

Foreclosing on a Crisis: How a Presumption of Public Use Could Help Courts Decide Whether Eminent Domain of Underwater Mortgages Is Beneficial

Jenifer Gee*

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* J.D. Candidate, University of the Pacific, McGeorge School of Law, to be conferred May 2016; B.A. University of Maryland, College Park, 2006. I would like to thank Distinguished Professor of Law John Sprankling for his tremendous guidance during the researching and writing of this Comment. I would also like to give a huge thank you to the law review editors for their assistance and for selecting this work for publication. Finally, I could not have made it to this point without the love, encouragement, and midnight snacks provided by my family and friends. Thank you all.

I. INTRODUCTION

The three-bedroom, one-bath home that Robert and Patricia Castillo moved into in Richmond could use a fresh coat of paint on the outside and does not have grass on the front lawn.¹ The couple wanted to find a home so they could more easily care for their autistic son.² In 2005, just before the housing market crash, they purchased the home for \$420,000, but following the market failure the value plummeted to \$125,000.³ Now, they are in a home that has lost most of its value, yet are struggling to make high mortgage payments while trying to recover from the financial crash.⁴ The national mortgage crisis that started in 2007 led to significant losses on mortgage payments to many financial institutions,⁵ and today many homeowners, like the Castillos, strain to make their payments.⁶ Others risk foreclosure and walking away from the homes they purchased before the bubble burst, leaving behind a wake of unpaid loans.⁷

Cities like Richmond are now considering an innovative solution to the housing crisis still impacting residents in its communities, like the Castillos: a city will buy residential mortgage loans at fair market value and refinance the loan so a homeowner can make lower monthly payments and stay in his or her home.⁸ The plan is set up to give cities and third-party investors the difference between the amount it would buy the loan for and the amount for which it would refinance the loan.⁹

Amidst the initial attempts of a few cities proposing to use eminent domain to take over underwater mortgages, opponents have quickly launched reactions to

1. Shaila Dewan, *A City Invokes Seizure Laws to Save Homes*, N.Y. TIMES (July 29, 2013), http://www.nytimes.com/2013/07/30/business/in-a-shift-eminent-domain-saves-homes.html?pagewanted=all&_r=0 [hereinafter *Dewan Invokes*] (on file with *The University of the Pacific Law Review*).

2. *Id.*

3. *Id.*

4. *Id.*

5. Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 7 (2009).

6. *Dewan Invokes*, *supra* note 1.

7. Kimbriell Kelly, *Lenders Seek Court Actions Against Homeowners Years After Foreclosure*, WASH. POST (June 15, 2013), http://www.washingtonpost.com/investigations/lenders-seek-court-actions-against-homeowners-years-after-foreclosure/2013/06/15/3c6a04ce-96fc-11e2-b68f-dc5c4b47e519_story.html (on file with *The University of the Pacific Law Review*).

8. *Dewan Invokes*, *supra* note 1.

9. *Id.* Under the plan, “a home mortgaged for \$400,000 is now worth \$200,000. The city plans to buy the loan for \$160,000 Then the city would write down the debt to \$190,000 and allow the homeowner to refinance at the new amount . . . [t]he \$30,000 difference goes to the city, the investors who put up the money to buy the loan, closing costs and M.R.P. The homeowner would go from owing twice what the home is worth to having \$10,000 in equity.” *Id.*

try to stop those proposals before they are adopted.¹⁰ Some of opponents' attempts include staking out a spot near the entrance to a city council meeting to sell hotdogs to entice people to listen to their point of view.¹¹ Others include drawing hard lines by refusing to offer loans in communities that allow eminent domain of residential mortgages.¹² As discussions regarding using eminent domain on residential mortgages continue and attempts to stop it remain strong, the issue of whether the taking satisfies a public use will be at the heart of what to do with former homeowners who are struggling to keep their homes under difficult financial circumstances and the investors who want their investment back.¹³ As a result, cities that want to use eminent domain of mortgages will face an obstacle of proving the act meets the "public use" requirement of the Fifth Amendment.¹⁴

Courts should presume a city meets the public use requirement of the Fifth Amendment when it takes a residential mortgage through eminent domain and gives the loan to a private, third-party lender.¹⁵ But, lenders can rebut the presumption by proving that a homeowner does not qualify for that type of assistance, the profits to the city and a private third-party investor are high enough to raise suspicion that the taking benefits a private party over the public, and the lack of an overall economic development plan supports a claim that the taking is not for the public's benefit.¹⁶

Part II of this Comment provides an overview of the history of defining "public use" under the Fifth Amendment of the U.S. Constitution and how that definition has allowed government actors to take private property for the private use of another.¹⁷ Part III discusses the public use element of city plans to use eminent domain to take residential mortgages.¹⁸ Part IV supports a finding that a city asserting its eminent domain rights on residential mortgages is based on a valid public purpose.¹⁹ Part V discusses the implications of a presumption of

10. Shaila Dewan, *Eminent Domain: A Long Shot Against Blight*, N.Y. TIMES (Jan. 11, 2014), http://www.nytimes.com/2014/01/12/business/in-richmond-california-a-long-shot-against-blight.html?_r=0 [hereinafter Dewan *Eminent*] (on file with *The University of the Pacific Law Review*).

11. *Id.*

12. *Id.*

13. Dewan *Eminent*, *supra* note 10.

14. See *Kelo v. City of New London*, 545 U.S. 469, 477 (2005) (stating that "a State may transfer property from one private party to another if future 'use by the public' is the purpose of the taking").

15. *Infra* Part VI.

16. *Infra* Part VI.

17. *Infra* Part II.

18. *Infra* Part III.

19. *Infra* Part IV.

public use on both cities and lenders.²⁰ Finally, Part VI discusses the use of a balancing test that allows lenders to rebut the presumption of a valid public use.²¹

II. LEGAL BACKGROUND

The Fifth Amendment of the U.S. Constitution allows local governments to seize private property as long as the government actors prove the seizure was for a public use.²² Public use is broadly defined, and the Court expanded that definition even further when it allowed a city to force a woman out of her home for the sake of economic redevelopment.²³ Now, cities want to take that broad application of public use and apply it to their efforts to seize home mortgages, refinance those mortgages, and give them to private third-party investors.²⁴ This plan purports to keep residents in their homes.²⁵

A. *Midkiff and Broadening the Public Use Requirement*

The government's ability to take private property is based on the Fifth Amendment to the Constitution, which states, "nor shall private property be taken for public use, without just compensation."²⁶ Whether the government's avowed purpose satisfies the definition of public use has been at issue in the past and is at issue for cities that want to take mortgages of residential homes.²⁷

In the Supreme Court case *Hawaii Housing Authority v. Midkiff*, the Court expanded the definition of public use in response to state legislation.²⁸ In the 1960s, Hawaiian legislatures determined that a relatively few number of private owners controlled almost half of non-government owned land.²⁹ The Legislature believed that concentrated ownership resulted in a skewed housing market,

20. *Infra* Part V.

21. *Infra* Part VI.

22. See *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241–42 (1984) (allowing Hawaii to essentially force land sales to break up an oligopoly thwarting the functioning of the residential land market).

23. *Kelo v. City of New London*, 545 U.S. 469, 473–75, 483–84 (2005).

24. *Dewan Invokes*, *supra* note 1 (explaining how the City of Richmond and third-party investors would split the difference between the amount of the loan and the refinance rate given to a homeowner).

25. *Dewan Eminent*, *supra* note 10.

26. U.S. CONST. amend. V.

27. Compare *Berman v. Parker*, 348 U.S. 26, 31 (1954) (determining whether allowing the taking of a department store to revitalize the area was for a public use), with *Notice of Motion & Motion to Dismiss for Lack of Subject Matter Jurisdiction* at 3, *The Bank of New York Mellon v. City of Richmond*, No. CV-13-3664-CRB (N.D. Cal. Nov. 1, 2013) [hereinafter *Notice*] (arguing that the city will need to "state the public purpose" to justify the taking).

28. See *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 240–41 (1984) (using an earlier decision by the Court to declare that the Court "will not substitute its judgment for a legislature's judgment").

