing/2009-03-05-foreclosure_N.htm (stating that more than half of the nation's foreclosures in the prior year were located within 35 counties).

67. See Katie Doyle, Top 10 States for Foreclosure in January, BANKRATE (Feb. 21, 2014, 2:00 PM), http://www.bankrate.com/finance/real-estate/foreclosures-by-state/ (including California, ranked tenth in foreclosure rate, because it is the state where the Proposal has gained the most traction).

68. See U.S. Const. amend. V.
for takings purposes.\textsuperscript{69} \textit{Louisville Joint Stock Land Bank v. Radford} confirms that mortgage security interests are condemnable under the Takings Clause.\textsuperscript{70} The Court determined, "[i]f the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain."\textsuperscript{71} The loan contract obligation itself, separate from the mortgage security interest, will be treated as intangible property subject to condemnation. Contract rights are subject to exercises of eminent domain, as "[a] contract is property, and, like any other property, may be taken under condemnation proceedings for public use."\textsuperscript{72} The Court has approved the use eminent domain for other forms of intangible property as well.\textsuperscript{73}

\textbf{b. Eminent Domain and Intangible Property: State Standards}

The five survey states represent the overwhelming stance among the states permitting seizure of intangible property via eminent domain. California courts expansively interpret the state government’s authority to condemn tangible and intangible property.\textsuperscript{74} Similarly, the California Supreme Court broadly construes cities’ constitutional and statutory eminent domain authority to encompass intangible property, concluding “the power which is statutorily extended to cities is not limited to certain types of property.”\textsuperscript{75}

\begin{itemize}
  \item \textsuperscript{69} See \textit{W. River Bridge Co. v. Dix}, 47 U.S. 507, 533-34 (1848) (“The distinction thus attempted we regard as a refinement which has no foundation in reason . . . A franchise is property, and nothing more; it is incorporeal property, and is so defined”).
  \item \textsuperscript{70} \textit{Louisville Joint Stock Land Bank v. Radford}, 295 U.S. 555 (1935) (challenge to the Frazier-Lemke Act, passed during the Great Depression, which allowed debtor-farm owners to stay bankruptcy proceedings for five years, during which the debtor retained possession of mortgaged real property if the debtor paid a reasonable annual rent. The Act also gave debtors the option at any time before five years to purchase the mortgaged property for its appraised value, discharging the mortgage and giving the debtor title and full possession of the property), \textit{implicitly overruled on other grounds by Wright v. Vinton Branch of Mountain Trust Bank}, 300 U.S. 440 (1937).
  \item \textsuperscript{71} \textit{id.} at 601-02.
  \item \textsuperscript{72} \textit{Long Island Water Supply Co. v. City of Brooklyn}, 166 U.S. 685, 690 (1897). \textit{See also U.S. Trust Co. v. New Jersey}, 431 U.S. 1, 19 n.16 (1977) (“Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid.”).
  \item \textsuperscript{74} \textit{See City of Oakland v. Oakland Raiders}, 646 P.2d 835, 837-39 (Cal. 1982).
  \item \textsuperscript{75} \textit{id.} at 838 (“A city may acquire by eminent domain any property necessary to carry out any of its powers or functions. . . ‘Property’ includes real and personal property and any interest therein.”) (quoting \textit{Cal. Gov’t
Nevada courts have not directly addressed whether intangible property is condemnable under Nevada’s Constitution and eminent domain statutes. However, a Nevada Supreme Court decision related to taking tangible personal property evidences a view that the eminent domain power is broadly interpreted to encompass all private property.

Illinois case law supports the conclusion that intangible property is encompassed within “private property” under the State’s constitution. Maryland case law also points to intangible property being subject to eminent domain. Florida case law recognizes the permissibility of taking intangible property pursuant to the State Constitution.

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76. See Nev. Const. art. I, § 8, cl. 6.
78. See ASAP Storage, Inc. v. City of Sparks, 173 P.3d 734, 739 (Nev. 2007) (sidestepping expressly answering whether tangible and intangible may be subject to a takings claim, but speaking in broad strokes nonetheless, noting “the term ‘private property’ in Nevada’s takings clause is plain on its face. . . . [T]hat provision broadly applies to all types of privately owned ‘property. . . .’ An alternative construction ‘would undermine the spirit of that provision, which . . . ‘contemplates expansive property rights’ and provides the foundation of Nevada’s ‘rich history of protecting private property owners against government takings’”).
79. See Horn v. City of Chicago, 87 N.E.2d 642, 646 (Ill. 1949) (citing to eminent domain provision of state constitution and concluding “a landowner may claim compensation for the destruction or disturbance . . . of such other intangible rights as he enjoys in connection with, and as incidental to, the ownership of the land itself.”).
80. See generally Ill. Const. art. I, § 15.
81. See De Lauder v. Comrs, 50 A. 427, 428-29 (Md. 1901) (“[Property] extends to easements and other incorporeal hereditaments, which, though without tangible or physical existence, may become the subject of private ownership.”). See also Washington Suburban Sanitary Comm’n v. Nash, 396 A.2d 538, 541 (Md. 1979) (condemnation of contract rights must adhere to strict requirements of eminent domain statute); Washington Suburban Sanitary Comm’n v. Frankel, 470 A.2d 813, 820 (Md. Ct. Spec. App. 1984) (“[A]t one time property was conceived of as tangible. But . . . the . . . notion of property . . . some tangible and some intangible, began to gain currency. The . . . concept of property for eminent domain purposes . . . addresses itself to every sort of interest the citizen may possess. This concept has long been recognized in Maryland.”), vacated on other grounds, 487 A.2d 651 (Md. 1985).
82. See State v. Basford, 119 So. 3d 478, 482 (Fla. Dist. Ct. App. 2013) (“[R]eal property, tangible property, and intangible property may be the subject of a takings claim.”).
c. The "Public Use" Requirement: Federal Standard

The requirement that an exercise of eminent domain be for a public use, rather than a private use, is evident in the text of the Takings Clause. In the absence of a public use justifying the taking of property, the taking is constitutionally invalid. The Court soundly rejects a narrow interpretation of the term "public use," which argues only government possession of the seized property or the legal right of the general public to use the property qualify as the public uses permitted by the Takings Clause. Rather, the Court has consistently construed the term "public use" to encompass the broader concept of "public purpose." Three cases, Berman v. Parker, Hawaii Hous. Auth. v. Midkiff, and Kelo v. New London, illustrate the "public purpose" interpretation and the analysis used to determine whether a taking is for a public use.

84. See U.S. Const. amend. V.
85. See Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229, 245 (1984) ("A purely private taking could not withstand the scrutiny of the public use requirement; it... would thus be void.").
86. See Kelo v. City of New London, 545 U.S. 469, 479-80 (2005) ("[W]hile many... courts in the mid-19th century endorsed 'use by the public' as the proper definition of public use, that narrow view... eroded over time. Not only was the 'use by the public' test difficult to administer... but... impractical given the diverse and... evolving needs of society... [W]hen this Court began applying the Fifth Amendment to the States... it embraced the broader... interpretation of public use as 'public purpose.'"). See also Midkiff, 467 U.S. at 244 ("The Court long ago rejected any literal requirement that condemned property be put into use for the general public. ... Government does not itself have to use property to legitimate the taking... "); Rindge Co. v. L.A. Cnty., 262 U.S. 700, 707 (1923) ("It is not essential that the entire community, nor even any considerable portion... directly enjoy or participate in any improvement in order [for it] to constitute a public use.").
87. But see Kelo, 545 U.S. at 508 (Thomas, J., dissenting) (arguing for a narrow interpretation of the term "public use" based on definition of "use" at time of framing of Takings Clause and concluding, "[t]he most natural reading of the Clause is that it allows the government to take property only if the government owns, or the public has a legal right to use, the property").
88. See Fallbrook Irrigation Dist. v. Bradley, 164 U.S. 112, 161, 164 (1896). See also Midkiff, 467 U.S. at 241 (utilizing the term "public purpose" in Public Use Clause analysis); Berman v. Parker, 348 U.S. 26, 32 (1954) ("The role of the judiciary in determining whether [eminent domain] is being exercised for a public purpose is an extremely narrow one."); Block v. Hirsh, 256 U.S. 135, 155 (1921) ("[Cited cases] illustrate... that the use by the public generally of each... thing affected cannot be made the test of public interest... [Cited cases] dispel the notion that what in its immediate aspect may be only a private transaction may not be raised by its class or charter to a public affair.").
89. See Kelo, 545 U.S. at 469; Midkiff, 467 U.S. at 229; Berman, 348 U.S. at 26.
Berman v. Parker focuses on a congressional statute that authorized the use of eminent domain to seize blighted, private real property in Washington, D.C. as part of a comprehensive redevelopment plan. Congress authorized the use of eminent domain for the prevention, reduction, and elimination of blighting factors or causes of blight. The statute called for the seized land to be leased or sold to public or private entities to carry out the redevelopment plan. Commercial property owners brought suit claiming their real property - which was not "slum housing" - was being seized not to eliminate "slums" or "blight," but rather to develop a balanced, more attractive community, and this was not a valid public use. The owners contended the area would be redeveloped for private uses, such as privately owned and occupied housing and commercial space, which violated the public use requirement.

