

2013

# Eminent Domain: The Solution to the Foreclosure Crisis or Overstepping Government Boundaries?

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## Recommended Citation

Anne T. T. Jensen, *Eminent Domain: The Solution to the Foreclosure Crisis or Overstepping Government Boundaries?*, 12 Rich. J. Global L. Bus. 543 (2013).

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# COMMENT: EMINENT DOMAIN: THE SOLUTION TO THE FORECLOSURE CRISIS OR OVERSTEPPING GOVERNMENT BOUNDARIES?

*By: Anne T. T. Jensen\**

## I. INTRODUCTION

In the summer of 2012, the relatively unknown county of San Bernardino, California made national headlines when its CEO announced that he would entertain a venture fund's proposal to use the county's power of eminent domain to seize mortgages and sell them for restructuring in an effort to assist the county's struggling homeowners. While many, including California Lieutenant Governor Gavin Newsom, backed the county's resourcefulness in desperate times,<sup>1</sup> others have questioned whether the county could be overstepping its constitutional bounds and causing more harm than good. Is this the long-awaited solution to America's floundering housing market?

Unfortunately, it seems a revival of the market through eminent domain is unlikely. While the San Bernardino proposal would be within the limits of the power afforded to states and municipalities by the U.S. and state constitutions, it may have a long-term cooling effect on the lending market that would greatly outweigh any short-term relief it may offer.

This article will provide both an analysis of the legal concept of eminent domain and its likelihood of success in resuscitating real estate markets in towns like San Bernardino. Sections Two and Three will explore the background of the mortgage crisis and provide an in-depth description of the eminent domain proposal by the Mortgage Resolution Partners ("MRP"). Section Four takes a deeper look into the state and federal precedent on a municipality's power to use eminent domain, revealing that the definition of "legitimate public purpose" would likely apply to the seizing of mortgages. Finally, Section Five will focus on the predicted effect this proposal, if enacted, would have on lenders and borrowers, proving that San Bernardino should refrain from using eminent domain to seize private mortgages.

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<sup>1</sup> Sam Forgione, *FHFA Raises Concerns About Eminent Domain Plan*, REUTERS (Aug. 8, 2012, 3:16 PM), <http://www.reuters.com/article/2012/08/08/us-mortgages-restructuring-idUSBRE8771C420120808>.

## II. THE MORTGAGE CRISIS

The mortgage crisis, which began in 2007, has had a crippling effect on the country's housing market over the last six years. As of January 2012, there were approximately 12 million underwater homeowners nationwide,<sup>2</sup> with sources estimating that they collectively owed \$1.2 trillion more than their homes are worth.<sup>3</sup> Moreover, of the 12 million underwater homeowners, approximately 28 percent were behind on their payments, putting them at a higher risk of default.<sup>4</sup> Such defaults typically result in lengthy and expensive short-sale or foreclosure proceedings<sup>5</sup> (totaling upwards of 3.9 million in 2011<sup>6</sup>), during which both lenders and homeowners suffer. While refinancing the loan for lower interest rates is an option for some, many homeowners owe as much as twice what their house is currently worth.<sup>7</sup> For those borrowers, a principal modification, a special form of debt relief offered by the lender, is the only thing that will save their homes.<sup>8</sup>

So why, in the face of a national financial crisis of this scale, is it so difficult for homeowners to obtain loan modifications? One of the biggest problems is that while homebuyers initially sign a mortgage with a bank or financial service company, most of those firms only service, or manage, the loan.<sup>9</sup> Many loans are then bought and sold to investors on the secondary market as mortgage-backed securities.<sup>10</sup> Unfortunately, it is where the loans end up, not where they originate,

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<sup>2</sup> BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 21 (2012), available at <http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf>.

<sup>3</sup> Ben Hallman, *San Bernardino Eminent Domain Fight Closely Watched By Other Struggling Communities*, HUFFINGTON POST (Sept. 25, 2012, 3:29 PM), [http://www.huffingtonpost.com/2012/09/01/eminant-domain-mortgages\\_n\\_1836710.html](http://www.huffingtonpost.com/2012/09/01/eminant-domain-mortgages_n_1836710.html).