29. *Id.* at 232 (stating that forty-seven percent of Hawaii's land was owned by seventy-two private owners).

inflated home prices, and general damage to the public welfare.³⁰ As a result, it enacted legislation that essentially forced landowners to sell their property.³¹ The landowners resisted and filed a lawsuit that alleged, among other claims, that the Hawaiian law was unconstitutional.³² The Ninth Circuit agreed with the landowners because the law was not based on a valid public purpose.³³ The Supreme Court disagreed.³⁴ The Court held that public use is “coterminous with the scope of a sovereign’s police power.”³⁵ In further explaining its decision, the Court said it would not “substitute its judgment for a legislature’s” in determining what acts “constitute a public use” unless there was no reasonable foundation for the use.³⁶ The Court added that taking private property from one owner and transferring it to a different private owner “does not condemn that taking as having only a private purpose.”³⁷ Instead, the Court said, “it is only the taking’s purpose, and not its mechanics, that must pass scrutiny under the Public Use Clause.”³⁸

Applying that reasoning to the facts of *Midkiff*, the Court held that the state’s law served a legitimate public purpose because it was trying to restore normalcy to the market of buying, selling, and owning land in Hawaii.³⁹ In addition to supporting the legislature’s ability to determine a valid public use, the *Midkiff* Court added that a taking could still have a public purpose even if it benefited a private person.⁴⁰ As a result, the focus remains on the purpose of the taking and whether it is “rationally related to a conceivable public purpose,”⁴¹ rather than who uses the seized property.⁴² In its conclusion, the *Midkiff* Court noted that it was important that the legislation was enacted “not to benefit a particular class of identifiable individuals but to attack certain perceived evils of concentrated property ownership in Hawaii—a legitimate public purpose.”⁴³

30. *Id.*

31. *See id.* at 233–34 (detailing how the Hawaiian Legislature condemned property to provide a tax benefit to the landowners being forced to sell their land).

32. *Id.* at 235.

33. *Id.*

34. *Id.* at 236 (reversing the Ninth Circuit’s holding).

35. *Id.* at 240.

36. *Id.* at 241.

37. *Id.* at 243–44.

38. *Id.* at 244.

39. *Id.* at 242.

40. *Id.* at 243–44.

41. *Id.* at 241.

42. *Id.* at 244.

43. *Id.* at 245.

B. *History and Background of Kelo*⁴⁴

The Supreme Court established the government's right to take public property for economic purposes in the landmark case *Kelo v. City of New London*.⁴⁵ In 1998, the City of New London faced blight.⁴⁶ Acting with the city's authorization, and to counter the city's apparent decline, the city, the state, a private pharmaceutical company, and a non-profit mobilized to inject money into a large-scale economic development plan that would reinvigorate the city's economy and population.⁴⁷ The plan called for \$315 million of investments⁴⁸ and was going to transform ninety acres into a thriving community of residences, businesses, and recreational activities that would create jobs and a lifestyle that would draw people to the area and reinvigorate the city's tax revenue.⁴⁹ However, the multi-stage plan ran into problems when the city wanted to take the property of homeowners who did not want to move.⁵⁰

Suzette Kelo and her fellow petitioners filed a lawsuit when the City of New London, through the New London Development Corporation, stated it would take the property of Kelo and others via eminent domain.⁵¹ When the case reached the Supreme Court, Kelo argued against eminent domain for the purposes of economic redevelopment.⁵² The Court, in a 5–4 decision,⁵³ upheld the use of eminent domain for an economic purpose because it “unquestionably serve[d] a public purpose.”⁵⁴ The Court reviewed its past jurisprudence to find that the general public does not have to use the land to constitute a public purpose.⁵⁵ Public use has a broad definition that allows a court to evaluate the entirety of a project's purpose rather than evaluate it on a “piecemeal basis,”⁵⁶ and even if property is transferred to a private individual, it is the purpose behind the transfer

44. *Kelo v. City of New London*, 545 U.S. 469 (2005).

45. *Id.*

46. *See id.* at 473 (stating the City was designated a “distressed municipality” and its unemployment rate was almost twice the rate of the state and it recorded its lowest population since 1920).

47. *Id.*

48. *Id.* The state issued two bonds—a \$5 million bond for planning purposes and a \$10 million bond to create a state park—as part of the plan, and pharmaceutical company Pfizer announced plans to build a \$300 million research plant next to the area targeted for revitalization. *Id.*

49. *Id.* at 474–75.

50. *Id.* at 475.

51. *Id.*

52. *Id.* at 484 (claiming that economic development was not a public use that would satisfy the Takings Clause of the Fifth Amendment). Kelo and her fellow petitioners also highlighted and the court acknowledged that their homes were not “blighted” and only subject to eminent domain because their residences were located in the area of the economic development plan. *Id.* at 475.

53. *Id.* at 479.

54. *Id.* at 484.

55. *Id.* at 479–80.

56. *Id.* at 481 (quoting *Berman v. Parker*, 348 U.S. 26, 35 (1954)).

and not the result that matters.⁵⁷ Relying on this broad definition of public purpose, the *Kelo* plurality determined that the City of New London's project was for a public purpose because the city wanted to increase tax revenue and create jobs, the entirety of the project was designed to fulfill that goal, and the Court's prior case law limited its ability to review the city's purpose.⁵⁸

The *Kelo* plurality's broad interpretation of public use and the dissent's rigid construction of the term⁵⁹ were offset by Justice Kennedy's concurrence, which struck a balance between the plurality's deference to legislatures and the dissent's need for judicial review of a taking's purpose.⁶⁰ Justice Kennedy said it was important to scrutinize whether a taking is for a public purpose or if the public benefit is only incidental to the benefit given to a private party.⁶¹ He agreed with the plurality that a bright-line rule that a taking was presumptively invalid because it was part of an economic development plan was inappropriate in a takings analysis.⁶² He explained that a bright-line rule would "prohibit a large number of government takings that have the purpose and expected effect of conferring substantial benefits on the public at large."⁶³ However, Justice Kennedy's concurrence considered the possibility of a heightened standard of review in takings cases in which private parties benefitted from the government action.⁶⁴ He reasoned that there may be cases when "the risk of undetected impermissible favoritism of private parties is so acute that a presumption (rebuttable or otherwise) of invalidity is warranted."⁶⁵ He did not elaborate as to when a higher standard would apply and did not believe it necessary to consider in *Kelo* because the City of New London acted based on a public purpose.⁶⁶ In concluding, Kennedy stated that there was no improper purpose in the case of *Kelo* even though "there may be categories of cases in which the transfers are so suspicious, the procedures employed so prone to abuse, or the purported benefits

57. *Id.* at 482. ("[I]t is only the taking's purpose, and not its mechanics" used to determine whether there is a public use). *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 244 (1984).

58. *Kelo*, 545 U.S. at 483–84.

59. *See id.* at 497 (O'Connor, J., dissenting) (stating that the public use requirement allows a taking for a public use and not for a private individual's benefit).

60. *See* Marla E. Mansfield, *Takings and Threes: The Supreme Court's 2004-2005 Term*, 41 TULSA L. REV. 243, 288 (2005) ("Justice Kennedy twice reminded his colleagues of the availability of some substantive due process requirements for legislation.").

61. *Kelo*, 545 U.S. at 491 (Kennedy, J., concurring).

62. *Id.* at 492–93.

63. *Id.* at 492.

64. *Id.* at 493.

65. *Id.*

66. *Id.* Justice Kennedy agreed that the City of New London had a proper public purpose because the taking was part of an overall plan to convey a significant benefit to the local economy and there was a sufficient review process that supported the city's claim that it did not enact the plan to favor one private party over another. *Id.*

are so trivial or implausible that courts should presume an impermissible private purpose.”⁶⁷

The Court’s decision in *Kelo* sparked outcry among the public and government officials.⁶⁸ However, despite some states taking a statutory stance against the *Kelo* plurality and Justice Kennedy’s reasoning,⁶⁹ the case remains the judicial definition of a public purpose under the Takings Clause of the Fifth Amendment.⁷⁰

III. CITIES CLAIM PUBLIC USE SATISFIED IN USING EMINENT DOMAIN ON MORTGAGES

Cities like Richmond that propose to use eminent domain on foreclosures face heavy resistance from mortgage companies both in court and in the legislature.⁷¹ The proposal to use eminent domain on residential mortgages could serve a public purpose because it allows a city to take over an underwater mortgage at market price and refinance at a new rate, thus lowering mortgage payments for homeowners and keeping residents in their homes.⁷² Potential legal battles facing Richmond and cities that attempt similar takings likely begin with the disagreements between trustees and investors over what a different private lender is allowed to do with a bad loan a city is trying to take over.⁷³ At least one company stated it would consider taking legal action if a plan like Richmond’s

67. *Id.*

68. Adam Liptak, *THE NATION*; *Case Won on Appeal (To Public)*, N.Y. TIMES (July 30, 2006), <http://query.nytimes.com/gst/fullpage.html?res=9807E2DE133FF933A05754C0A9609C8B63&n=Top/Reference/Times%20Topics/Subjects/P/Public%20Opinion> (on file with *The University of the Pacific Law Review*) (describing that the public reaction included state legislatures passing bills to counter *Kelo*’s holding and an attempt to take one Supreme Court Justice’s home via eminent domain); see also John M. Broder, *States Curbing Right to Seize Private Homes*, N.Y. TIMES (Feb. 21, 2006), http://www.nytimes.com/2006/02/21/national/21domain.html?pagewanted=all&_r=0 (on file with *The University of the Pacific Law Review*) (reporting that three states passed bills limiting the state’s ability to use eminent domain and dozens of others proposed similar legislation in reaction to *Kelo*).