The Court emphasized the deference owed to legislative determinations of the public interest noting "when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive." The Court asserted that the aforementioned deference owed to the legislature in exercise of its general police power extended equally in the context of eminent domain, establishing "[t]his principle admits of no exception merely because the power of eminent domain is involved." The Court characterized eminent domain as just one mechanism available to a government to execute its expansive police power, asserting "once the object" or the end "is within the authority of [the government unit], the right to realize it through the exercise of eminent domain is clear. For the power of eminent domain is merely the means to the end." The Court articulated a broad conception of the ends for which eminent domain could be utilized - essentially determining that public use is satisfied when eminent domain is used to exercise a permissible police power. The Court acknowledged the breadth of permissible public use and the deference owed to legislative determinations, noting "[i]f those who govern the Dis-

90. See Berman, 348 U.S. at 31. Although the case dealt with a Congressional statute governing Washington D.C., the Court expressly acknowledged the applicability of the decision to states and their subdivisions. Id.
91. See id. at 28-30.
92. See id. at 29.
93. See id. at 30.
94. Id. at 31.
95. See id.
96. Id. at 32.
97. The police power refers to the authority of the states to adopt legislation governing the health, safety, and general welfare of its residents.
98. Berman, 348 U.S. at 32.
99. Id. at 33.
100. See id. at 32 ("Public safety, public health, morality, peace and quiet, law and order-these are some . . . examples of the traditional application of the police power to municipal affairs. Yet they merely illustrate the scope of the power and do not delimit it.").
district of Columbia decide [it] should be beautiful as well as sanitary, there is nothing in the Fifth Amendment that stands in the way.~101

The Court decisively concluded that it is the exclusive province of the legislature to determine the particularities of how a permissible end is achieved and how eminent domain figures in.102 The property owners contended the government’s decision to rely heavily on private parties to achieve redevelopment would constitute a private taking, as property would effectively be transferred from one private party to another private party.103 The Court rejected the argument whole-heartedly, concluding, “the means of executing the project are for . . . Congress alone to determine, once the public purpose has been established.”104 The Court relied on the idea that the legislature is free to conclude that private parties would more effectively accomplish the public purpose, as opposed to government entities.105 The Court refused to offer any requirement that seized property remain under government ownership or be open to the public to qualify as a valid public use.106

In Hawaii Hous. Auth. v. Midkiff, the Court addressed a Hawaii statute authorizing use of eminent domain to correct distortions in the residential real estate market caused by concentrated land ownership.107 The Midkiff Court picked up where the Berman Court left off with regard to the relationship between state police powers and the use of eminent domain to carry out those powers. The Court was explicit on the symmetrical relationship between the two, commenting after a summary of Berman that “[t]he ‘public use’ requirement is . . . coterminous with the scope of a sovereign’s police powers.”108 The Court recognized a role for courts to play in reviewing a legislature’s judgment of what constitutes a public use, albeit a limited one.109 The approach to reviewing the legislature’s determination of public use

101. Id. at 33.
102. See id. ("Once the object is within the authority of Congress, the means by which it will be attained is also for Congress to determine.").
103. See id.
104. Id. See also Luxton v. North River Bridge Co., 153 U.S. 525, 529-30 (1894).
105. See id. at 33-34 ("The public end may be as well or better served through an agency of private enterprise than through a department of government or so the Congress might conclude.").
106. See id. at 34 ("We cannot say that public ownership is the sole method of promoting the public purposes of community redevelopment projects.").
107. Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229 (1984) (authorizing the state to seize real estate held by large private landowners via eminent domain and subsequently resell the land to other private parties in an effort to diversify land ownership, and thus, mitigate the deleterious effects of concentrated land ownership).
108. Id. at 240.
109. See id. at 240-41.
was marked by deference and rational basis review. The Court would not substitute its judgment for that of the legislature regarding what constituted a public use “unless the use be palpably without reasonable foundation.” The Court pointed out that it had never invalidated a compensated taking as violating a public use, so long as the exercise of eminent domain “is rationally related to a conceivable public purpose.”

The Court found that regulating land oligopoly and its consequences was a classic exercise of the police power and a legitimate purpose. Further, the legislature’s decision to exercise eminent domain as the means to achieve the purpose was rational as “the [constitutional requirement] is satisfied if . . . the . . . [state] Legislature rationally could have believed that the [Act] would promote its objective.” It was inconsequential to the Court that the statute “may not be successful in achieving its intended goals.”

Midkiff dismissed the argument that a transfer of private property from one private party to another private party was sufficient grounds for invalidation. Rather, the Court eschewed the lower court’s fixation on the particular logistics of how eminent domain operated, and instead, refocused the inquiry on the character of the ends the government sought to achieve, asserting, “it is only the taking’s purpose, and not its mechanics, that must pass scrutiny under the Public Use Clause.” The Court rejected the lower court’s black and white, mutually exclusive approach to private use and ownership on one hand and public purpose on the other, finding that private use of property subsequent to a taking is not inherently incompatible with a public purpose and “does not condemn that taking as having only a private purpose.” A “purely private taking” is invalid under the Takings Clause, but the Court offered a narrow definition. A taking “executed for no reason other than to confer a private benefit on a particular private party” would not satisfy public use. The Court refused to root this invalidity on the character of the parties involved, but rather, once again, determined that such a purely private taking would fail because “it would serve no legitimate purpose of government.”

110. See id. at 244 (“[I]f a legislature . . . determines there are substantial reasons for an exercise of the taking power, courts must defer to its determination that the taking will serve a public use.”).
111. Id. at 241.
112. Id.
113. Id.
114. Id. at 242.
115. Id.
116. Id. at 244.
117. Id. at 243-44.
118. Id. at 245.
119. Id.
In *Kelo v. City of New London*, property owners challenged the use of eminent domain by New London to seize non-blighted homes and land as part of a comprehensive plan to redevelop a section of the economically depressed city.\(^{120}\) The land would be devoted to a privately owned hotel and conference center, housing, shopping center, and office space.\(^{121}\) The city asserted that economic development, in the form of new jobs and increased tax revenue, was a valid public use.\(^{122}\)

The Court held that the takings met the public use requirement. In finding economic development to be a valid public use, the Court relied on the principles of deference to legislative determinations of what constitutes a public purpose, and to the legislature's choice of the mechanism to achieve it.\(^{123}\) The Court noted the symmetry between the scope of both the police power and the valid scope of eminent domain, as seen in *Berman* and *Midkiff*.\(^{124}\) The Court echoed the two cases in regards to the role of private parties and the lack of a necessary contradiction between a private use and a public purpose.\(^{125}\) However, the Court noted possible situations that would arouse the suspicion of an impermissible private purpose.\(^{126}\)

Justice Kennedy's concurrence adds an important layer to *Kelo*. Kennedy focused on the city's subjective intentions and motivations for the taking in determining whether a public or private use was present. He asserted that even in the face of the minimal, rational basis standard of review applied by the Court, "transfers intended to confer benefits on particular, favored private entities, and with only incidental or pretextual public benefits, are forbidden by the Public Use Clause."\(^{127}\) Kennedy surmised that "a clear showing" of such intent is necessary to invalidate the taking, and that the government should enjoy the presumption that its actions were reasonable and intended to serve a public purpose.\(^{128}\) He cited examples of factors suggesting the government's intent was not improper including: testimony from city officials and corporate beneficiaries, review of their communications, evidence corroborating the city's concerns regarding economic stagnation, competitive bidding for the project, and the unknown

\(^{120}\) See *Kelo v. City of New London*, 545 U.S. 469, 469 (2005).