<sup>4</sup> BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 2; Ted Gayer, *How Many Borrowers Might Qualify for Principal Reduction Under the Mortgage Settlement?*, BROOKINGS INSTITUTE (Mar. 1, 2012, 3:24 PM), <http://www.brookings.edu/blogs/up-front/posts/2012/03/01-mortgage-agreement-gayer>.

<sup>5</sup> Estimates from 2008 suggest that a foreclosure costs approximately \$77,000, a cost that is split between the lender, homeowner, neighborhood, and local government. Glenn Setzer, *Foreclosures Cost Lenders, Homeowners, the Community Big Bucks*, MORTGAGE NEWS DAILY, (June 2, 2008), [http://www.mortgagenewsdaily.com/622008\\_Foreclosure\\_Costs.asp](http://www.mortgagenewsdaily.com/622008_Foreclosure_Costs.asp).

<sup>6</sup> *Home Foreclosure Statistics*, STATISTIC BRAIN (Oct. 15, 2012), <http://www.statisticbrain.com/home-foreclosure-statistics/>.

<sup>7</sup> Hallman, *supra* note 3.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

that matters for the homebuyers seeking to qualify for principal reduction.<sup>11</sup>

Underwater homeowners with loans at the largest banks are currently receiving the most assistance. Five banks, including Bank of America and JPMorgan Chase, reached a settlement agreement with state attorney generals in early 2012 to offer debt forgiveness of at least \$10 billion.<sup>12</sup> While it is questionable whether this assistance will reach a significant number of homeowners,<sup>13</sup> the banks must reach the \$10 billion target or face financial penalties.<sup>14</sup>

The second and largest pool of loans are those owned or controlled by Fannie Mae and Freddie Mac, government-owned mortgage companies. In early 2012, it was estimated that approximately 3.3 million of those loans were underwater.<sup>15</sup> Unfortunately, those homeowners do not currently qualify for any type of principal reduction.<sup>16</sup>

Private investors, including pension funds like California Public Employees' Retirement System and the bond fund Pacific Investment Management Co., own much of the remaining approximately ten percent of all loans.<sup>17</sup> These mortgages are the most likely to be deep underwater (three times as likely as Fannie Mae or Freddie Mac loans), and are thus at the highest risk of failing.<sup>18</sup> The banks managing these loans typically point to their contracts with private investors as the barrier to principal reduction.<sup>19</sup> Their loans are often divided into bonds that are owned by many different investors, so there are usually no single entities that the banks can approach for revisions of the agreements.<sup>20</sup> Thus, millions of upside down homeowners are unlikely to see any relief in the form of principal reduction from their lenders.

### III. EMINENT DOMAIN PROPOSAL

When MRP, a self-described community advisory firm,<sup>21</sup> formulated its theory that the power of eminent domain could revitalize the housing market, San Bernardino County seemed like the perfect

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.*; Gayer, *supra* note 4.

<sup>13</sup> *See* Gayer, *supra* note 4.

<sup>14</sup> Hallman, *supra* note 3.

<sup>15</sup> Gayer, *supra* note 4.

<sup>16</sup> Hallman, *supra* note 3.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> MORTGAGE RESOL. PARTNERS, <http://mortgageresolution.com/> (last visited Dec. 2012).

place to test the concept. The recession had hit San Bernardino's homeowners harder than most. In late 2012, the County's 11.9 percent unemployment rate was one of the nation's highest,<sup>22</sup> and housing prices had plummeted as a result. Unsurprisingly, every second homeowner in San Bernardino was underwater by the summer of 2012.<sup>23</sup>

MRP sought out the county CEO, Greg Devereaux, and presented its CARES theory (Community Action to Restore Equity and Stability<sup>24</sup>) to use eminent domain to help county homeowners.<sup>25</sup> Eminent domain is the authority of the government "to take private property for a public use" so long as the owner receives "just compensation" for the property taken.<sup>26</sup> This authority is available to the federal government under the Fifth Amendment to the U.S. Constitution.<sup>27</sup> Every state government has also inherently been granted this authority as an attribute of sovereignty, subject to limitations found in each state's constitution or statutory law.<sup>28</sup> Eminent domain is, in theory, applicable to any type of property, including mortgages.