69. See *Planned Indus. Expansion Auth. of Kansas City v. Ivanhoe Neighborhood Council*, 316 S.W.3d 418, 426 (Mo. Ct. App. 2010) (explaining that the legislature enacted a statute providing landowners with sufficient appraisals as a reaction to the Supreme Court’s ruling in *Kelo v. City of New London*).

70. See Ilya Somin, *The Judicial Reaction to Kelo*, 4 ALB. GOV’T L. REV. 1, 30 (2011) (describing the Second Circuit’s post-*Kelo* takings analysis as “extremely deferential”).

71. Dewan *Eminent*, *supra* note 10; see also James Queally, *ACLU, NJ Join Fight to Protect Cities Using Eminent Domain to Fight Foreclosure Crisis*, THE STAR-LEDGER (Apr. 7, 2014), http://www.nj.com/essex/index.ssf/2014/04/aclu_nj_leaders_join_fight_to_protect_cities_using_eminent_domain_to_fight_foreclosure_crisis.html (on file with *The University of the Pacific Law Review*) (reporting that city officials in Irvington, New Jersey want to use eminent domain on foreclosed mortgages and identified 199 that are eligible).

72. Alexandra M. Perry, *Eminent Domain: A Solution to the Mortgage Crisis?*, 86 TEMP. L. REV. 181, 191–92 (2013).

73. Dewan *Invokes*, *supra* note 1 (explaining that in Richmond, investors requested their trustees to sue the city to stop their plan).

was implemented with federal support.⁷⁴ If that were to happen, it would not be the first attempt to take the city to court over its plan.⁷⁵ In 2013, Wells Fargo requested a preliminary injunction in federal court to stop Richmond's plan.⁷⁶ The bank and its co-plaintiffs challenged the "public use" purpose of the city's plan because it financially benefits a private investor and targets individual homeowners who are making their mortgage payments.⁷⁷ As a result, restructuring a loan leaves a homeowner with a "windfall" while the initial loan backers lose money.⁷⁸ The judge dismissed the motion because Richmond's proposed plan was not final and as such, the validity of the challenge remains unanswered.⁷⁹

Cities also face opposition from mortgage groups that lobby Congress to stop efforts to take mortgages by eminent domain.⁸⁰ The House of Representatives introduced a bill in 2013 to prevent Fannie Mae from issuing mortgages in counties that use or have used eminent domain to take home mortgages.⁸¹ The same bill also seeks to prohibit the Federal Housing Administration (FHA) from securing mortgages under the National Housing Act or an FHA program in a county that uses eminent domain on residential mortgages.⁸² Other efforts to stop the use of eminent domain on mortgages have significantly diminished the intended effects of at least one state law seeking to protect homeowners.⁸³ These legislative efforts may undermine the argument that using eminent domain on

74. Nick Timiraos, *Freddie Mac Considers Legal Action to Block Eminent Domain Plan*, WALL ST. J. (Aug. 7, 2013, 1:44 PM), <http://blogs.wsj.com/developments/2013/08/07/freddie-mac-considers-legal-action-to-block-eminant-domain-plan/> (on file with *The University of the Pacific Law Review*) (quoting William McDavid, general counsel for Freddie Mac, as saying the mortgage company "would consider taking legal action" if Richmond took loans using eminent domain).

75. Complaint for Declaratory and Injunctive Relief, *Wells Fargo Bank v. City of Richmond*, No. 3:13-CV-03663 (N.D. Cal. Aug. 7, 2013) [hereinafter *Complaint*].

76. Motion for Preliminary Injunction, *Wells Fargo Bank v. City of Richmond*, No. 3:13-CV-03663 (N.D. Cal. Aug. 8, 2013) [hereinafter *Wells Fargo Bank*].

77. *Id.* at 9.

78. *Id.* at 9–10.

79. Order Granting Defendants' Motion to Dismiss and Denying Plaintiffs' Motion for a Preliminary Judgment, *Wells Fargo Bank v. City of Richmond*, No. 3:13-CV-03663 (N.D. Cal. Sept. 16, 2013) [hereinafter *Order*] (stating the claim was not yet ripe).

80. Dewan *Eminent*, *supra* note 10 (reporting that one asset management group supported a bill proposed by a Texas legislator that prohibited federal backing of loans vulnerable to eminent domain).

81. H.R. 2767, 113th Cong. § 108 (2013). Author's note: This bill was pending as of Jan. 4, 2014.

82. H.R. 2767. Author's note: This bill was pending as of Oct. 5, 2015. The bill's most recent activity shows that additional sponsors joined it in 2014, but there has been no other action. 160 Cong. Rec. 6399-02 (July 17, 2014).

83. Dewan *Eminent*, *supra* note 10 (explaining that the Georgia Legislature passed a law guarding against predatory loans only for the law to be "guttled" a year later after some lenders stopped providing loans in the state).

mortgages serves a public purpose because history shows that the public supports limiting the government's ability to seize private property.⁸⁴

Cities and a citizens' rights group are fighting back.⁸⁵ In New Jersey, city leaders in Irvington and Newark sent a joint letter with the American Civil Liberties Union state chapter to ask the U.S. Attorney General and the FHA to adopt an explicitly neutral policy regarding municipal use of eminent domain on mortgages.⁸⁶ Richmond's mayor has publicly stated on more than one occasion she will not stop efforts to promote the proposal despite heavy resistance.⁸⁷

But without public support, cities that are considering using eminent domain to take over mortgages can find it difficult to fight for public use, especially when facing intense resistance from mortgage companies.⁸⁸ By a 6–1 vote, the Irvington, New Jersey City Council approved a measure allowing its mayor to draft a redevelopment ordinance that permitted the use of eminent domain of mortgages.⁸⁹ However, that was before the May elections.⁹⁰ After a key councilman retired and with the newly elected mayor opposing the use of eminent domain on underwater mortgages, the council voted 4–2 to hold off on the plan.⁹¹ That has not stopped the neighboring city of Newark from continuing with an aggressive plan to rehabilitate the housing market in its city by using eminent domain on mortgages if necessary.⁹²

IV. SEIZING A MORTGAGE SATISFIES THE PUBLIC USE REQUIREMENT

Cities may successfully argue that their seizure of underwater mortgages satisfies the public use requirement given the Court's broad interpretation of the

84. See Liptak, *supra* note 68 (describing that the public reaction included state legislatures passing bills to counter *Kelo*'s holding and an attempt to take one Supreme Court Justice's home via eminent domain); see also Broder, *supra* note 68 (reporting that three states passed bills limiting the state's ability to use eminent domain and dozens of others proposed similar legislation in reaction to *Kelo*).

85. Queally, *supra* note 71.

86. *Id.*

87. See Dewan *Invokes*, *supra* note 1 (quoting the mayor as saying, "[t]hey can put forward as much pressure as they would like but I'm very committed to this program and I'm very committed to the well-being of our neighborhoods."); Dewan *Eminent*, *supra* note 10 (quoting the mayor as saying, "I'm not trying to minimize what we're dealing with; it's just like, if you're willing to buck up against an unjust set of circumstances, you're going to have those attacks coming at you. And in some sense that says you're doing your job.").

88. Joe Tyrrell, *Tale of Two Towns: Newark, Irvington Mayors Tackle Housing Issues*, NJ SPOTLIGHT (Sept. 25, 2014), <http://www.njspotlight.com/stories/14/09/24/tale-of-two-towns-newark-irvington-mayors-tackle-housing-issues/> (on file with *The University of the Pacific Law Review*); Dewan *Invokes*, *supra* note 1 (reporting that San Bernardino dropped its plan to use eminent domain on foreclosed mortgages).