\(^{121}\) See id. at 474.

\(^{122}\) See id. at 469-70.

\(^{123}\) See id. at 480 ("Without exception, our cases have defined [public use] broadly, reflecting our longstanding policy of deference to legislative judgments in the field.").

\(^{124}\) See id. at 482-83.

\(^{125}\) See id.

\(^{126}\) See id. at 486-87 (commenting that a "one-to-one transfer. . .executed outside the confines of a[ ] . . .redevelopment plan. . .would certainly raise a suspicion that a private purpose was afoot" but that was not present in this case).

\(^{127}\) Id. at 490 (Kennedy, J., concurring).

\(^{128}\) Id. at 491.
identity of several private beneficiaries at the time the city approved the plan.\textsuperscript{129}

\textit{Kelo} is most relevant, however, for the opposition it engendered in several states. Government officials and voters responded by enacting stronger limitations on eminent domain, including stricter definitions of public use and limitations on the use of eminent domain for economic redevelopment.\textsuperscript{130} States with notably high rates of foreclosure, including a subset of the five sample states, were no exception.\textsuperscript{131}

d. The "Public Use" Requirement: State Standards

California public use requirements for a local government taking hew closely to U.S. Supreme Court precedent.\textsuperscript{132} Case law employs generous language identifying a public use as, "a use which concerns the whole community or promotes the general interest in its relation to any legitimate object of government."\textsuperscript{133} In \textit{City of Oakland v. Oakland Raiders}, the California Supreme Court rooted its analysis of permissible public use in state eminent domain statutes applicable to local governments.\textsuperscript{134} The Court asserted that these laws did not impose any greater restriction on the use of eminent domain than the federal or state Constitutions.\textsuperscript{135} Moreover, deference to local government determinations of public use is required.\textsuperscript{136} Most notably, \textit{Oakland Raiders} provided elastic boundaries for the valid ends towards which eminent domain could be used, rejecting ridged notions of what constitutes a municipal function.\textsuperscript{137} The California courts focus on the purpose to be achieved and not on the mechanics of the eminent domain process or the involvement of private parties.\textsuperscript{138}

\begin{thebibliography}{9}
\bibitem{129} See \textit{id. at 491-92}.
\bibitem{130} See William Yardley, \textit{Anger Drives Property Rights Measures}, N.Y. TIMES (Oct. 8, 2006), \url{http://www.nytimes.com/2006/10/08/us/08domain.html?page_wanted-print&_r=0}.
\bibitem{131} See \textit{id. (click on multimedia graphic of the United States on left-hand side of article)}.
\bibitem{132} See \textit{CAL. CONST. art. I, § 19. See also CAL. GOV'T CODE § 37350.5 (2014); CAL. CIV. PROC. CODE § 1235.170 (2014)}.
\bibitem{133} Bauer v. Cnty. of Ventura, 289 P.2d 1, 6 (1955).
\bibitem{135} See \textit{id. at 69-72}.
\bibitem{136} See \textit{id. at 70 ("[T]he general statutory scheme would appear to afford cities considerable discretion in identifying and implementing public uses.").}
\bibitem{137} See \textit{id. at 72 (acknowledging the "evolving nature" of public use, which expands valid eminent domain exercises beyond traditional, limited public purposes).}
\bibitem{138} See \textit{L & M Prof'l Consultants, Inc. v. Ferreira}, 146 Cal. App. 3d 1038, 1053 (Cal. Ct. App. 1983) ("Once it is determined that the taking is for a public purpose, the fact that private persons may receive benefit is not sufficient to take away from the enterprise the characteristics of a public purpose.").
\end{thebibliography}
transfer of property from one private party to another private party via eminent domain is not fatal to a finding of valid public use, so long as a public purpose is served.\textsuperscript{139}

Illinois statute provides local governments with the ability to utilize eminent domain on property “useful, advantageous or desirable for municipal purposes or public welfare,” seemingly a broad grant of power.\textsuperscript{140} The statute establishes specific requirements for situations in which a taking results in private ownership or control.\textsuperscript{141} In such a situation, the burden lies with the government to prove by clear and convincing evidence that the acquisition is necessary for a public purpose and primarily for the benefit, use, or enjoyment of the public.\textsuperscript{142} The finding of necessity, in practice, presents a low bar for local governments to clear.\textsuperscript{143} The second requirement – primary benefit, use, or enjoyment by the public – has been subject to debate in the courts.

In Southwestern Illinois Dev. Auth. v. Nat’l City Envtl. L.L.C., (SWIDA)\textsuperscript{144} the Illinois Supreme Court invalidated a taking by a regional development authority on grounds that it was not for a public use.\textsuperscript{145} While the Court was clear that the transfer of private property from one private party to another via eminent domain was not fatal to finding a public use,\textsuperscript{146} the Court employed bold language suggesting approval of the narrow interpretation\textsuperscript{147} of public use so roundly dismissed by the U.S. Supreme Court.\textsuperscript{148} Public benefits alone were not enough to sustain a taking, as prior case law “expressed . . . that ‘to constitute a public use, something more than a mere benefit to the public must flow from the . . . improvement.’”\textsuperscript{149} The Court also employed more exacting scrutiny and gave little deference to the Authority’s judgment that condemnation would most effectively serve the asserted

\textsuperscript{139} See id. at 1047 (upholding exercise of eminent domain for a utility easement by private developer to provide sewer and storm drainage services to private community and finding state statutes were not unconstitutional for allowing the condemnation of private property for private use).

\textsuperscript{140} 65 ILL. COMP. STAT. 5/11-61-1 (2014).

\textsuperscript{141} See id.

\textsuperscript{142} See 735 ILL. COMP. STAT. 30/5-5-5(c) (2014).

\textsuperscript{143} See Cnty. Bd. of Sch. Trs. v. Batchelder, 130 N.E.2d 175, 178 (Ill. 1955) (“The word ‘necessary,’ as used in this connection, is construed to mean expedient, reasonably convenient, or useful to the public, and does not mean ‘indispensable’ or ‘an absolute necessity’ . . . . A determination of the question of necessity is left largely to the corporation or municipality, and its determination will be rejected only for an abuse of the power.”).


\textsuperscript{145} See id. at 9.

\textsuperscript{146} See supra note 84.

\textsuperscript{147} See Sw. Illinois Dev. Auth., 768 N.E.2d at 9 (quoting Gaylord v. Sanitary Dist., 68 N.E. 522, 524 (1903)) (“[T]he public must be to some extent entitled to use or enjoy the property, not as a mere favor or by permission of the owner, but by right.”).

\textsuperscript{148} Id. (quoting Gaylord, 68 N.E. at 524).
purposes. Recent appellate court decisions, however, have narrowly interpreted the language employed by the Court.

City of Chicago v. Midland Smelting Co. is one such case. The court in Midland Smelting interpreted SWIDA narrowly, focusing on the subjective motivations of the condemning authority to benefit private over public interests as the primary grounds the Illinois Supreme Court used to invalidate the taking, and dismissing the narrow definition of "public use" as the grounds for the decision. Midland Smelting cited to Illinois Supreme Court precedent that limited the restrictive language used in SWIDA. The court pointed to SWIDA's rejection of a bright-line rule - used to determine if a taking confers a purely private benefit - as cutting against a strict requirement that seized property be open to the public as of right. In total, the cases point towards a case-by-case evaluation of the actual purposes and motivations of the condemning authority to determine whether the taking was executed for the primary benefit of the public or for the benefit of private interests.

The status of Maryland law is in flux. On March 20, 2014, the Maryland Senate overwhelmingly passed a two year moratorium on local government condemnations of foreclosed and underwater mortgage loans. The sponsor of the Senate Bill, Joan Carter Conway, faced a primary challenge from a supporter of the Proposal, Baltimore City Councilman Bill Henry. The Maryland House of Delegates followed...
suit, and the bill was signed into law by Governor Martin O'Malley. In adhering to a flexible notion of public use, the courts do not adopt any bright-line test of public use, and caution against doing so. Public use is generally satisfied if a taking serves a primarily public benefit. The transfer of property from one private party to another is not fatal to public use. The courts show a willingness to scrutinize the actual, subjective motivations and purpose for the taking in order to determine if it is primarily designed to serve a public benefit.