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<sup>22</sup> GOOGLE PUBLIC DATA EXPLORER, [http://www.google.com/publicdata/explore?ds=z1ebjgk2654c1\\_&ctype=l&strail=false&bcs=d&nselm=h&met\\_y=unemployment\\_rate&fdim\\_y=seasonality:U&scale\\_y=lin&ind\\_y=false&rdim=country&idim=county:CN060710&iifdi=country&tstart=631861200000&tend=1336536000000&hl=en&dl=en&ind=false&q=san+bernardino+county+unemployment+rate#!ctype=l&strail=false&bcs=d&nselm=h&met\\_y=unemployment\\_rate&fdim\\_y=seasonality:U&scale\\_y=lin&ind\\_y=false&rdim=country&idim=county:CN060710&iifdi=country&tstart=1290747600000&tend=1359176400000&hl=en\\_US&dl=en&ind=false](http://www.google.com/publicdata/explore?ds=z1ebjgk2654c1_&ctype=l&strail=false&bcs=d&nselm=h&met_y=unemployment_rate&fdim_y=seasonality:U&scale_y=lin&ind_y=false&rdim=country&idim=county:CN060710&iifdi=country&tstart=631861200000&tend=1336536000000&hl=en&dl=en&ind=false&q=san+bernardino+county+unemployment+rate#!ctype=l&strail=false&bcs=d&nselm=h&met_y=unemployment_rate&fdim_y=seasonality:U&scale_y=lin&ind_y=false&rdim=country&idim=county:CN060710&iifdi=country&tstart=1290747600000&tend=1359176400000&hl=en_US&dl=en&ind=false) (last visited Jan. 20, 2013).

<sup>23</sup> *Realtors, Banks Warn Plan To Seize Distressed Homes May Backfire: Half of San Bernardino County Homeowners 'Underwater'*, CBS LOS ANGELES (July 6, 2012, 8:31 AM), <http://losangeles.cbslocal.com/2012/07/06/realtors-banks-warn-plan-to-seize-distressed-homes-may-backfire/>.

<sup>24</sup> MORTGAGE RESOL. PARTNERS, *supra* note 21.

<sup>25</sup> Joe Nocera, Op-Ed., *Housing's Last Chance?*, N.Y. TIMES, Jul. 9, 2012 at A21, available at [http://www.nytimes.com/2012/07/10/opinion/nocera-housings-last-chance.html?\\_r=0](http://www.nytimes.com/2012/07/10/opinion/nocera-housings-last-chance.html?_r=0).

<sup>26</sup> See, e.g., *Landgraf v. USI Film Prod.*, 511 U.S. 244, 266 (1994) (noting that the Fifth Amendment allows the government to take private property for a "public use" and upon payment of "just compensation"); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1004-05 (1984) (distinguishing between a taking when the government "deprive[s] the owner of all or most of his interest in a subject matter" and mere "regulation," not requiring just compensation).

<sup>27</sup> U.S. CONST. amend. V.

<sup>28</sup> *Gober v. Stubbs*, 682 So. 2d 430, 433 (Ala. 1996) (explaining that "[t]he power of eminent domain does not originate in [the constitution, i]nstead, it is a power inherent in every sovereign state"); see also *Calmat of Ariz. v. State ex rel. Miller*, 859 P.2d 1323, 1326 (Ariz. 1993); *Mt. San Jacinto Cmty. Coll. Dist. v. Super. Ct.*, 11 Cal. Rptr. 3d 465, 469 (Cal. Ct. App. 2004).

In this case, the idea is that a municipality could buy underwater mortgages using its power of eminent domain and then write the homeowner a new, reduced mortgage.<sup>29</sup> Proponents argue it would be an effective avenue to get around the roadblock of securitization contracts that prevent people from modifying loans.<sup>30</sup> MRP maintains that it could be a way to prevent future foreclosures.<sup>31</sup> Ultimately, the goal would be a stabilization of housing prices.<sup>32</sup>

The plan calls for the county to buy mortgages at a large, but fair, discount to their face value,<sup>33</sup> and then offer to refinance the homeowner into a new mortgage with a “sustainable” balance.<sup>34</sup> The plan would take associated fees and costs out of the spread.<sup>35</sup> The money to buy the mortgages would come from investors whom MRP has already started to secure.<sup>36</sup>