89. Tyrrell, *supra* note 88.

90. *Id.*

91. *Id.*

92. *Id.*

requirement.⁹³ But is that broad interpretation enough to support a city's claim when there is no economic plan to revive an area like in *Kelo* and *Midkiff*?⁹⁴ At least one commentator contends that there are or should be special protections provided for the residential home.⁹⁵ However, the Court has not recognized a special protection for the home in takings cases.⁹⁶ Instead, a closer look at the jurisprudence may show that cities with plans that only benefit the individual homeowner, and do not economically benefit the community, may fail to convince a court to approve of their taking of a residential mortgage.⁹⁷ Applying the findings Justice Kennedy reviewed in his concurring opinion in *Kelo* provides guidance to courts evaluating a city's plans to seize mortgages.⁹⁸

A. Applying *Kelo*⁹⁹ to Eminent Domain of Residential Mortgages

If a private lending company challenged a city's seizure of underwater mortgages, a federal court would rely on the *Kelo* holding.¹⁰⁰ The Court supported its holding by stating that its past decisions gave deference to local government bodies in deciding what kinds of public use support a taking.¹⁰¹ In *Kelo*, the city of New London wanted to take private property to revive the area's overall economy.¹⁰² Today, a town with many foreclosed homes could similarly argue that communities with foreclosed homes suffer¹⁰³ and using eminent domain to

93. See *Kelo v. City of New London*, 545 U.S. 469, 479–80 (2005) (upholding the Court's prior rejections of narrow test defining public use).

94. See *id.* at 474 (describing the City of New London's development plan); *Midkiff*, 467 U.S. at 233 (explaining the Land Reform Act and the process instituted for the Legislature to determine if a public purpose is served).

95. See Thomas G. Sprankling, *Does Five Equal Three? Reading the Takings Clause in Light of the Third Amendment's Protection of Houses*, 112 COLUM. L. REV. 112, 142 (2012) (arguing that the protection of the home provided for in the Third Amendment should be read into the Takings Clause).

96. *Infra* note 97.

97. See *Berman v. Parker*, 348 U.S. 26, 35–36 (1954) (stating that when there is a public purpose, the government can take a private business to carry out a redevelopment plan); *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 245 (1984) (holding that legislation forcing the sale of private homes to another private individual satisfied the public use requirement when doing so did not benefit a particular class of individuals but "attacked certain perceived evils of concentrated property ownership"); *Kelo*, 545 U.S. at 490 (holding that the City's plans to condemn residential homes for economic development plan was a valid public use).

98. *Kelo*, 545 U.S. at 491–92 (Kennedy, J., concurring).

99. *Id.* at 469.

100. *Id.* at 484 (holding that the government entity could take private property for economic development because the taking was for a public purpose).

101. *Id.* at 483; see also *Midkiff*, 467 U.S. at 241 (stating the Court will defer to the legislature's decision as to what is considered a public use).

102. *Kelo*, 545 U.S. at 483–84 (stating the City wanted to implement its plan to increase tax revenue and create new jobs).

103. G. THOMAS KINGSLEY ET AL., THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES 18 (The Urban Institute 2009), available at http://www.urban.org/uploadedpdf/411909_impact_of_forclosures.pdf

restructure a mortgage would serve the public purpose of keeping people in their homes and maintaining communities.¹⁰⁴ As a result, a city could use the loose standards of defining what constitutes a public use¹⁰⁵ to justify taking residential mortgages to protect individual homeowners.¹⁰⁶ However, the public use element is challenged on grounds that it favors different, private, third-party investors and targets specific individual homeowners who can pay their mortgage bills.¹⁰⁷ A court can also turn to the Court's analysis in *Midkiff*.¹⁰⁸ There, the Court determined that the taking of land from one private owner to force a sale to another private owner was a public purpose, and part of the Court's reasoning was that the law enforcing the sale was enacted before any individual beneficiaries of it were identified.¹⁰⁹ The City of Richmond reportedly targets both performing and non-performing loans.¹¹⁰ Whether that constitutes targeting an individual before a plan is enacted is undecided and is an open question for a court to answer.¹¹¹

A closer examination of Justice Kennedy's concurrence in *Kelo* could support a city's taking of residential mortgages.¹¹² In approving the Court's decision in *Kelo*, Justice Kennedy relied on several trial court factual findings that justified the conclusion that the City of New London had a valid public purpose in condemning Ms. Kelo's home.¹¹³ Those findings included testimony from City of New London officials about the purpose and evidence of blight in the city.¹¹⁴ Leaders of communities with large numbers of homeowners saddled

(on file with *The University of the Pacific Law Review*) (describing how foreclosures lower property values which in turn results in less tax revenue to local governments).

104. Dewan *Eminent*, *supra* note 10 (reporting that the City of Richmond's purpose in using eminent domain on foreclosed mortgages was to "prevent foreclosures and the blight of vacant properties."); *see also* Perry, *supra* note 72, at 204–05 (analyzing that a court would likely find that transferring mortgages by using eminent domain would fulfill the public purpose of preventing blight).

105. *See* David Schultz, *Economic Development and Eminent Domain After Kelo: Property Rights and "Public Use" Under State Constitutions*, 11 ALB. L. ENVTL. OUTLOOK J. 41, 46 (2006) (stating that there is a broad definition of public use that includes an acquisition that "serves a public purpose, confers a benefit on the public, furthers the state's police powers, or otherwise is within a state's legitimate governmental authority").

106. *See* Dewan *Eminent*, *supra* note 10 (reporting that the City of Richmond's purpose in using eminent domain on foreclosed mortgages was to "prevent foreclosures and the blight of vacant properties."); *see also* Queally, *supra* note 71 (explaining that one New Jersey city mayor wanted to use eminent domain on foreclosed mortgages to help homeowners afford their monthly payments).

107. *See* Complaint, *supra* note 75, at 10 (claiming there is no "legitimate 'public use'" for the city program to seize residential mortgages).

108. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 239 (1984).

109. *Id.* at 245.

110. Dewan *Invokes*, *supra* note 1.

111. *See* Order, *supra* note 79 (dismissing a claim against the City of Richmond because its city council had not yet approved use of eminent domain on underwater mortgages).

112. *Kelo v. City of New London*, 545 U.S. 469, 490 (2005) (Kennedy, J., concurring).

113. *Id.* at 491–92.

114. *Id.* at 491.

with underwater mortgages have publically supported the use of eminent domain on those mortgages because it is for the benefit of their blighted community.¹¹⁵ These communities can also point to statistics showing the number of underwater mortgages and foreclosed homes in their area are significant enough to make a negative impact, which further justifies taking this kind of governmental action.¹¹⁶ Therefore, a city arguing in federal court for the use of eminent domain of a mortgage may stand up to a closer evaluation of their purpose under the Justice Kennedy concurrence.¹¹⁷

B. Protecting the Individual Homeowner is a Valid Public Use

When cities want to use eminent domain on mortgages, Justice Kennedy's *Kelo* concurrence may provide guidance and support for a court to hold that the taking serves a valid public purpose.¹¹⁸ Justice Kennedy stated that if a litigant objects to a taking on the grounds that it "impermissib[ly]" favors private parties, a federal court should treat this objection seriously with the presumption, however, that the government action aims to serve a public purpose.¹¹⁹ Opponents of the City of Richmond's plan contend that the taking of residential mortgages unjustly favors different, private, third-party investors.¹²⁰ But, the city can rely on the presumption that the government action aims to serve a public purpose and support that presumption by arguing that courts should provide individual homeowners a special protection given the benefits of homeownership to the individual and the community in which they reside.¹²¹

Homeownership can provide many financial and personal benefits to the individual homeowner.¹²² It also provides benefits to the greater community in

115. See Tyrrell, *supra* note 88 (reporting that Newark mayor Ras Baraka wants to use eminent domain on mortgages to slow foreclosures and address vacant buildings "plaguing the city."); Dewan *Invokes*, *supra* note 1 (describing how the city of Richmond wants to use eminent domain to address "fraying neighborhoods and a depleted middle class").

116. See Dewan *Eminent*, *supra* note 10 (reporting that post-recession homes in Richmond lost sixty-six percent of their value, and sixteen percent of homeowners lost their homes in foreclosure).

117. See *Kelo*, 545 U.S. at 493 (explaining that a stricter review may be necessary when a taking poses a risk of invalid favoritism to a private party).

118. *Id.* at 491.

119. *Id.*

120. Complaint, *supra* note 75, at 10.

121. See William M. Rohe, Shannon Van Zandt & George McCarthy, *The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research*, in JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, LOW-INCOME HOMEOWNERSHIP WORKING PAPER SERIES 1, 3 (2001) (describing studies that found a correlation between personal satisfaction and homeownership); see also Selma Hepp, *Social Benefits of Homeownership and Stable Housing*, NATIONAL ASSOCIATION OF REALTORS (Mar. 27, 2012), <http://economist.soutlook.blogs.realtor.org/2012/03/27/social-benefits-of-homeownership-and-stable-housing/> (on file with *The University of the Pacific Law Review*) (describing benefits such as better self-esteem, healthier living, and financial wealth).