Florida presents an example of a state response to *Kelo* that narrowed the contours of public use. In 2006, in the direct aftermath of *Kelo* the Florida Legislature adopted a statute that flatly prohibited the use of eminent domain to affect the transfer of property between private persons or entities. Shortly after the statute's passage, the Legislature proposed a constitutional amendment that was subsequently approved by Florida voters in November of 2006, which

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158. See Prince George's Cnty. v. Collington Crossroads Inc., 339 A.2d 278, 284 (Md. 1975) (“[T]he courts have had ... difficulty in their efforts to define 'public use.' No satisfactory single clear-cut rule regarding what is a public use... has yet been formulated. Moreover, even if it were possible to formulate such a rule, it would probably not be prudent to do so.”).
159. See Herzinger v. Mayor & City Council of Baltimore, 98 A.2d 87, 92 (Md. 1953) (“We think the fact that after the taking the property may be put into private hands does not destroy the public character of the taking insofar as that taking may accomplish a proper public benefit.”). See also Collington Crossroads Inc., 339 A.2d at 289 (“Under our cases, projects reasonably designed to benefit the general public... are public uses...”); Marchant v. City of Baltimore, 126 A. 884 (1924) (approving redevelopment of Baltimore Harbor even though the improvements would not be made available to use by public, and noting approvingly that it was a project of public purpose).
160. See Collington Crossroads Inc., 339 A.2d at 284 (“This Court has made clear that 'public use' does not mean that in all cases the public must literally or physically be permitted to use the property taken by eminent domain. Nor is it necessary that title to the condemned property be in the government.”).
161. See id. at 287-88 (“[W]here the predominant purpose or effect of a particular condemnation action has been to benefit private interests... the taking is not for a 'public use'... There has been no suggestion in this case that the purpose of the County's action is to benefit any particular private businesses or persons...”). See also Van Witson v. Guzman, 29 A. 608, 610 (Md. 1894) (invalidating taking of area in alley way for construction of wall by private citizen and noting “the extinguishment of their interests does not appear to inure in any way to the public service... nor to promote any public interest... nor... to have any relation to the public convenience or public welfare”).
banned the transfer of property between private parties via eminent domain. The three-fifths vote required by the state legislature to overcome the prohibition deprives local governments the of unilateral ability to evade the provision.

Nevada adopted a constitutional amendment in response to Kelo. Nevada’s provision redefines public use to exclude transfers of property between two private parties using eminent domain, reading “[p]ublic use shall not include the direct or indirect transfer of any interest in property taken in an eminent domain proceeding from one private party to another private party.” Following ratification, the Legislature revisited its eminent domain statutes and codified a similar prohibition. Commentators note the breadth of the prohibition encompassed in the statute.

e. “Public Use” and the Proposal

Supporters of the Proposal cite a plethora of ends the Proposal seeks to achieve that qualify as valid public uses. Richmond’s experience, serves as an instructive representation of local governments’ arguments that the taking of underwater home loans and mortgages is for a public use. Richmond points to the burdens of foreclosure that fall on the city and its residents, the mitigation of which, via the Proposal, amounts to a public use. Richmond cites threats to the health, safety, and general welfare posed by foreclosures, principally in the form of an increased number of vacant homes and the problems resulting from such vacancy. The problems include neighborhood blight, illegal garbage dumping, increased crime, and the diversion of city resources to address these problems. High foreclosure

164. See FlA. Const. art. X, § 6(c) (reading in pertinent part “private property taken by eminent domain pursuant to a petition to initiate condemnation . . . may not be conveyed to a natural person or private entity except as provided by general law passed by a three-fifths vote of the membership of each house of the Legislature”).
165. Id.
167. See Nev. Rev. Stat. § 37.010 (2013) (“[T]he public uses for which private property may be taken by the exercise of eminent domain do not include the direct or indirect transfer of any interest in the property to another person or entity.”).
169. See Defendants’ Opposition to Motion for Preliminary Injunction, supra note 18, at 14 (in 2010, the city removed 295 tons of trash from private property, a large percentage came from vacant homes).
170. Id. (noting police find it necessary to devote more resources to the neighborhoods with high vacancy rates).
171. Id. (noting fire services find it necessary to devote more resources to the neighborhoods with high vacancy rates).
rates have also depressed residential property values across the city.\textsuperscript{172} This market reality has led to decreased property tax collection and reductions in city services.\textsuperscript{173} The city also asserts that high levels of vacancy discourage prospective homebuyers from relocating to the city, which in turn, keeps property values low. Finally, underwater homes’ negative equity erodes broader economic recovery and hurts the local economy, as it dissuades homeowner consumption.

Even if an underwater home does not foreclose, there are additional rationales that support the Proposal as a public use. Lower levels of homeowner investment, property maintenance, and home improvements by underwater homeowners, compared to homeowners with positive equity, increase the risk of blight.\textsuperscript{174} Underwater homes also cause distortion in the local housing market, stemming from current loan holders’ unwillingness to consent to short sales and homeowners’ inability to sell homes at current market value.\textsuperscript{175} The inability to sell without a drastic loss also dissuades worker mobility.\textsuperscript{176}

The Proposal complies with the federal public use standard. \textit{Berman} and its progeny are clear that courts owe substantial deference to local government decisions to exercise its police powers and further the public interest. Further, eminent domain is merely a mechanism used to exercise police powers; eminent domain’s proper reach extends as far as a government’s legitimate police powers. In Richmond, the city identifies several public interests that fall within the city’s legitimate police power,\textsuperscript{177} even in its most traditional and narrow sense. Crime prevention, nuisance prevention, preservation and efficient allocation of city services and resources, and economic development - to name a few - are all served by the Proposal and are widely accepted as objects within the legitimate police power of local governments. Few would quarrel with the assertion that the aims of the Proposal are legitimate ends to be pursued by a local government. As such, the ability to use eminent domain as a mechanism to realize such ends is clear.

Richmond’s experience\textsuperscript{178} and documentation of\textsuperscript{179} the negative side effects of vacant housing created by foreclosure allows it to easily clear \textit{Midkiff}’s rational basis review. There are several conceivable public purposes accomplished by the Proposal and the use of eminent do-

\textsuperscript{172} Id. at 13.
\textsuperscript{173} See id. (noting between 2007 and 2012, the city’s property tax revenue declined by more than 14.5%. In 2009, the city had 950 people on staff, but for the current fiscal year only 786).
\textsuperscript{174} See \textit{Mortgage Resolution Partners}, supra note 20.
\textsuperscript{175} See \textit{Hockett}, supra note 23, at 47.
\textsuperscript{176} See \textit{Mortgage Resolution Partners}, supra note 20.
\textsuperscript{177} See supra notes 163-69 and accompanying text.
\textsuperscript{178} See Defendants’ Opposition to Motion for Preliminary Injunction, supra note 18, at 13 (noting that approximately 2,000 foreclosures occurred in city in the past 3 years, or 16% of homeowners with a mortgage).
\textsuperscript{179} See supra notes 163-69 and accompanying text.
main is a *rational* means to achieve those purposes. The city’s experience and widely available data confirm: (1) negative equity is the strongest predictor\(^{180}\) of foreclosure; (2) foreclosure leads to vacant housing; and (3) vacant housing produces conditions injurious to the health, safety, and general welfare of the city’s residents. The well-documented connection between negative equity, and the injurious conditions the city seeks to prevent, qualifies the Proposal as a rational means to address conditions on the ground, as the Proposal alleviates the root cause of all the conditions – negative equity.

The involvement of MRP, a private firm intimately engaged in the mechanics of the Proposal, and private investors who will financially benefit from the Proposal, presents no hurdle to satisfying the federal standard. *Berman* and *Midkiff* are clear that once a public use is established, it is the legislature’s prerogative to choose its method to execute a program. It is the taking’s purpose – not its mechanics – that must pass scrutiny. The city’s decision to utilize a private firm to manage and administer a complex program falls within the city’s recognized sphere.\(^{181}\) The city’s decision to sell the new, renegotiated home loans and mortgages to private investors, rather than to continue to hold them and collect payment, reflects the city’s determination that private parties possess considerably more resources and expertise to better carry out the responsibilities incident to ownership of the loans and mortgages. This is exactly the determination made by Congress in *Berman*, which the Court respected.