In addition to San Bernardino, about a dozen other communities have voiced some level of interest in the eminent domain plan, including Chicago, Sacramento, New York’s Suffolk County, and Detroit.<sup>37</sup>

#### IV. LEGITIMATE PUBLIC PURPOSE?

In order for the use of eminent domain to be legal under the U.S. Constitution and the majority of state constitutions, the government must take the property for a “public use” and the owner must receive “just compensation” for the acquired property.<sup>38</sup> Since San Bernardino would be offering a fair price for the property, the more frequent objection to MRP’s plan is that the taking of private mortgages would not be a legitimate public use, in violation of the U.S. and most state constitutions. In fact, the Federal Housing Finance Agency (“FHFA”) launched a formal investigation into the proposal in late 2012, issuing a request for input from industry groups.<sup>39</sup> In an open letter to the FHFA, the California Association of Realtors expressed its apprehension at the idea, stating:

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<sup>29</sup> Nocera, *supra* note 25; MORTGAGE RESOLUTION PARTNERS, *supra* note 21.

<sup>30</sup> Nocera, *supra* note 25.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> MORTGAGE RESOL. PARTNERS, *supra* note 21.

<sup>35</sup> Nocera, *supra* note 25.

<sup>36</sup> *Id.*

<sup>37</sup> Hallman, *supra* note 3.

<sup>38</sup> See, e.g., *Landgraf v. USI Film Prod.*, 511 U.S. 244, 266 (1994); *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1004-05 (1984).

<sup>39</sup> Notice of Input Accepted on Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 154 (Aug. 9, 2012), available at [http://fhfa.gov/webfiles/24147/77\\_FR\\_47652\\_8-9-12.pdf](http://fhfa.gov/webfiles/24147/77_FR_47652_8-9-12.pdf).

While we applaud local officials' efforts to continually search for innovative solutions to expedite a full economic recovery, we cannot support this proposal . . . The use of eminent domain to seize underwater performing loans, alter their loan terms, and then resell them to another investor is . . . a violation of the "public use" requirement of eminent domain.<sup>40</sup>

However, the critics of MRP's plan are unlikely to find much support for their challenge under either the federal or state law. The definition of what constitutes a valid public use has been greatly expanded by the majority of both state and federal courts over the years so that, now, almost any acquisition will satisfy the test.

#### A. Federal Law

As early as 1954, the United States Supreme Court faced the issue of whether a taking that involves sale to a private party could fulfill the requirement for legitimate public purpose under the U.S. Constitution. In *Berman v. Parker*, the Court held that Washington D.C.'s use of eminent domain for the public use of acquiring commercial property was constitutional.<sup>41</sup> The Court found that the taking of property for slum clearance and the removal of urban blight was a legitimate public purpose within the police powers of the state.<sup>42</sup> The Court based its decision on an expanded definition of public use that allows private enterprises to be involved in the taking of private property for its redevelopment and resale.<sup>43</sup> To elaborate on this point, the Court stated that:

[T]he means of executing the project are for Congress and Congress alone to determine, once the public purpose has been established. The public end may be as well or better served through an agency of private enterprise than through a department of government—or so the Congress might conclude. We cannot say that public

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<sup>40</sup> Open Letter from Arnold LeFrancis, President, California Association of Realtors, to Alfred M. Pollard, General Counsel, FHFA on the Use of Eminent Domain to Restructure Performing Loans (Sept. 7, 2012) (on file with the FHFA), available at [http://www.fhfa.gov/webfiles/24290/16\\_California\\_Association\\_of\\_REALTORS.pdf](http://www.fhfa.gov/webfiles/24290/16_California_Association_of_REALTORS.pdf).

<sup>41</sup> *Berman v. Parker*, 348 U.S. 26 (1954).

<sup>42</sup> *Id.* at 32.

<sup>43</sup> *Id.* at 33 (noting that the public welfare may include "spiritual . . . physical, aesthetic . . . and monetary" values).

ownership is the sole method of promoting the public purposes of community redevelopment projects.<sup>44</sup>

As a result, an early standard was set for allowing private party involvement in valid eminent domain takings under the U.S. Constitution.

