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Reuters: Freddie Mac May Sue California City on Eminent Domain Loan Seizures.

Freddie Mac (FMCC.OB), the government-owned mortgage finance company, on Wednesday said it is considering legal action against Richmond, California, if the city uses eminent domain to seize mortgages of local residents who owe more than their properties are worth in a bid to keep them in their homes.

The northern California city recently sent notice to the holders of more than 620 so-called underwater home mortgages in the city, asking them to sell the loans to the city. It would buy the mortgages for 80 percent of the fair value of the homes, write them down and help the homeowners refinance their loans.

"Our sense is that those so-called voluntarily loan sales would not be very voluntary," said Freddie Mac's general counsel William McDavid in a conference call with reporters to discuss the company's second-quarter financial results. "They're loan sales under pressure – in fact, under a threat of seizure by eminent domain. We would consider taking legal action."

Freddie Mac and its larger sister company, Fannie Mae, are some of the biggest buyers of private home-loan bonds. The two government-backed companies' finances would be affected if the eminent domain plan went forward and wiped out the worth of those bond investments.

"Fannie Mae and Freddie Mac are investors in these securities. This is an issue that we are discussing," said Denise Dunckel, a spokeswoman for the companies' regulator, the Federal Housing Finance Agency.

Both companies, operating under conservatorship since they were taken over by the government in 2008 during the financial crisis, would need the Federal Housing Finance Agency's permission to take legal action against the city of Richmond and possibly block the eminent domain seizures. The FHFA itself has previously raised concerns with an approach like Richmond's.

Using eminent domain in this fashion to force banks and other investors to sell mortgages is novel. Historically cities have used the power to force the sale of properties if they obstruct the construction of a project deemed beneficial to the wider community, such as a road or bridge.

Richmond is working with San Francisco-based Mortgage Resolution Partners, a private investment firm that has been pitching the plan to U.S. cities and municipalities for more than a year. MRP, raising money from private sources, would work with the city to obtain the financing to buy the distressed mortgages and restructure them. MRP would receive a fee for every troubled loan it restructured under the plan.