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FHFA Says GSEs May Cease Business in Towns Seizing Mortgages.

The regulator of Fannie Mae and Freddie Mac is considering directing the companies to stop doing business in communities that seize mortgages through eminent domain, the agency's general counsel said today in a memorandum.

The Federal Housing Finance Agency may also initiate legal challenges to eminent domain actions, Alfred M. Pollard, the general counsel, said in the memorandum, which was posted on the agency's website.

"There is a rational basis to conclude that the use of eminent domain by localities to restructure loans for borrowers that are 'underwater' on their mortgages presents a clear threat to the safe and sound operations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks as provided in federal law," Pollard wrote.

The city of Richmond, California announced last month it is moving ahead with a plan to seize mortgages from investors and write down the loan balances to help borrowers at risk of foreclosure. The public benefit of the seizures is to fend off foreclosures that cause blight and create other costs for the community, according to the plan's supporters.

Other Cities

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 such plans after considering them last year.

The FHFA statement comes a year after the agency first requested public input on the issue, and a day after Fannie Mae (FNMA) and Freddie Mac joined investors authorizing a lawsuit to stop Richmond from seizing loans.

The eminent domain program is advocated by Mortgage Resolution Partners LLC, which would provide services and arrange for private investment funds that would profit by buying the loans for less than property values, and reworking them.

The FHFA is violating its conservatorship mandate and obligations to protect taxpayers by opposing the use of eminent domain to restructure mortgages, said Mortgage Resolution Partners Chief Strategy Officer John Vlahoplus.

"Instead of fighting loan sales, increasing risk, and wasting assets, they should support a rapid loan sell down and consequent risk reduction," Vlahoplus said in an e-mailed statement. "Those financial institutions that reduce risk and their exposure to risky assets do well."