122. See Hepp, *supra* note 121 (extolling the virtues of homeownership).

which it is established.¹²³ One commentator argues that there should be special protections for the home because, in part, the Third Amendment's history of protecting the home suggests that the Framers "may have intended for the Takings Clause to provide greater protection to homes than to other types of property."¹²⁴ Further, the political process supports an argument that the home is provided special protection because in response to *Kelo*,¹²⁵ many states enacted laws that offered greater protection to homeowners from government takings.¹²⁶ Here, cities like Richmond and Newark want to help their citizens stay in their homes so their communities remain vibrant and productive.¹²⁷

Using Justice Kennedy's analysis of the facts in *Kelo*, a city that wants to use eminent domain on mortgages can point to the fact that many of the residents who would benefit from the program are not known when the city considers or would approve a plan to use eminent domain of residential mortgages.¹²⁸ Thus, by cities showing that promoting individual homeownership is not "impermissib[ly]" favoring a private party¹²⁹ and providing evidence that there should be an additional protection to individual homeowners, a court may find that a government taking of a residential mortgage fulfills a public purpose.¹³⁰

C. *Risk of Favoritism Invites Closer Scrutiny*

Critics of residential mortgage takings contend there are other considerations that invite closer scrutiny of the public use requirement.¹³¹ Justice Kennedy's *Kelo* concurrence opens the door for this argument by suggesting there may be takings cases that warrant a "more stringent standard of review."¹³²

123. See Rohe, Van Zandt & McCarthy, *supra* note 121, at 12 (explaining that homeowners stay in their neighborhood longer than renters and the longevity leads to increased property values in the neighborhood).

124. See Sprankling, *supra* note 95, at 142 (arguing that the protection of the home provided for in the Third Amendment should be read into the Takings Clause).

125. *Kelo v. City of New London*, 545 U.S. 469, 469 (2005).

126. See Christopher W. Smart, *Legislative and Judicial Reactions to Kelo: Eminent Domain's Continuing Role in Redevelopment*, 22 PROB. & PROP. 60, 61 (2008) (reporting that "since 2005, some 42 states have adopted some form of anti-*Kelo* legislation").

127. See The Associated Press, *Eminent Domain to Fight Foreclosures is Divisive*, NJ.COM (Nov. 23, 2013, 1:54 P.M.), http://www.nj.com/essex/index.ssf/2013/11/eminent_domain_to_fight_foreclosures_is_divisive.html [hereinafter *Eminent Domain*] (on file with *The University of the Pacific Law Review*) (reporting that the mayor wants to help his struggling town); Dewan *Invokes*, *supra* note 1 (reporting that Richmond wants to use eminent domain to boost its "depleted middle class").

128. See *Kelo*, 545 U.S. at 492 (stating that city planners' lack of knowledge of other private beneficiaries of its redevelopment plan was evidence that the taking was for a public purpose).

129. See *id.* at 491 (explaining that favoring a private party could be impermissible in the context of a taking).

130. See *id.* (stating that evidence of government's reason for taking fulfilled the public use requirement).

131. See Complaint, *supra* note 75, at 19 (arguing the eminent domain proposal transfers wealth from one private party to another).

132. *Kelo*, 545 U.S. at 493.

In supporting the Court's conclusion that the City of New London's economic redevelopment plan was a permissible public purpose, Justice Kennedy relied on the factual findings and evidence presented to the trial court justifying that purpose.¹³³ Those findings included evidence that the city invested money in its plan before a majority of the private beneficiaries were known, that the city chose developers and a plan from a group of applicants, and that other, private beneficiaries were still unknown after the city approved the plan.¹³⁴ Mortgage companies fighting a city's use of eminent domain to take foreclosed mortgages could use this analysis to argue that there should be a higher standard of review in these cases because private investors in one mortgage company are being favored over the private investors who originally funded the mortgage.¹³⁵ Thus, because the transfer is from one private investor to another, mortgage companies may argue that the transfer of private property does not involve an economic development plan aimed toward bettering the public good.¹³⁶ To support this claim, the companies, at least in the case of Richmond, could state that the private beneficiary of the plan is already known before the city council approves the plan, and there was no selection from a group of applicants.¹³⁷ Therefore, a claim that reducing mortgage rates via eminent domain serves a public purpose of keeping people in their homes is potentially subject to a stricter standard of review because there could be strong evidence that the taking favors a private party more than creating a public benefit.¹³⁸ However, given that the *Kelo* plurality acknowledged the importance of deference to the legislature, it appears a mortgage company may struggle to overcome broad definitions of public use despite hints of favoritism.¹³⁹

133. *Id.* at 491–92.

134. *Id.*

135. See Brian Elzweig & Valrie Chambers, *Legal and Practical Implications of the Eminent Domain of Mortgages*, 33 BANKING & FIN. SERVICES POL'Y REP. 1 (2014) (describing how investors part of Mortgage Resolution Partners would fund city plans to lower mortgages and then receive payment).

136. See Dewan *Eminent*, *supra* note 10 (reporting that Richmond City Council took a vote on a proposal to use eminent domain but did not state it was part of an overall economic development plan); Elzweig & Chambers, *supra* note 135, at 4 (arguing that the real beneficiary of a city's use of eminent domain on mortgages are private investors who make the funding to do so possible); see also *Eminent Domain*, *supra* note 127 (quoting a New Jersey town's mayor as saying eminent domain of foreclosures would not be a "panacea"); see

137. See Notice *supra* note 27, at 1 (naming Mortgage Resolution Partners as co-defendants with the City of Richmond). See also Dewan *Eminent*, *supra* note 10 (reporting that the mayor of Richmond heard about the eminent domain plan from Mortgage Resolution Partners).

138. See *Kelo*, 545 U.S. at 493 (Kennedy, J., concurring) (stating a higher standard may be allowed when there is a possibility of giving an advantage to private parties); Dewan *Eminent*, *supra* note 10 (reporting that the City of Richmond's purpose in using eminent domain on foreclosed mortgages was to "prevent foreclosures and the blight of vacant properties.").

139. See *id.* at 480 (acknowledging the Court's "longstanding policy of deference to legislative judgments" in takings cases).

Justice Kennedy did not support a higher review standard in cases of economic redevelopment takings.¹⁴⁰ Yet, he left open the possibility of a higher standard for different types of takings cases.¹⁴¹ Opponents of a city's plan to seize a residential mortgage would use the same fact that plans to keep individual homeowners in their homes are done on a case-by-case basis¹⁴² as evidence that the takings are not part of an overall economic redevelopment plan that is detailed in the same way as the plan the *Kelo* court approved.¹⁴³ This evidence might raise the risk of "impermissible favoritism of private parties" that supports a presumption that the taking is for an invalid public purpose because opponents allege specific mortgages are targeted before approving the plan.¹⁴⁴ Further, in the case of Richmond, there is already an identified beneficiary that the city did not select from a group of applicants, which was an important piece of evidence to Justice Kennedy in *Kelo*.¹⁴⁵

Additionally, there are no special legal considerations for individual homeowners. Supreme Court jurisprudence and a plain reading of the Constitution appear to provide support for the claim that the takings clause applies to all property.¹⁴⁶ Also, in determining the just compensation prong of the Takings Clause, the Court does not award compensation for the intangible aspects of homeownership.¹⁴⁷ Thus, there is a foundation for imposing a higher standard of review in cases using eminent domain on mortgages because homeowners do not receive special protections and some cities lack an overall economic development plan.¹⁴⁸

140. *Id.* at 493.

141. *Id.*

142. *See* Complaint, *supra* note 75, at 19 (contending that the eminent domain plan "cherry-pick[s]" specific loans with the best chance of repayment).

143. *See Kelo*, 545 U.S. at 491–92 (explaining how the city's lack of knowledge regarding many of the beneficiaries and selection of the primary developer from a group was evidence of a valid public purpose).

144. *See* Complaint, *supra* note 75, at 19 (contending that the eminent domain plan "cherry-pick[s]" specific loans with the best chance of repayment).

145. *See* Dewan *Eminent*, *supra* note 10 (reporting that Richmond mayor embraced eminent domain of mortgages after meeting with Mortgage Resolution Partners, which would be the investment company assisting the city in restricting the mortgages).

146. *See* Sprankling, *supra* note 95, at 120 (arguing that the language of the Takings Clause "treat[s] all 'private property' as equally subject to government seizure").

147. *See* U.S. v. 564.54 Acres of Land, 441 U.S. 506, 514 (1979) (determining that there is no compensation for the intangible value of property).