It is worth noting that three of the reasons offered by Richmond for adoption of the Proposal, namely blight prevention, mitigation of distortions in the local housing market, and economic development, are the same three purposes the Court already deemed to be valid public uses in *Berman*, *Midkiff*, and *Kelo*, respectively.\(^{182}\)

The opponents of the Proposal acknowledge as much; they couch their public use challenges on a narrow argument that the Richmond Proposal is an elaborate scheme designed to enrich MRP and private investors.\(^{183}\) Opponents point to what they deem to be suspect selection criteria for identifying loans to be condemned – criteria they contend favor selection of *performing* underwater loans not in immediate danger of foreclosure because these loans will generate the greatest profit.\(^{184}\) The argument is easily dismissed. The selection criteria utilized by local governments and MRP easily meet the test of *Midkiff* that

\(^{180}\) See U.S. DEP’T OF HOUS. & URBAN DEV., supra note 8, at 16.

\(^{181}\) MRP’s role is no different than, in a prototypical taking, a government relying on a private construction firm to redevelop a seized piece of private real property - a practice employed regularly with little protest.


\(^{183}\) See Plaintiffs’ Motion for Preliminary Injunction, supra note 27, at 9.

\(^{184}\) See id. at ii.
the condemnation bears a rational relationship to the public use. Richmond and MRP offer solid rationales for the selection criteria, noting the need for conformity with certain federal standards to allow the new, reduced principal loans to be eligible for federal insurance. Additionally, Richmond and MRP reject that only performing loans will be selected.\textsuperscript{185}

Even when measured against the \textit{Kelo} majority opinion and Justice Kennedy's concurrence relating to the motivations and intentions of the local government, it is evident the asserted public benefits are not merely pre-textual. First, the city is given the presumption of acting for a public benefit; this must be overcome by a clear showing to the contrary by the challengers. Second, MRP receives a flat fee for each condemnation, undercutting opponents' contention that the selection criteria are skewed in favor of the highest profitability. Third, the Proposal is not the isolated one-to-one transfer that the \textit{Kelo} majority believed would rightfully arouse suspicion of an impermissible private purpose.\textsuperscript{186} Instead, like the comprehensive redevelopment plan in \textit{Kelo}, the Proposal is an integrated plan targeting over 600 mortgages selected by various criteria — not an isolated, stand-alone transfer of property from one private party to another.

Finally, the Proposal meets Justice Kennedy's standard. Where the Proposal falls short, it owes to the unique problem it confronts. Richmond will have little difficulty documenting its awareness of the detrimental effects wrought by foreclosure on the city and producing evidence that corroborates these effects. Additionally, the identities of the private beneficiaries of the Proposal (the private investors who will fund the condemnation awards) were completely unknown at the time Richmond adopted the Proposal. Much hay could be made at the lack of competitive bidding to administer the Proposal, as Richmond did not consider bids from other firms besides MRP. While this fact could suggest a scheme between MRP and Richmond to enrich MRP, consideration of the circumstances undercuts this argument. The use of eminent domain as a means to solve the Foreclosure Crisis is highly innovative. The model was plucked from the realm of legal theory and pioneered for practical use by MRP. As a result, the universe of potential bidders to administer the Proposal was exceedingly limited. The circumstances dictate against construing the lack of competitive bidding as evidence of a private purpose to benefit MRP.

State specific barriers present possible hurdles for the Proposal in key states. The specific mechanics of the Proposal become extremely important in light of the Florida and Nevada constitutional provisions.\textsuperscript{187} Arguably, the Proposal eludes both states' prohibitions, as the seized home loans and mortgages are held only by the local gov-

\textsuperscript{185} See Mortgage Resolution Partners, \textit{supra} note 20.
\textsuperscript{186} See \textit{supra} note 120 and accompanying text.
\textsuperscript{187} See \textit{supra} notes 162-65.
Commentators argue that the Proposal eludes even Nevada’s stricter prohibition on direct or indirect transfers between private parties because the old loan never actually enters into private hands. Such a position is flawed because it mischaracterizes what property is actually being seized. The property seized is an interest in real property (the mortgage security interest) and the contract rights embodied in the home loan note—not the pieces of paper they are recorded on. The sleight of hand attempted by the Proposal relies on the pieces of paper being treated as the seized property. Only under this strained premise would extinguishing the old loan and mortgage, followed by creation of a new loan and mortgage conveying identical interests and contract rights connected to the same piece of real property, be anything but a direct transfer of private property.

To illustrate, the Proposal seizes a privately owned interest in a specified piece of real property (the mortgage) and privately owned contract rights connected with real property (the home loan). The Proposal expressly calls for that interest and right to be taken and extinguished and an identical interest and right (a home loan and mortgage in the same piece of real property) to be conferred on new, private parties. The interest and contract right once held by private party “A” is now held, albeit on slightly different substantive terms, by private party “B” to the exclusion of private party “A.” The interest and contract right private party “B” now holds owes its very existence to the exercise of eminent domain over the same interest and right formerly held by private party “A.” This lends a practical, common sense level of connection between loan and mortgage “A” and loan and mortgage “B.” The Proposal effectuates a direct transfer of private property between two private parties and, as a result, runs afoul of both the Florida and Nevada Constitutions.

188. See HOCKETT, supra note 23, at 30 (noting if a homeowner and the local government are unable to renegotiate a seized loan, the local government would be required by the constitutional provisions to hold the old loan and receive payment on it and could not resell the old loan into the private market).


190. The use of “identical” is referring to identical in form. It is true that the old loan and mortgage and the new loan and mortgage differ in their substantive terms, but the interests and rights they represent are identical in nature.

The Takings Clause commands “nor shall private property be taken . . . without just compensation.”191 The Court describes just compensation to be “the full and perfect equivalent in money of the property taken,” resulting in “[t]he owner . . . be[ing] put in as good position pecuniarily as he would have occupied if his property had not been taken.”192 The primary standard the Court uses to determine just compensation is the fair market value of the taken property.193 Fair market value is “what a willing buyer would pay in cash to a willing seller.”194 The objective standard does not take into account the subjective value an individual owner places in condemned property.195 The Court acknowledges the standard is not perfect. It points out that even where a market for the property exists, determination of fair market value will often rely on assumptions that make it unlikely an appraisal will reflect market value exactly and will often be determined by “a guess by informed persons.”196

The Court has dealt with the important question of timing – namely, when in the eminent domain process should the fair market value be ascertained and to what extent past and future events, occurring before and after condemnation, should be considered in determining current fair market value. The Court makes clear “value is to be ascertained as of the date of taking.”197 Past value of the property is inconsequential to determination of the current fair market value, as “[i]t is the property and not the cost of it that is safeguarded by state and Federal Constitutions.”198 As a result of this stance, “[fair market value] may be more or less than the owner’s investment.”199 When calculating fair market value, it is improper to consider whether the owner “may have acquired the property for less than its worth or he may have paid a speculative and exorbitant price” or that “[i]ts value may have changed substantially while held by him.”200 The Court is concerned with the danger of a windfall coming to the government or the property owner as a result of past value fluctuations, asserting “[t]he public may not by any means confiscate the benefits, or be re-

191. U.S. Const. amend. V.
193. See id. at 373-74.
194. Id. at 374.
195. See id. at 375. See also United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979) (“Because of serious practical difficulties in assessing the worth of an individual places on particular property at a given time, we have recognized the need for a relatively objective working rule. . . . The Court therefore has employed the concept of fair market value to determine the condemnee’s loss.”).
196. Miller, 317 U.S. at 375.
197. Id. at 374.
199. Id.
200. Id.
quired to bear the burden of the owner’s bargain.” In essence, the Court rejects adding any additional compensation, beyond current fair market value, in recognition of past value.

Consideration of the potential future value of seized property is somewhat limited, although not as circumscribed as past value, in determining just compensation. Harkening to the principle that fair market value is rooted in what a willing buyer would pay a willing seller, the Court directed “all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining” should be taken into account. Such future factors properly considered include, for instance, the most profitable, reasonably probable future use of the property. However, the Court is quick to condemn the use of “speculation” and “conjecture” related to possible future uses to discern current value. In essence, the Court considers reasonably probable future uses to be figured into the market price.