The U.S. Supreme Court again opted for a broad definition of public use in *Hawaii Housing Authority v. Midkiff*.<sup>45</sup> At issue in this case was the constitutionality of Hawaii's Land Reform Act, which aimed to reduce the social and economic evils caused by large land estates that dated back to the high chiefs of the pre-statehood Hawaiian Islands.<sup>46</sup> To reduce the concentration of inland ownership, the Act created the Hawaii Housing Authority, whose mission was to take title to the real property from lessors of large land estates, condemn the land, then sell the property to the lessees inhabiting the land at the time that it was condemned.<sup>47</sup> Lessees could file to have the land they lived on condemned, but the process would only be instituted once the Authority determined through a public hearing that the "acquisition of the tract would promote the public purposes of the Act."<sup>48</sup>

In *Midkiff*, lessors who had refused to comply with the Authority's condemnation process had filed suit in federal court claiming that the Act was unconstitutional.<sup>49</sup> On appeal, the U.S. Supreme Court held that a "literal requirement" of general public use of property is not necessary to meet the conditions of eminent domain.<sup>50</sup> Thus, the Court disagreed with a lower court decision that the government must possess and use the property at some point during the condemnation process.<sup>51</sup> Justice O'Connor, writing for the unanimous Court stated that:

The mere fact that property taken outright by eminent domain is transferred in the first instance to private beneficiaries does not condemn that taking as having only a private purpose. The Court long ago rejected any literal requirement that condemned property be put into use for

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<sup>44</sup> *Id.* at 33-34; David Schultz, *Economic Development and Eminent Domain After Kelo: Property Rights and "Public Use" Under State Constitutions*, 11 ALB. L. ENVTL. OUTLOOK J. 41, 47 (2006).

<sup>45</sup> *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229 (1984).

<sup>46</sup> HAW. REV. STAT. § 516.1-516.56 (1993) (granting the housing finance and development corporation the power to use eminent domain or purchase land with the threat of eminent domain); *Midkiff*, 467 U.S. at 232-33; Schultz, *supra* note 44, at 48.

<sup>47</sup> *Midkiff*, 467 U.S. at 233-34.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 234-35.

<sup>50</sup> *Id.* at 244.

<sup>51</sup> *Id.* at 243.

the general public. "It is not essential that the entire community, nor even any considerable portion . . . directly enjoy or participate in any improvement in order [for it] to constitute a public use ." . . . "[W]hat in its immediate aspect [is] only a private transaction may . . . be raised by its class or character to a public affair."<sup>52</sup>

Thus, in *Midkiff*, the U.S. Supreme Court endorsed the use of eminent domain for redistribution of private resources within a community if it accomplishes a widely drawn public purpose.<sup>53</sup>

As recently as 2005, the U.S. Supreme Court has yet again ruled in favor of an expanded interpretation of public use, this time expanding it to economic development. In *Kelo v. City of New London*, the Court affirmed a Connecticut Supreme Court decision that held the taking of unblighted private property with the goal of economic development constituted a valid public use under both the state and federal constitutions.<sup>54</sup>

In this case, the City of New London, a municipal corporation, and the New London Development Corporation, a private nonprofit entity, planned to use the authority granted to them under a state law<sup>55</sup> to take unblighted land in the waterfront area known as Fort Trumbell to build a residential and commercial development in an effort to revitalize the city's downtown area.<sup>56</sup> The development plan was divided into seven parcels, with most of the parcels planned for use in projects such as waterfront walkways or museums.<sup>57</sup> However, one parcel, known as Lot 3, was designated for sale to Pfizer Pharmaceutical Company for construction of a \$300 million research and development office complex and parking facility.<sup>58</sup>

Nine owners of Fort Trumball homes, four of which were located in Lot 3, brought suit, claiming that the taking of their unblighted land for economic development purposes was in violation of the Fifth Amendment.<sup>59</sup> They contended that using eminent domain for economic development "impermissibly blurs the boundary between public and private takings."<sup>60</sup> The U.S. Supreme Court granted certio-

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<sup>52</sup> *Id.* at 243-44 (quoting *Rindge Co. v. Los Angeles*, 262 U.S. 700, 707 (1923); *Block v. Hirsch*, 256 U.S. 135, 153 (1921)); Schultz, *supra* note 44, at 50.