148. *See Kelo*, 545 U.S. at 493 (Kennedy, J., concurring) (stating there is a possibility for a higher standard of review in takings cases).

D. *Presumption of a Public Purpose Will Likely Prevail*

Cities wanting to use eminent domain can establish the act fulfills a valid public use whether or not they have a comprehensive redevelopment plan.¹⁴⁹ While there is legal support to not provide special protections to individual homeowners,¹⁵⁰ it is likely not enough to warrant a higher standard of review when a city is challenged over its use of eminent domain on a residential mortgage.¹⁵¹ Justice Kennedy stated only a “narrowly drawn category of takings” would justify a presumption of invalidity, but a higher standard is not warranted if the purpose is economic development.¹⁵² A city that does not include the taking of a residential mortgage as a part of an overall economic development plan is not foreclosed from taking the mortgage because Justice Kennedy did not state what other purposes may or may not warrant a stricter standard of review.¹⁵³ While the cities may not yet have detailed plans as in *Kelo*, the Court does not require that level of specificity.¹⁵⁴ Further, the cities seek a broader purpose of maintaining their communities and keeping residents in their homes, and this has benefits that extend beyond the individual homeowner.¹⁵⁵ Additionally, the plan the Court approved in *Midkiff* was not as detailed as the redevelopment plan in *Kelo*, nor did it have the same pieces of evidence Justice Kennedy weighed in his concurring opinion.¹⁵⁶ Instead, the *Midkiff* court focused on a broad definition of public use that deferred to the local legislature.¹⁵⁷ Given the Court’s history of broadly defining public use and its deference to local governments, a federal

149. See Dewan *Eminent*, *supra* note 10 (describing that the Richmond mayor wants to use eminent domain to keep residents in their home but does not state it’s part of an overall redevelopment plan).

150. See *564.54 Acres of Land*, 441 U.S. at 514 (determining that there is no compensation for the intangible value of property).

151. See *Kelo*, 545 U.S. at 493 (Kennedy, J., concurring) (determining that a higher standard of review is not required just because there is an economic purpose to a taking).

152. *Id.*

153. *Id.*

154. See *id.* at 492 (Kennedy, J., concurring) (rejecting a broad, “*per se*,” invalid presumption of takings for an economic purpose).

155. See Rohe, Van Zandt & McCarthy, *supra* note 121, at 4 (describing studies that found a correlation between personal satisfaction and homeownership); see also Hepp, *supra* note 121 (describing benefits such as better self-esteem, healthier living, and financial wealth).

156. Compare *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 233–34 (1984) (describing the Act that forced the sale of private property to tenants on the land), with *Kelo*, 545 U.S. at 491–92 (Kennedy, J., concurring) (weighing trial court testimony, documents exchanged between the parties, apparent economic distress of the city, significant contribution of public funds before private beneficiaries selected, unknown private beneficiaries still outstanding, and selection of a developer from a group).

157. See *Midkiff*, 467 U.S. at 241 (determining that the Court will not use its judgment in place of the legislature’s).

court is more likely to reject a higher standard of review for a case of a city using eminent domain on mortgages.¹⁵⁸

V. IMPLICATIONS OF A PRESUMPTION FOR CITIES, HOMEOWNERS, AND LENDERS

Applying a presumption that a public purpose exists when cities elect to use eminent domain on residential mortgages raises important questions as to whether the courts have a role in this debate¹⁵⁹ and whether this might have a negative impact on the housing market.¹⁶⁰

A. *States Should Determine a Proper Public Use*

Cities seeking to use eminent domain on mortgages can claim the court's role is very limited to determine a proper public use.¹⁶¹ These cities could use court decisions that defer to legislative authority to bolster the argument that legislatures, not the courts, should decide the limits of a city's use of eminent domain.¹⁶² Further, following the Court's decision in *Kelo*, more than forty states undermined the case's holding by passing laws that gave added protections to homeowners.¹⁶³ Thus, a city that plans to use eminent domain on mortgages may argue in court that the opponent must comply with state law, and the court must defer to its prior precedents.¹⁶⁴ As a result, a presumption that a plan of seizing a residential mortgage fulfills a public purpose would favor cities.¹⁶⁵

158. *See id.* (determining that the Court will not use its judgment in place of the legislature's); *Berman v. Parker*, 348 U.S. 26, 33 (1954) (stating that Congress determines how to carry out powers that are within its authority).

159. *See Berman*, 348 U.S. at 33 (declaring that once a public purpose of a project is established only Congress can determine the means to execute it).

160. *See* Complaint, *supra* note 75, at 10, (claiming that allowing cities to use eminent domain on foreclosed mortgages would "severely disrupt the United States mortgage industry").

161. *See Berman*, 348 U.S. at 33 (stating that only Congress can determine the means of executing a project that serves a public purpose); *Midkiff*, 467 U.S. at 241 (declaring that a court will not substitute "its judgment for the legislature's judgment"); *Kelo*, 545 U.S. at 489–90 (noting that the Court only has authority to determine whether an act constitutes a public use under the Fifth Amendment).

162. *See Berman*, 348 U.S. at 33 (stating that Congress is the only one to implement a project once it has an established public purpose).

163. *See* Smart, *supra* note 126, at 60–61 (reporting that "since 2005, some 42 states have adopted some form of anti-*Kelo* legislation.").

164. *See Kelo*, 545 U.S. at 489–90 (stating that the Court's role is limited to determining a valid public use based on centuries of case law).

165. *Infra* Part VI.

B. Taking Mortgages Could Harm the Housing Market

A presumption of validity for taking underwater mortgages does not account for the loss to investors and will wreak havoc on the housing market.¹⁶⁶ Opponents also contend that allowing cities to seize mortgages will negatively impact pension plans¹⁶⁷ and make borrowing more costly for other homebuyers and owners.¹⁶⁸ In response, several lenders threatened to stop providing loans to communities that approve of using eminent domain to take mortgages.¹⁶⁹ Thus, a presumption of public use could ignite backlash against communities that are looking for ways to help their residents.¹⁷⁰ However, the ability to rebut the presumption allows lenders to appropriately challenge a city's plan to seize residential mortgages, and prior attempts indicate that these lenders are prepared with evidence to potentially successfully rebut the presumption.¹⁷¹

VI. THE CASE FOR A REBUTTABLE PRESUMPTION

A court can strike a compromise of sorts between the two sides by applying a presumption that a taking of a residential mortgage fulfills a public use,¹⁷² which can be rebutted with evidence why it should or should not determine the outcome of a case.¹⁷³ The presumption would assume that a local government is taking a residential mortgage for a public use. However, balancing factors tied to the public use requirement for lenders and investors against factors for a municipality seeking to use eminent domain on mortgages to decide for the party who has the most factors weighing in their favor could rebut the presumption.¹⁷⁴

A. Factors to Consider for Lenders and Investors

The factors a court should consider when determining whether the balance weighs for or against a lender are: (1) the financial status of the debtor at the time the loan was initially issued; (2) the terms of the loan; (3) the value of a home

166. See Complaint, *supra* note 75, at 10 (asserting that the national mortgage industry will be "severely disrupted" if cities can take mortgages using eminent domain).

167. Dewan *Eminent*, *supra* note 10.

168. Dewan *Invokes*, *supra* note 1.

169. Dewan *Eminent*, *supra* note 10.

170. See *id.* (reporting that some lenders stopped issuing loans in Georgia because of tough lending laws the state passed in 2012 and the laws have since been changed).

171. *Infra* Part VI.

172. *Infra* Part VI.

173. *Infra* Part IV.

174. See Part IV.A–B.

nearing foreclosure; and (4) the difference the lender could receive in a deficiency judgment whether or not one is possible in the jurisdiction.¹⁷⁵

In many cases of loans issued to homeowners in the time period before the housing crash, individuals who could not afford the homes they purchased still received loans.¹⁷⁶ In some instances, homeowners were told they did not need to meet other qualifying conditions such as making a down payment.¹⁷⁷ Not surprisingly, those loans did not meet prior industry standards.¹⁷⁸ If a lender issued a loan under these conditions, factors one and two would cut against them. A city claiming it is using eminent domain on a mortgage near foreclosure can bolster its public purpose argument because it is helping vulnerable residents who signed up for loans under false conditions and on bad terms.¹⁷⁹ These were likely working residents contributing to the local economy, and now they face leaving the community because they could be losing their homes.¹⁸⁰ Therefore, when a court is evaluating the lender's argument that the taking is not for a public purpose, it can determine that a city is taking the mortgage for a public purpose if the lender issued a non-conforming loan to a vulnerable borrower, and the city is responding by helping its community recover.¹⁸¹ If the lender issued a conforming loan¹⁸² to a borrower in good standing, then this factor would support the lender's argument that the taking of a mortgage nearing foreclosure is not for a public purpose because it supports the lender's claim that the city is purposefully targeting performing loans to gain a profit for an independent third-party.¹⁸³

175. See *infra* text accompanying notes 179–81, 189–85, and 191–92.

176. Loans given to individuals with bad or questionable credit history or significant loans given to people who did have good credit history were called subprime loans. Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373 (2008).