The Court does not mandate that possible future value of the property be added in addition to the fair market value. Such a mandate would run afoul of the general principle that “[w]here . . . there is a market price prevailing at the time and place of the taking, that price is just compensation . . . [m]ore would be unjust to the [government], and less would deny the owner what he is entitled to.” The Court makes clear that “[j]ust compensation includes all elements of value that inhere in the property, but it does not exceed market value fairly determined.” However, to the extent possible future value is reflected in the current fair market value, the Court does not quarrel with its inclusion in the market value. The approach of the Court makes sense, as to a great extent, the current owner is already compensated for future value based on the current market price because probable future value is generally built into the current market value. A willing buyer and a willing seller, in most instances, consider the possible future value of the property during bargaining. To award the owner any compensation in addition to fair market value, based on considerations of future value, would overcompensate the property owner.

While fair market value is the primary and preferred method for arriving at just compensation, the Court will utilize other methods in...

201. Id.
202. Id. at 257.
203. See id.
205. Id., 292 U.S. at 255.
206. See id. at 257 (establishing, in connection with estimates of fair market value, that “all considerations that fairly might . . . reasonably be given substantial weight” in bargaining between a buyer and seller and “all facts affecting the market value” are to be considered).
certain circumstances. The Court applies other standards when market value is too difficult to find or when market value would result in a “manifest injustice” to either the property owner or the government. In most instances, a market of some kind will exist for a type of property. Market value is too difficult to find when the property is “so infrequently traded that we cannot predict whether the prices previously paid . . . would be repeated.” Market value is still used even if the market “[i]s not an extremely active one.” The Court places a high bar on the lack of a market, covering only those situations “involv[ing] properties that are seldom, if ever, sold in the open market.”

Compensation amounting to a “manifest injustice,” the second circumstance that makes application of fair market value inappropriate, is keyed to the “indemnity principle” of just compensation. The indemnity principle is the notion of placing the owner in as good of a position pecuniarily as he would have been if the property was not taken. The Court, however, is clear that a perfect indemnity principle is not required or desirable. An award based on fair market value “does not necessarily compensate for all values an owner may derive from his property.” Illustrative examples of the imperfect indemnity principle are Court decisions refusing to require a condemnation award in the amount required to obtain replacement property.

207. See United States v. 50 Acres of Land, 469 U.S. 24, 29 (1984) (“Deviation from [fair market value] measure . . . has been required only ‘when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public.’”).

208. See id. at 30 (concluding that there was a robust market for landfill properties and noting that fair market value is not to be used in cases involving property “that [is] seldom, if ever, sold in the open market”).


210. United States v. 564.54 Acres of Land, 441 U.S. 506, 513 (1979) (citing examples of public facilities, such as roads and sewers).

211. Id. (going on to note that eleven recent sales of summer camps in the vicinity was sufficient market). But see United States v. Toronto, Hamilton & Buffalo Navigation Co., 338 U.S. 396, 402-03 (1949) (determining that five sales of dissimilar vessels occurring over several years not enough to establish market for Great Lakes car ferry).

212. 50 Acres of Land, 469 U.S. at 30.

213. See 564.54 Acres of Land, 441 U.S. at 510-11.

214. See id. at 511 (commenting “this principle of indemnity has not been given its full and literal force” and noting the serious practical difficulties of assessing the worth an individual places in a piece of property). See also United States v. Miller, 317 U.S. 369, 374 (1943) (rejecting as too broad the argument that all elements that go to make up value are to be considered in determining fair market value and determining that it was improper to include the effect of recent, nearby condemnations when determining the value of property laying within the same proposed project site as those prior condemnations).

215. 564.54 Acres of Land, 441 U.S. at 511.

216. See 50 Acres of Land, 469 U.S. at 34 (rejecting replacement value as mandated compensation out of fear that property owners would receive a wind-
While some deviation from the indemnity principle is tolerated, the Court draws the line between permissible deviation and manifest injustice at the point where the fair market value diverges "substantially" from the indemnity principle. Case law is helpful for illustrative purposes. In United States v. 564.54 Acres of Land, the owner of a summer camp contended that the payment of fair market value was manifestly unjust because that amount made acquiring a replacement facility impossible, due to a plethora of new regulations that would be applicable to the replacement facility. In United States v. 50 Acres of Land, the Court addressed a similar claim made by a municipality after the federal government condemned its garbage facility. The municipality contended that the cost to replace the facility exceeded the fair market value of the old facility, and it was unjust not to provide replacement costs because the municipality was compelled to acquire a new facility to provide an essential service. In both cases, the Court refused to award replacement costs on the rationale that it provided a windfall to the property owner. The Court determined that such a windfall ran afoul of the "guiding principle" that the owner "must be made whole but is not entitled to more." Anything properly characterized as a windfall to the property owner is not compensation, which, if denied, leads to manifest injustice. Rather, its award would go above and beyond the requirements of the imperfect indemnity principal.

The Court has weighed in on the role forward looking calculations of future value play in determinations of manifest injustice. United States v. Commodities Trading Corp. involved the requisitioning of pepper during World War II when price ceilings were in place. The owners of the pepper contended that the amount of compensation awarded should include an additional "retention value" because pepper, as a non-perishable commodity, could be held until price controls were removed and then sold for a higher cost. The owners contended that as "investors," they should not be deprived of the pe-

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217. 564.54 Acres of Land, 441 U.S. at 513.
218. See id. at 514.
220. See id. at 34.
221. See id. at 34-35 (asserting that the increased quality of the new facility, reflected in the higher price, would be enjoyed by the property owner without any additional expenditure for that increased quality). See also 564.54 Acres of Land, 441 U.S. at 515-16 (commenting that awarding replacement costs constitutes a windfall because replacement facilities may never be purchased or may be acquired and then sold).
222. 564.54 Acres of Land, 441 U.S. at 516 (emphasis omitted) (quoting Olson v. United States, 292 U.S. 246, 255 (1934)).
224. See id. at 122-23.
cuniary benefits, which future higher prices would have created in the absence of the taking. 225 The Court refused to include any concept of retention value into the compensation owed and instead determined that the price ceiling at the time of the taking was the market price and, thus, just compensation. 226 The Court acknowledged that while “current market value may sometimes be higher because a buyer anticipates future rises in prices,” it was only “exceptional circumstances” that would “justify resort to evidential forecasts of potential future values in order to determine present market value.” 227 The Court pointed to the “highly speculative nature” of future prices on which retention value relied, and the “haphazard . . . calculations” required to arrive at the amount, which were based on, at worst, “guesses,” and at best, many “unknowns.” 228 Completely contrary to the position that withholding the retention value was unjust, the Court determined “[a] rule so difficult to apply” actually “leads to . . . unjust results” and is not required for just compensation. 229

The Court also addressed the role past value plays in determining fair market value and manifest injustice. In Olson v. United States, the Court undercut the position that consideration of past value is necessary to avoid unjust compensation, in the event the seizure occurs after a precipitous drop in value. 230 The Court steadfastly held to the principle that fair market value at the time of the taking is proper, even if “[i]t may be more or less than the owner’s investment . . . or [the owner] paid a speculative and exorbitant price.” 231 Just as the public was not entitled to confiscate the benefits of the investment, the Court concluded the public was not required to carry the burden of a bad investment. This would place the property owner in a better financial position, not an equal financial position, and would be beyond the requirements of the indemnity principle.

g. “Just Compensation:” State Standards

California law mimics the federal standard in all relevant dimensions. California statutes require just compensation be paid to the property owner. Fair market value, defined as what a willing buyer would pay a willing seller, is the default standard of compensation. 232 Deviation from fair market value is permissible when there is no relevant, comparable market available. Nevada’s just compensation requirement is similar. Fair market value is adopted as the primary

225. See id. at 128-29.
226. See id. at 130.
227. Id. at 126.
228. Id. at 126-27.
229. Id. at 127-28 (emphasis added).
231. Id. at 255.
standard. Factors that a well-informed buyer would use in arriving upon a price are properly considered in ascertaining fair market value. Illinois and Maryland law likewise mirror the federal standard in many regards. The standard is fair market value, determined by what a purchaser willing to buy the property would pay to an owner willing to sell in a voluntary sale. The Maryland Supreme Court expressly acknowledged the close association between the State Constitution and the U.S. Constitution on just compensation issues, establishing that decisions of the U.S. Supreme Court are “practically direct authority” for the state’s just compensation clause.

