Bond Case Briefs

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Bloomberg: Pimco, BlackRock Seek to Bar California Mortgage Seizures.

Pacific Investment Management Co., BlackRock Inc. (BLK) and Bank of New York Mellon Corp. are seeking a court order blocking Richmond, California, and Mortgage Resolution Partners LLC from seizing mortgages through eminent domain, saying the initiative would hurt savers and retirees.

The city's plan is unconstitutional, according to complaints filed yesterday by mortgage-bond trustees in federal court in San Francisco. The trustees, Wells Fargo & Co. (WFC) and Deutsche Bank AG, were directed to take the action by investors in the debt that also include Jeffrey Gundlach's DoubleLine Capital LP, said John Ertman, a partner at Ropes & Gray LLP. Bank of New York said in a separate complaint the beneficiaries of trusts it oversees include pension funds and mutual funds.

"Mortgage Resolution Partners is threatening to seriously harm average Americans, including public pension members, other retirees and individual savers through a brazen scheme to abuse government powers for its own profit," Ertman said in an e-mailed statement on behalf of investors.

The plan advanced last month with Richmond backing offers to buy 624 loans, making it the first city to push the idea so far forward. Those offers would need to be refused before the city could follow through with its mayor's vow to invoke its potential powers to force sales of the mostly non-delinquent loans, so that homeowners could get their debt balances cut to less than the current values of their properties.

'Cease Business'

The Federal Housing Finance Agency said today in a statement that it may direct Fannie Mae (FNMA), Freddie Mac and the Federal Home Loan Banks "to limit, restrict or cease business activities within the jurisdiction of any state or local authority employing eminent domain to restructure mortgage loan contracts."

Andrew Wilson, a spokesman for Fannie Mae, and Thomas Fitzgerald, a spokesman for Freddie Mac, said the companies were among the investors authorizing Wells Fargo and Deutsche Bank to sue. The government-controlled firms guarantee almost 70 percent of new mortgages.

The program would harm owners of mortgage bonds by paying them too little for loans, as well as damage communities by drying up lending, at least 18 trade groups representing asset managers, bankers, real-estate firms and builders have said in past statements. Costs to investors could exceed $200 million just on loans in Richmond, according to the Wells Fargo complaint.

Court Scrutiny

Proponents of the plan including Cornell University law professor Robert Hockett and Steven Gluckstern's Mortgage Resolution Partners, which is advising municipalities and lining up private funds that would profit as the buyer of the loans, dispute those claims. They have said that the plan will survive court scrutiny.

At least a dozen cities still dealing with the fallout of worst slump in home prices since the Great Depression are studying the eminent domain idea. Others include El Monte, California, North Las Vegas, Nevada, and Irvington, New Jersey. Communities such as San Bernardino County, California, and Chicago abandoned the plan after considering it last year.

Under the program that Mortgage Resolution Partners has pitched, a private investment fund would buy loans from bond trusts for amounts less than current property values. The prices would be based on financial models or comparable trades and sanctioned by courts.

The mortgages would then be reduced and homeowners refinanced into new debt insured by the Federal Housing Administration.

Interstate Commerce

Richmond's plan would harm interstate commerce because lenders will be less willing to underwrite mortgages and investor confidence in the market for mortgage-backed securities and "by extension, the national housing market and national economy" would be undermined, according to the complaint by Wells Fargo and Deutsche Bank.

The plan is also discriminatory because it targets only certain loans, the trustees alleged. It violates California and U.S. constitutional protections against impairing private contracts and the taking of private property for public use without just compensation, according to the complaint.

Richmond Mayor Gayle McLaughlin didn't immediately return a message left at her office today seeking comment about both complaints. Yesterday she declined to comment on specifics of the Wells Fargo lawsuit because she hadn't seen it yet.

'Another Stage'

"I continue to stand by this program and the benefits to our residents," she said in a telephone interview. "We feel comfortable with the legality of this."

Hockett, the Cornell professor, said the Wells Fargo lawsuit makes the same arguments he has previously called unsound.

"It's essentially another stage in their strategy to scare cities," Hockett said yesterday in a telephone interview. "The industry is essentially trying to head them off at the pass."

Mortgage Resolution Partners, which is based in San Francisco, has reviewed the Wells Fargo suit and is confident it can prevail in court, Gluckstern said in an e-mail.

"No investor in any trust will be made worse off by the sale of any loan. Rather, it is these trustees that are wasting trust assets at the expense of America's pensioners by pursuing fruitless litigation," Gluckstern said. "Sadly, the financial institutions that brought us this crisis are yet again part of the problem rather than part of the solution."

Foreclosures, Blight

The goal of the eminent domain plan is to help communities by fending off foreclosures that cause blight and create other costs, according to its supporters. The 32 loan servicers and bond trustees that received letters seeking voluntary sales of the Richmond loans were told they must respond by

Aug. 13, said Mortgage Resolution Partners Chief Strategy Officer John Vlahoplus.

The initiative has targeted mainly the loans of borrowers who are current on their payments, which make up 444 of the initial batch in Richmond, where the city council still hasn't formally authorized the use of eminent domain. Mayor McLaughlin vowed to take the step on a July 30 call with reporters.

Richmond is a largely blue-collar city of 106,000 north of San Francisco with long ties to heavy industry where almost half of mortgages have higher values than the homes they finance.

Freddie Mac

The ultimate investors in the securities whose trustees sued yesterday "include state and local pension plans, 401(k) plans, college savings plans, insurance companies, mutual funds, university endowments, and government-sponsored enterprises" according to the Wells Fargo complaint.

Pacific Investment Management Co., known as Pimco, manages the world's largest bond fund, while BlackRock is the biggest asset management company. Bank of New York sued in its role as trustee of trusts created to hold the loans.The bank received a letter from Richmond demanding to purchase more than 100 loans from the trusts, the bank said in its complaint.

Freddie Mac (FMCC) is also unhappy with the "threat" of eminent domain being invoked, William McDavid, its general counsel, said yesterday on conference call with reporters. While loans in mortgage bonds guaranteed by the company and rival Fannie Mae aren't being targeted, the firms also own non-agency securities.

Under Water

Eminent domain, the right of governments to take private property for the public good while providing fair compensation to the owner, has typically been used to seize real estate, such as to build highways or parks.

Richmond's planned use is a legacy of the housing bubble that began to burst seven years ago, leaving millions of Americans owing more than the value of their properties even after prices began recovering last year.

About 25 percent of U.S. homes with a mortgage, or 13 million properties, were under water in the first quarter of this year, according to Zillow Inc., a real-estate information firm. The housing recovery and foreclosures reduced the amount from 31 percent a year earlier.

At the same time, the share of mortgages held by bonds without government backing defaulting for the first time fell to a 5.2 percent annualized pace as of July data, from 7.5 percent a year earlier and almost 20 percent in 2009, according to a report yesterday by Amherst Securities Group LP.

The cases are Wells Fargo Bank v. City of Richmond, 13-3663, and Bank of New York Mellon v City of Richmond, 13-3664, U.S. District Court, Northern District of California (San Francisco).