177. Kelly, *supra* note 7.

178. Subprime loans are considered “very high risk” because the borrowers clearly show they cannot repay the loan in a timely manner. Office of the Comptroller of Currency, Bd. of Governors for the Fed. Reserve Sys., *Subprime Lending: Expanded Guidance for Subprime Lending Programs*, 1, 9–10 (2001), available at <http://www.occ.gov/news-issuances/bulletins/2001/bulletin-2001-6a.pdf> (on file with *The University of the Pacific Law Review*).

179. See Kelly, *supra* note 7 (reporting that one man was told he didn't have to put down a down payment for a condo purchase).

180. See *id.* (reporting local man who worked in community and enrolled his son in one of its schools had to move after his home was foreclosed on); Dewan *Invokes*, *supra* note 1 (stating that one couple “watched as their daughter's playmates on the block have, one by one, lost their homes.”).

181. See Dewan *Invokes*, *supra* note 1 (discussing that communities like Richmond were targets of predatory loan tactics and now city officials want to help by using eminent domain).

182. Conforming loans are those that meet a loan limit set annually by the federal government that is the maximum amount at which a lender can purchase a single-family home mortgage. Fed. Hous. Fin. Agency, *Conforming Loan Limits*, <http://www.fhfa.gov/DataTools/Downloads/Pages/Conforming-Loan-Limits.aspx> (on file with *The University of the Pacific Law Review*) (last visited Jan. 3, 2015).

183. See Complaint *supra* note 75, at 10 (claiming there is no public use to the city's “profit-driven” plan).

Factors three and four examine what the city and third-party investor stand to gain to either support or negate a lender's argument that there is no valid public purpose for taking a mortgage. If the value of the home nearing foreclosure and the difference the lender could receive in a deficiency judgment is a minimal amount in comparison to the value of the home, then there is less risk of impermissible favoritism and more support toward a program that is helping residents and the community.¹⁸⁴ However, these factors would weigh in favor of the lender if there were a large gain to be made because a large gain supports a lender's claim that the taking is for profit and not a public purpose.¹⁸⁵ A city using this program would base its taking on the home's fair market value.¹⁸⁶

Fair market value is also a factor used to determine whether a lender has set a valid price for a home when it will be up for bid at a foreclosure auction.¹⁸⁷ Fair market value usually considers such factors as a property's potential uses, zoning attachments, the cash value of the home, and the possibility for development.¹⁸⁸ Therefore, the fair market value and how cities calculate it can either bolster or diminish a lender's argument that a city seizing mortgages at "steeply discounted prices" to gain a profit would not support a public purpose.¹⁸⁹ Or, if it is the same price a lender is required to set, then that factor supports the implication that the city is using valid means to determine the value of the home to help its residents.¹⁹⁰

The final factor courts should consider is the difference in value between the sale price at foreclosure and the remaining loan amount, which lenders usually try to retrieve by filing for a deficiency judgment against the borrower.¹⁹¹ A court should weigh this factor against a lender if the value of the deficiency judgment plus the amount of interest charged is disproportionate to the current value of the

184. See *Dewan Invokes*, *supra* note 1 (stating that the plan for taking underwater mortgages includes "both current and delinquent loans" and doesn't target homes with second mortgages).

185. See *Complaint*, *supra* note 75, at 9 (describing how the takings plan proposed by the City of Richmond and a third-party investor would yield a twenty percent profit).

186. See *Dewan Invokes*, *supra* note 1 (reporting that the City of Richmond is "offering to buy the loans at what it considers the fair market value.").

187. See *Citicorp Real Estate Inc. v. Smith*, 155 F.3d 1097, 1107 (9th Cir. 1998) (outlining factors to be considered in whether a property price was set at fair market value).

188. *Id.*

189. *Complaint*, *supra* note 75, at 9.

190. See CAL. CIV. PROC. CODE § 580(a) (West 2014) (requiring that a home's auction price be set at fair market value).

191. A deficiency judgment is defined as "[a] judgment against a debtor for the unpaid balance of the debt if a foreclosure sale or a sale of repossessed personal property fails to yield the full amount of the debt due." BLACK'S LAW DICTIONARY (9th ed. 2009).

home at the time the eminent domain action is filed because it underscores the lender's claims that the city's goal is to make a profit.¹⁹²

B. Factors to Consider for the Borrower/Debtor and City

Courts should consider whether the borrower was knowledgeable as to the terms of the loan in determining whether a borrower/debtor receives the benefit of a government taking that restructures his or her mortgage payment.¹⁹³ Other factors courts should consider include: the percentage of homes underwater in the city seeking to use eminent domain on foreclosed mortgages;¹⁹⁴ whether the taking is part of an overall economic development plan or addresses a crisis in the community;¹⁹⁵ and the impact of the percentage of underwater homes on the municipality's tax revenue for services.¹⁹⁶

Additional factors a court should consider when determining whether the borrower was knowledgeable about the terms of their loan include a borrower's ability to secure a loan through multiple lenders and his or her income level.¹⁹⁷ These factors work in favor of borrowers because—with some assistance from the government—lenders made it easy for many borrowers to enter into unsound loan agreements in the first place.¹⁹⁸ Therefore, if a city can prove this element, it would support a city's claim that it is helping vulnerable residents stay in their homes.¹⁹⁹

192. Compare Kelly, *supra* note 7 (reporting that one former homeowner owed \$21,000 in interest in addition to \$95,500 for the unpaid portion of his loan), with Complaint, *supra* note 75, at 9 (claiming that third-party investors would gain a twenty percent profit through an allegedly impermissible program).

193. Many subprime loans were usually given to low-income homebuyers and minorities who had limited access to larger commercial financial institutions to secure a loan. Solomon Maman, *New Tools for Combating Unfair, Deceptive and Abusive Mortgage Practices: New Amendments to Regulation Z*, 21 LOY. CONSUMER L. REV. 194, 199 (2008); see also Kelly, *supra* note 7 (reporting that one man was shown homes he thought he could not afford but was then told he did not have to pay a down payment).

194. One extreme example occurred in San Bernardino County where after 2006, fifty-seven percent of residential mortgages in the county were underwater. Tad Friend, *Home Economics: Can an Entrepreneur's Audacious Plan Fix the Mortgage Mess?*, THE NEW YORKER (Feb. 4, 2013), available at <http://www.newyorker.com/magazine/2013/02/04/home-economics-2> (on file with *The University of the Pacific Law Review*).

195. See *Kelo v. City of New London*, 545 U.S. 469, 484 (2005) (holding an economic development plan was a valid public purpose).

196. Kingsley, *supra* note 103, at 18 (describing how foreclosure lowers property values which in turn results in less tax revenue to local governments).

197. Many lenders administered subprime loans to low-income homebuyers and minorities. Maman, *supra* note 193, at 199.

198. Steven L. Schwarcz, Keynote Address, Understanding the Subprime Financial Crisis (Oct. 24, 2008) in 20 S.C. L. REV. 549, 550 (2009).

199. See also Dewan *Invokes*, *supra* note 1 (quoting Richmond Mayor Gayle McLaughlin as saying she is "committed to the well-being of [Richmond's] neighborhoods.").

Next, the court should look at factors that weigh for or against the city. For instance, a city may not have an economic development plan to revive the local economy through eminent domain of foreclosures; however, balancing the other factors may allow a court to find in favor of a city if its goal is to maintain its community by keeping residents in their homes.²⁰⁰ This goal satisfies a public use because keeping homeowners in their homes benefits the community.²⁰¹ In considering the various factors supporting or denying a city's attempt to use eminent domain on a foreclosed mortgage, the court should evaluate each factor separately with an understanding that one factor can outweigh another.

