Bond Case Briefs

Municipal Finance Law Since 1971

Forbes: Mortgage-Seizure Plan Resurfaces As Investors Try To Kill It For Good.

Later this week, securities-industry representatives will jet out to Nevada and California to try and tamp out a brushfire they thought they'd extinguished last year. In meetings with officials in North Las Vegas; Richmond, Calif. and possibly other foreclosure-plagued cities they will once again argue against a plan in which cities would use their eminent-domain powers to seize mortgages so they can be refinanced at lower rates.

"I feel like I'm playing a game of Whac-A-Mole," said Vincent Fiorillo, a portfolio manager with DoubleLine Capital, which has more than $50 billion invested in mortgage-backed securities. "This idea keeps coming back."

Fiorillo belongs to the Association of Mortgage Investors, which, along with the Securities Industry Financial Markets Association, talked San Bernardino, Calif. and several neighboring cities out of adopting the eminent-domain scheme last year, saying it would be "immensely destructive to U.S. mortgage markets" and force lenders to avoid those cities in the future. Despite their efforts, Mortgage Resolution Partners, a firm affiliated with Evercore Partners, has signed up the city of Richmond and several others it won't name to try and pursue the same plan.

John Vlahoplus, MRP's chief strategy officer, said the program is designed to do what banks and loan servicers are unwilling or unable to do: Restructure mortgages with lower principal amounts and payments, taking advantage of state and federal incentives that can mount to as much as $100,000 per loan. The "public purpose," necessary for any condemnation, would be is to prevent further foreclosures and erosion in property values, he says.

"These are toxic loans, and they are toxic for the community," Vlahoplus told me.

Investors like Fiorillo disagree – vehemently. They say the moment for MRP's plan, if it ever made sense, was in early 2009, when the percentage of loans in hard-hit cities like Richmond that were falling into delinquency and default peaked above 60%. Since then even in Richmond, where unemployment still runs above 13%, delinquencies have fallen to a fraction of their peak levels while private lenders – the only ones targeted by MRP's proposal for political and legal reasons – have extended principal forgiveness to 20% of borrowers.

Another big problem with MRP's plan, critics say, is despite protestations to the contrary the only mortgages the firm will be able to restructure are performing loans. That's because the plan relies on pulling loans out of private-label securities trusts at a discount and reselling them to agencies like Fannie Mae, Freddie Mac or the Federal Housing Administration.

"Even FHA has some underwriting standards," said Tim Cameron, head of the asset management group at SIFMA, which represents big banks and asset managers. "If a city seizes a non-performing loan, they own it. The theory only works if they can refinance it."

Vlahoplus says cities could still provide borrower relief by restructuring the loans themselves,

possibly with financial assistance from the Treasury's Hardest Hit program.

Unanswered legal questions swirl around the entire proposal. Proponents say cities can seize any kind of property they want under eminent domain, even paper assets like stocks and bonds. Robert Hockett of Cornell Law School, considered the intellectual father of the MRP plan, told me "intangibles are quite commonly taken," although he acknowledged there are no examples of residential mortgages being seized.

Second, the mortgages are claims embedded in trusts, typically governed by Delaware law and traded far from the cities doing the seizing. Investors like DoubleLine don't own the underlying mortgages except through bonds issued by those trusts, and no one has ever used eminent domain to pluck individual mortgages out of a trust. The assumption is that would cause the entire trust structure to collapse, causing mayhem in the mortgage-backed securities market.

Hockett said property law is clear that local courts have jurisdiction over claims against real estate in their area, and investors who bought securities backed by those loans should understand that cities can seize them through eminent domain. The cities are actually trying to do these trusts a favor, he adds: By seizing loans that are in high danger of default because they exceed the value of the underlying home, Hockett says, cities would be improving the overall quality of the pool.

"The thought is the trustees would love to sell these out of the trust, but they can't," he said.

Fiorillo laughed at that suggestion. Hedge funds and managers like DoubleLine have been coining money on subprime loans for several years now specifically because defaults are plunging at the same time as the value of the underlying collateral rises. Since cities will likely only be able to seize performing loans, Fiorillo says, the plan really represents a transfer of wealth from one set of investors to another, with an otherwise current borrower getting lower payments in the deal.

"Just because you're upside-down doesn't mean you're in need of forgiveness," Fiorillo said. "You borrowed your money, you pay it back."

Finally, there's the question of how to value the loans. The Fifth Amendment requires cities to pay fair market value for property they seize, but nobody can explain precisely how a court in, say, Richmond can determine the value of one loan out of 1,000 or more in a given pool, which itself has been sliced and diced into a profusion of different securities. Investment banks assembled many of these pools with different types of loans in different regions as a sort of internal hedging mechanism; if all the performing loans in California are suddenly sucked out of the pool at a price a court there considers "market value," that could have severe repercussions for the remaining value of the pool and all the securities backed by it.

Vlahoplus, a Harvard Law grad and Rhodes Scholar with years in the real estate securities business, said "this is just business. These are just financial assets."

"How does DoubleLine determine the price of that loan? It uses financial models. And so will the city," he told me. As for undermining the internal structure of the pool, he said, investors would be in no different shape than if the cities seized the houses themselves and extinguished the debt that way. In either case, the loans would be sucked from the pool.

(I asked both Vlahoplus and Hockett why cities don't do exactly that. If, as they both maintain, even current borrowers who are underwater on their homes have a 70% chance of defaulting, why not rescue them from that situation by seizing their homes and renting them back to them at a lower monthly rate? They said that would leave on the table thousands of dollars in state and federal aid

for mortgage restructuring. Investors, of course, cite current statistics to show that less than 20% of current borrowers in cities like Richmond are likely to default in the future and the number is dropping rapidly, so current borrowers don't need help simply because they bought at the peak of the bubble and owe more on their homes than they are currently worth.)

It's one measure of the success of MRP's plan that it has driven investors like DoubleLine into Defcon 1 mode. Vlahoplus says investors have nothing to fear, because eminent domain will merely break up a financial and legal logjam that prevents private mortgage pools from restructuring loans. He says when it comes down to it, the cities – with MRP as advisor – will negotiate terms with the pools.

MRP has every incentive to do that: Under the terms of its proposals with Richmond and other cities, it stands to earn $4,500 for each loan it restructures. The firm is targeting only private mortgage pools, Vlahoplus said, because federal law preempts cities from seizing loans guaranteed by federal agencies like Fannie and Freddie.

Cameron of SIFMA said the reality is private pools are in many cases doing a better job than the agencies of restructuring these loans. Cities may get a rude shock when they try to seize private-label mortgages that are actually held in the trading portfolios of Fannie and Freddie, he said. He also ridiculed the idea of negotiating the sale of these mortgages when cities hold the gun of eminent domain to investors' heads.

"It's a non-starter," he said. "Asset managers, as fiduciaries, have to go to court to make sure somebody doesn't pick their pockets."

"They say we're threatening them," he added. "No, it's the obligation we have."

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com