Florida’s compensation standard differs in pertinent respects from the federal standard. The Florida Constitution mandates that “full compensation” be paid to the property owner. The requirements of full compensation are interpreted to be broader than the federal requirements for just compensation. Fair market value is the primary starting point for determining full compensation. However, fair market value does not include all the requirements of full compensation. Other costs to the property owner are included in the computation of full compensation. The courts adopt a more expansive view of full compensation’s requirements by taking a practical approach towards determining what is needed for a property owner to be “made whole so far as possible and practicable.” The practical approach is reflected in decisions incorporating costs such as appraiser fees into full compensation. Most notably, property owners’ reasonable attorney fees and costs are part of full compensation, a requirement that

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233. See Tacchino v. State Dep’t of Highways, 508 P.2d 1212, 1214 (1973) (deeming the potential income to be derived from subdivision lots to be relevant to the determination of fair market value, as “sophisticated investors make decisions on the basis of income capitalization”). See also Clark Cnty. v. Alper, 685 P.2d 943, 946 (Nev. 1984) (“Every factor which affects the value of the property and which would influence a prudent purchaser should be considered.”).

234. See 735 ILL. COMP. STAT. 30/10-5-60 (2014); MD. CODE ANN., REAL PROP. § 12-105 (2014).


236. FLA. CONST. art. X, § 6, cl. (a).


238. See Dep’t of Transp. v. Nalven, 455 So. 2d 301, 307 (Fla. 1984) (“In most cases it will be necessary and sufficient to full compensation that the award constitute the fair market value of the property.”).

239. See Jacksonville Expressway Auth., 108 So. 2d at 291 (“Fair market value is merely a tool to assist us in determining what is full or just compensation, within the purview of our constitutional requirement.”).

240. See id. at 292 (“The theory and spirit of [the full compensation] guarantee require a practical attempt to make the owner whole.”).

241. Id. (quoting Dade Cnty. v. Brigham, 47 So. 2d 602, 604 (Fla. 1950)).

242. See Brigham, 47 So. 2d at 604.

243. See Little, supra note 163, at 111.
was later codified. The statute awards attorney fees according to a percentage of the benefit achieved, which is the difference between the preliminary offer of compensation by the government and the court ordered compensation.

h. "Just Compensation" and the Proposal

The Proposal’s approach to calculating just compensation is problematic under the federal standard. The Proposal calls for the current owner of a seized home loan and mortgage to be compensated at 75 to 80 percent of the current fair market value of the corresponding home. The 20 to 25 percent reduction is described as a “foreclosure discount.” To illustrate, when a home forecloses, the current owner of the loan and mortgage will repossess the home and recapture the value of the home at the time of resale. In doing so, the loan and mortgage owner will bear the costs of the legal process, marketing to new buyers, and maintenance, among others, to the tune of an estimated 20 to 25 percent of the current value of the home. For its part, MRP contends its approach to valuation and compensation relies on market data for sales of distressed loans and mortgages, and that the foreclosure discount is a common market practice when reselling such loans and mortgages. MRP’s version of market data analysis, which leads to a loan and mortgage valuation in every case that equals the current fair market value of the home minus the foreclosure discount, does not accurately represent market dynamics.

The Proposal’s compensation logic is flawed for three principal reasons and, as a result, requires substantial revision. First, it ignores the mortgage loan’s value as an unsecured debt in recourse states. Second, the Proposal’s overreliance on the current fair market value of the home to arrive at the value of the loan and mortgage interest at condemnation is a tactic that presupposes the imminent foreclosure of any condemned home. The Proposal plays off the general principle

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245. See Fla. Stat. § 73.092 (2014). But see Fla. Stat. § 73.131(2) (2014) (property owner’s attorney fees are not covered on appeal if the property owner appeals and the judgment is affirmed).
246. See Mortgage Resolution Partners, supra note 20.
247. See Andra C. Ghent & Marianna Kudlyak, Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States 4-5 (Federal Reserve Bank of Richmond), available at https://www.richmondfed.org/publications/research/working_papers/2009/pdf/wp09-10r.pdf. Thirty-eight states are recourse jurisdictions, meaning that when a home is foreclosed, the creditor is still able to pursue the debtor for the difference between the proceeds of the home’s resale and the value on the face of the note. The extra value derived from being able to sue for the full value of the note is disregarded when the current fair market value of the home is mechanically applied as adequate compensation for the value of the mortgage note. Non-recourse states are: Alaska, Arizona, California, Connecticut, Florida, Minnesota, North Carolina, North Dakota, Texas, Utah, and Washington. Id.
that a mortgage is only as valuable as its collateral.\textsuperscript{248} So, goes the reasoning, if a home is worth $200,000 when condemned, the underlying mortgage interest is also worth $200,000. This is what the holder of the mortgage would recover in the event of a foreclosure. Such a tactic disregards the inherent differences in the particular foreclosure risk presented by different loans and mortgages.\textsuperscript{249} The overreliance on the current fair market value of the home ignores the well-developed, sophisticated secondary mortgage market. The secondary mortgage market more accurately represents the true fair market value of the note and the mortgage by incorporating the disparate risk inherent in different loans and mortgages into the market price.

The proposal ignores the basic fact that mortgages and borrowers vary, and that these variations are pertinent when measuring the risk of foreclosure versus the likelihood of repayment; this risk influences value. Such risk calculations invariably affect what a willing buyer of a loan and mortgage would pay on the secondary market. The lower the risk of foreclosure, the closer a buyer and seller would move towards the monetary amount on the face of the note—often an inflated amount emblematic of the bubble years; the higher the risk, the higher the likelihood of foreclosure is and the closer the buyer and seller would move towards the fair market value of home, as that is the value recovered in the case of foreclosure. For instance, common sense would dictate that a secondary purchaser of a loan and mortgage would pay more, and a seller would demand more for a performing loan with a 110 percent loan-to-value ratio (LTV ratio)\textsuperscript{250} corresponding to a home located in a relatively stable local housing market compared to a non-performing loan with a 170 percent LTV ratio in a turbulent local housing market, such as California. The former loan is considerably more likely to be paid up to the amount on the face of the loan note, as compared to the latter loan, which is considerably more likely to foreclose.

Risk is also assessed according to future projections of housing market dynamics. The LTV ratio is the single biggest predictor of foreclosure, however, inherent in its title is the concept of value—a term that fluctuates over time. If one subscribes to the position that the housing market is recovering and housing values will increase in the near future, the 150 percent LTV ratio of today could be the 130 percent

\textsuperscript{248} See generally \textit{Restatement (Third) of Property (Mortgages)} § 8:2 (1997).

\textsuperscript{249} See Bhutta, \textit{ supra} note 9, at 2, 25 (Study of foreclosure behavior in four states (Arizona, California, Florida, and Nevada) concluded the median foreclosing homeowner did not foreclose until 162% LTV is reached. In recourse states, the median foreclosing homeowner did so at 20 to 30 percentage points higher than in non-recourse states.).

LTV ratio of two years from now, making the purchase of that loan today considerably less risky and driving up its value to buyer and seller.

Risk fluctuates with projections of macroeconomic conditions, as well. It is well documented that for many homeowners, a “trigger event” (like loss of employment) is often the immediate cause of foreclosure. A buyer and seller who project worsening employment levels will be likely to assign more risk to the repayment of the loan and mortgage and, therefore, arrive at a lower price. There are several additional factors that could feasibly enter into determining the market price for a particular loan and mortgage.

The Proposal falls short by painting with too broad a brush. Its provision for compensation equaling the current fair market value of the home reveals its assumption that any condemned mortgage—regardless of its particular characteristics—will imminently foreclose. This approach accurately values those limited mortgages that would have foreclosed in the month immediately following condemnation, but systematically undervalues every other loan and mortgage not in immediate danger of foreclosure. The secondary market for mortgages is best suited to incorporate all loan and mortgage characteristics and risks and arrive at an amount that more accurately and fully reflects the value of a particular mortgage on the date of condemnation.