C. Applying the Presumption

While the court dismissed a lawsuit filed against the City of Richmond for its proposal to use eminent domain on foreclosures,²⁰² the city's efforts, along with the efforts of many others, warrant an analysis of the proposed presumption's applicability to a case challenging a city's use of eminent domain of underwater mortgages.²⁰³ The court's initial steps require it to balance factors in favor of or against the lenders.²⁰⁴ First, the lender needs to supply the terms of the loans for the mortgages in question.²⁰⁵ In Richmond, this factor likely weighs in favor of lenders who can argue the loan terms are fair and that the debtors are capable of paying the loans even if they are underwater; this is based on the lender's claim that the City of Richmond and its third-party investor, Mortgage Resolution Partners, only target performing loans not loans in default or in danger of default.²⁰⁶

Next, a court would look at the financial status of the debtor at the time the loan was issued.²⁰⁷ This factor likely weighs against the lender because in Richmond's case, many lenders likely issued loans to low-income homeowners.²⁰⁸ Then, the court would evaluate the fair market value of a home

200. Dewan *Eminent*, *supra* note 10 (reporting that the City of Richmond sought to prevent foreclosures and the damages those foreclosures cause).

201. See Dewan *Invokes*, *supra* note 1 (reporting that married homeowners refused to "walk away from [their] house in part for the sake of their son.>").

202. Order, *supra* note 79.

203. Timiraos, *supra* note 74 (quoting William McDavid, general counsel for Freddie Mac, as saying the mortgage company "would consider taking legal action" if Richmond took loans using eminent domain).

204. *Supra* Part VI.A.

205. *Supra* Part VI.A.

206. Complaint, *supra* note 75, at 10–11.

207. *Supra* Part VI.A.

208. The median household income in Richmond between 2009 and 2013 was \$54,589, which was lower than the \$61,094 median household income statewide during the same time period. Further, Richmond had 18.5 percent of its population living below the poverty line during that same period while the state averaged 15.9 percent living below the poverty line. *U.S. Census Bureau, Richmond (city), California*, U.S. DEP'T OF

nearing foreclosure.²⁰⁹ This factor could potentially cut both ways depending on if the city is using the fair market value standards required by law²¹⁰ or if they are setting a price that yields a large profit for them and a separate third-party investor.²¹¹

Finally, the court considers the amount of the deficiency judgment and interest charged to the debtor in comparison to the current value of the home.²¹² In Richmond's case, homes bought before the housing crash in 2006 lost sixty-six percent of their value.²¹³ Today, the median home value in Richmond is about \$270,200.²¹⁴ Therefore, this factor would likely weigh against a lender seeking to recover a large deficiency and high interest rate accrual²¹⁵ against a city that wants to pay fair market value for the loan because the factor supports the city's argument that it wants to keep residents in their homes to help the community.²¹⁶

In weighing factors for and against the individual borrowers and the city, the court considers first the individual borrower's knowledge.²¹⁷ This factor falls either for or against the individual depending on whether the lender can show the borrower had sufficient options and knowledge at the time the loan was issued.²¹⁸ In Richmond, it is questionable if the lender can show this given that much of the city's population was "steered into predatory loans."²¹⁹ However, the blanket statement that the population was prey to bad lending practices would be refuted by evidence that performing loans are targeted.²²⁰ Thus, if a city is helping homeowners who actually understand the terms of their loan and payment requirements, the city's purpose seems less likely for a public use because it is missing the element of addressing a community need during tough economic

COMMERCE, <http://quickfacts.census.gov/qfd/states/06/0660620.html> [hereinafter Census] (on file with *The University of the Pacific Law Review*) (last revised Dec. 4, 2014).

209. *Supra* Part VI.A.

210. See CAL. CIV. PROC. CODE § 580a (West 1988) (requiring that a home's auction price be set at fair market value).

211. See Complaint, *supra* note 75, at 9 (stating that MRP and its investors would receive a profit up to twenty percent).

212. See *supra* Part VI.A.

213. Dewan *Invokes*, *supra* note 1.

214. Census, *supra* note 208.

215. See Kelly, *supra* note 7 (reporting that one former homeowner owed \$21,000 in interest in addition to \$95,500 for the unpaid portion of his loan).

216. See Dewan *Invokes*, *supra* note 1 (discussing the reasons for Richmond seeking to use eminent domain to stop foreclosures).

217. *Supra* Part VI.B.

218. See Kelly, *supra* note 7 (discussing how one man was not required to make a down payment when purchasing a condo).

219. Dewan *Invokes*, *supra* note 1.

220. See Complaint *supra* note 75, at 10 (calling the City of Richmond's plan a "façade" because it targets loans of homeowners who pay on a monthly basis and have a good credit).

times and leans more toward benefiting “a particular class of identifiable individuals.”²²¹

Next, the court would consider the actions of the city attempting to use eminent domain on foreclosures.²²² One factor is the percentage of homes underwater in the community, which works with another factor of determining if the community is in crisis.²²³ In Richmond, about twenty-eight percent of homes were underwater, which is almost double the nineteen percent national average.²²⁴ This evidence weighs in favor of allowing the city to use eminent domain on foreclosures because a plan to address a significant problem in a community is a viable public purpose to justify a taking of the private property of one and giving it to another.²²⁵ Finally, a court considers the impact of the percentage of underwater homes on the city’s tax revenue.²²⁶ In Richmond, this factor weighs in favor of the city taking the mortgage for the public use of benefitting the community because the municipality reported that it faces “financial stress” from increased expenses and decreased revenue from property taxes and assessments.²²⁷

By balancing the factors and analyzing prior Supreme Court case law, it appears that the City of Richmond may have enough support to win a lawsuit against banks challenging a seizure of a private, residential, underwater mortgage. However, that could change if lenders provide enough evidence to show there is a risk of “impermissible favoritism”²²⁸ to a private third-party investor and to individual homeowners who can pay their loans.²²⁹ Therefore, as cities consider a proposal of taking a mortgage via eminent domain, it will have to be mindful of the evidence it needs to support its claim so when a court does

221. *Kelo v. City of New London*, 545 U.S. 469, 478 (2005).

222. *Supra* Part VI.B

223. *Supra* Part VI.B.

224. *Dewan Eminent*, *supra* note 10.

225. *See Schultz*, *supra* note 105, at 46 (stating that there is a broad definition of public use that includes if the use “serves a public purpose, confers a benefit on the public, furthers the state’s police powers, or otherwise is within a state’s legitimate governmental authority”); *see also Perry*, *supra* note 72, at 204–05 (analyzing that a court would likely find that transferring mortgages by using eminent domain would fulfill a public purpose of preventing blight).

226. *See supra* Part VI.B.

227. City of Richmond, Cal., 2012-13 Tax & Revenue Anticipation Notes, Series A, 1, 20 (2012), available at <http://www.ci.richmond.ca.us/DocumentCenter/Home/View/9391> (on file with *The University of the Pacific Law Review*).

228. *See Kelo v. City of New London*, 545 U.S. 469, 491 (2005) (Kennedy, J., concurring) (believing a court should seriously consider an objection that there is “impermissible favoritism to private parties”).

229. *See Complaint*, *supra* note 75, at 9–10, (claiming third-party investors will make a twenty percent profit and cities target performing loans).

determine that a complaint can proceed, there will be a full discussion on whether the public use requirement is satisfied.²³⁰

VII. CONCLUSION

The housing crash caused a financial crisis that still heavily impacts communities across the country.²³¹ Individual families like the Castillos, who want to stay in their homes and communities, face high payments in low-value homes while recovering from a tough economic collapse.²³² Leaders in some of those cities want to find a way to help their residents and using eminent domain to take over underwater mortgages may just be the solution that can effectively help residents and communities—who have watched as neighbors are forced to abandon their homes and their children lose more playmates—remain whole.²³³ Lender expectations and the need to recover their lost money is also a crucial factor that helps maintain the housing market.²³⁴ Thus, a court faced with deciding which side to support can be greatly aided by presuming there is a public purpose in the taking and balancing the evidence to support that purpose using the conditions that led to the current status of the city, homeowner, and lender to determine the best solution in that case to the crisis facing both sides.²³⁵ Under this analysis, there may be a way to keep the Castillos and their neighbors together so they can continue to be a community.²³⁶

230. See Order, *supra* note 79 (dismissing a case against Richmond’s attempt to use eminent domain because the city’s plan was not yet fully developed).

231. Dewan *Invokes*, *supra* note 1.

232. *Id.*

233. *Id.*; Queally, *supra* note 71.

234. See also Complaint, *supra* note 75, at 14–15 (arguing that the use of eminent domain on underwater mortgages would have negative effects on the housing market).

235. Compare *Kelo v. City of New London*, 545 U.S. 469, 491 (2005) (Kennedy, J., concurring) (stating that presumption of invalidity is not warranted unless the risk of “impermissible favoritism is so acute” that the presumption is not warranted), with Complaint *supra* note 75 (arguing that is it unconstitutional for a city to use eminent domain on foreclosures).

236. Dewan *Invokes*, *supra* note 1.