The third reason the Proposal’s compensation approach is flawed, the use of the foreclosure discount, arouses concerns similar to the immediately preceding paragraphs. It too applies the presumption of imminent foreclosure to all condemned loans and mortgages with no regard for the differing probabilities that foreclosure will occur. While research suggests that differences in loan characteristics (most principally LTV ratio) shape foreclosure versus non-foreclosure outcomes, the Proposal assumes a simplified, hyper-rational homeowner who will strategically defauh and foreclose when the LTV ratio becomes sufficiently negative. Working off the hyper-rational borrower presumption, the application of the foreclosure discount to all underwater mortgages would make sense. However, homeowner-debtors are not hyper-rational or hyper-informed, and many will not foreclose, even when facing high LTV ratios and an actual net benefit by foreclosing. Economically irrational factors, such as large perceived penalties, social stigma against foreclosure, or unrealistic optimism in

251. See Bhutta, supra note 9, at 3-4, 28 (the study found that sub-prime borrowers paid a substantial premium over the cost of renting to stay in their homes, leading the authors to conclude that this “challenges traditional models of hyper-informed borrowers operating in a world without economic friction.” The study surmised that “more typical borrowers may be willing to pay an even larger premium given they have likely invested more financially and emotionally in their house.”).

future equity growth\textsuperscript{254} prevent borrowers from foreclosing even when it is in their best interest to do so.\textsuperscript{255} A recent study confirmed homeowners are not hyper-rational, finding the median LTV ratio for foreclosures observed in the study to be 162 percent.\textsuperscript{256} Therefore, many homes, although underwater, are more likely not to foreclose than to ever foreclose and ever saddle the current loan and mortgage owners with the costs incident to foreclosure. To assess the discount as a matter of course creates a substantial likelihood that an owner will be denied compensation that the market would otherwise provide in recognition that a particular loan is unlikely to ever foreclose.

The Proposal's standard departs from the Court's strong preference for fair market value as the appropriate measure of just compensation. The two exceptions to using fair market value - the absence of a market for the property and its use working a "manifest injustice" to either party are simply not applicable. There is a substantial market for home loans and mortgages available. Given the high volume of sales in the secondary mortgage market, appraisers and expert witnesses could draw on a substantial amount of market data generated from recent sales of similarly situated loans and mortgages to arrive at an accurate estimate of the value the market assigns to a particular condemned loan and mortgage.

Utilizing the secondary mortgage market price as the lodestar would not work a manifest injustice to either the property owner or the government. Use of fair market value would not deviate so substantially from the indemnity principle, by greatly overcompensating or undercompensating the current owners, as to amount to a manifest injustice. Any argument by the loan and mortgage owners for a premium on top of fair market value will likely be rejected. The substantial investment losses suffered by the current owners, though unfortunate, are considerations of past value of the property that are not to enter the compensation determination.\textsuperscript{257} Requiring the public to bear the costs and burdens of poor investment decisions by the trusts and their private investors by compensating above fair market value would provide, in essence, a bailout, and in practice, a windfall for these private investors by leaving them in a better position as a result of the taking. Considering and internalizing the risks of foreclosure into its price, it would be a better position because such an amount would exceed that which the market has determined is the probable future payout of the loan. The indemnity principle is de-

\textsuperscript{253} See id. See also Luigi Guiso et al., Moral and Social Constraints to Strategic Default on Mortgages 8, 9 (Nat'l Bureau of Econ. Research, Working Paper No. 15145, 2009).

\textsuperscript{254} See Bhutta, supra note 9, at 28.

\textsuperscript{255} See id. at 4, 28.

\textsuperscript{256} See id. at 1.

\textsuperscript{257} See supra notes 198-94 and accompanying text.
signed to leave the property owner in as good of a position, not a better position, but for the taking. The market value is more loyal to the indemnity principle than any approach that pays a premium over market value based on the past value of the property and the large investment losses suffered.

Any premium over fair market value based on possible future value is also improper and is not required to comply with the indemnity principle. Such a premium is analogous to the "retention value" premium rejected in Commodities Trading Corp. Just like the future market conditions and the "retention value" premium advocated for in Commodities Trading Corp., which were both prone to speculation and conjecture, the future conditions of the housing market and the overall economy are uncertain. Both lend themselves to producing haphazard individual forecasts pertaining to the future value of seized loans and mortgages in excess of the current fair market value. The process of computing and arriving at such a premium would also be extremely difficult to apply, as was noted in Commodities Trading Corp. In contrast, the private market is capable of aggregating the information, calculations, and forecasts of thousands of highly skilled investors to arrive at a market price that more accurately incorporates the probable future value in its price already. Consistent with the fears expressed in Commodities, a premium could lead to overcompensation for some property owners. The overcompensation would arise from essentially double counting future value, as it is already incorporated in the market price and then awarded again by a premium. Such overcompensation would run afoul of the indemnity principle by leaving current property owners better off than if the taking never occurred.

If one accepts MRP's projection that market prices for every condemned loan and mortgage will be the value of the home minus the foreclosure discount, the use of such market data, if it in fact exists, would amount to a manifest injustice. This is so because deeply distressed loans would be valued in the same manner as considerably less distressed loans. Such an outcome would either substantially overvalue highly distressed loans and mortgages by pricing them using identical assumptions and risk projections as loans with considerably fewer risk factors, or substantially undervalue less distressed loans and mortgages by using identical assumptions and risk projections as loans with considerably more risk factors. In either instance, the indemnity principle is violated in a substantial way. If the market operates in the manner MRP contends, a different standard of valuation will be required.

Florida's full compensation requirement poses additional complications for the Proposal's financial viability in the state. Florida law requires that reasonable attorney fees and costs, along with appraiser

258. See supra note 218 and accompanying text.
and expert witness fees expended by the property owner, be included in the amount of compensation. Establishing fair market value using secondary mortgage market data will likely require sophisticated appraisal and expert witnesses to testify to value. With the issue of the appropriate measure of just compensation still very much in flux, substantial differences may arise between the government’s preliminary offer of compensation pursuant to the Proposal and the court ordered compensation utilizing the market data approach. The difference could saddle the governments with hefty obligations to pay legal fees. The local government would take on these costs for each loan condemned. The costs would eat into MRP’s fee or the returns to the local government’s private investors.

Conclusion

The Proposal faces significant state level difficulties in the realm of the public use requirement. Two epicenters of the Foreclosure Crisis, Florida and Nevada, constitutionally prohibit the type of property transfer the Proposal utilizes. State level action to specifically thwart the Proposal is gaining traction, ominously, in a state like Maryland, which has a political affiliation one would expect to ideologically identify with the Proposal’s raison d’être. Looking forward, the battleground for the Proposal’s future on the public use question will likely be state legislatures across the country. With all eyes on Richmond, it can be expected more state legislatures will act to redefine public use to exclude seizure of underwater mortgages if Richmond proceeds with the Proposal and actually seizes loans and mortgages.

The Proposal’s approach to the just compensation requirement suffers from many maladies. The just compensation rationale is plagued by faulty, blanket assumptions regarding the unique risk factors of individual loans, foreclosure behavior, and how the secondary mortgage market responds to both in valuing loans and mortgages to arrive at fair market value. The Proposal’s approach to just compensation is based, at best, on overly pessimistic beliefs regarding how the secondary mortgage market values loans and mortgages and, at worst, on an attempt to systematically undercompensate for any loan and mortgage not in imminent danger of foreclosure. While local governments are not required to bail out poor investment decisions by the current owners of the underwater home loans through the vehicle of just compensation or to provide a premium beyond fair market value, local governments are responsible for valuing each seized loan and mortgage individually. The secondary mortgage market aggregates the knowledge and expertise of thousands of traders around the world to

259. See supra Part III.d-e.
260. See supra Part III.h.
arrive at a market price that more accurately reflects the true value of seized loans and mortgages.

The Proposal’s financial viability depends on condemned loans being valued at 75 to 80 percent of the current fair market value of the home. If the secondary mortgage market does not share a local government’s belief that a seized loan will imminently foreclose, and instead, arrives at a higher value, the Proposal ceases to be financially sustainable, as the return to the private investors and MRP’s fee dries up. Of course, the Proposal can be tweaked to avoid the pitfalls of its current approach to compensation and still be economically viable. For instance, a scaled back version that reduces, but may not totally eliminate, negative equity is an approach that would compensate owners adequately and mitigate future foreclosures. In a cruel twist, the fate of the Proposal and, thus, the fates of numerous local governments and underwater homeowners, depend on the pricing behavior of the secondary mortgage market – the same market partially responsible for the current foreclosure plight.