<sup>53</sup> Schultz, *supra* note 44, at 50.

<sup>54</sup> *Kelo v. City of New London*, 545 U.S. 469, 490 (2005); Schultz, *supra* note 44, at 59.

<sup>55</sup> *Kelo*, 545 U.S. at 475 (citing CONN. GEN. STAT. §§ 8-188, 8-193 (2005)).

<sup>56</sup> *Id.* at 474; Schultz, *supra* note 44, at 59.

<sup>57</sup> *Kelo*, 545 U.S. at 474; Schultz, *supra* note 44, at 59.

<sup>58</sup> *Kelo*, 545 U.S. at 473-74. See generally Schultz, *supra* note 44, at 59.

<sup>59</sup> *Kelo*, 545 U.S. at 475.

<sup>60</sup> *Id.* at 485.

rari to the federal question of whether a city's decision to take private property for economic development purposes, when it involved the transfer of land from one private owner to another, satisfied the public use requirement under the Fifth Amendment.<sup>61</sup>

The Supreme Court ruled that the taking was not a violation of the public use requirement of the Fifth Amendment.<sup>62</sup> The Court reasoned that it was not a private taking because the decision to acquire the property was part of a "carefully considered" development plan" and there was no motive by the county to convey a private benefit on a "particular class of identifiable individuals."<sup>63</sup>

Additionally, the Court rejected the homeowners' argument that the plan did not satisfy the public use requirement because the property was going to be sold to and used by a private party.<sup>64</sup> Justice Stevens, writing for the majority, stated that "this 'Court long ago rejected any literal requirement that condemned property be put into use for the general public,'"<sup>65</sup> and, instead, this narrow reading of public use had been rejected in favor of a broader "public purpose" reading of the public use doctrine.<sup>66</sup> The main issue then became whether the seizure of Lot 3 served a valid public purpose,<sup>67</sup> and the court looked to the precedent in *Berman*<sup>68</sup> and *Midkiff*,<sup>69</sup> both of which deferred to legislative determinations of what is considered a public purpose. Thus, since the City of New London had acted within its state statutory power in using eminent domain, the *Kelo* court held that the taking of private property for economic development purposes was a valid public use under the Fifth Amendment.<sup>70</sup>

### B. State Law

Several state supreme courts have also ruled in favor of a broad interpretation of public use in their own state constitutions. In the early 1980s, the Michigan Supreme Court, in *Poletown Neighborhood Council v. City of Detroit*, upheld the City of Detroit's use of its eminent domain authority to level an entire neighborhood, relocate over 1300 households, and acquire over 150 private businesses to

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<sup>61</sup> *Id.* at 477; Schultz, *supra* note 44, at 60.

<sup>62</sup> *Kelo*, 545 U.S. at 485.

<sup>63</sup> *Id.* at 478 (quoting *Kelo v. City of New London*, 843 A.2d 500, 536 (Conn. 2004)); *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 245 (1984); Schultz, *supra* note 44, at 60.

<sup>64</sup> *Kelo*, 545 U.S. at 478-80; Schultz, *supra* note 44, at 60-61.

<sup>65</sup> *Kelo*, 545 U.S. at 479 (quoting *Midkiff*, 467 U.S. at 244).

<sup>66</sup> *Id.* at 479-80; Schultz, *supra* note 44, at 60-61.

<sup>67</sup> *Kelo*, 545 U.S. at 480.

<sup>68</sup> *Berman v. Parker*, 348 U.S. 26, 26 (1954); Schultz, *supra* note 44, at 61.

<sup>69</sup> *Midkiff*, 467 U.S. at 229; Schultz, *supra* note 44, at 61.

<sup>70</sup> *Kelo*, 545 U.S. at 489-90.

make room for a General Motors assembly plant.<sup>71</sup> The City exercised its eminent domain authority pursuant to the Michigan Economic Development Corporations Act.<sup>72</sup> A neighborhood association and several residents of the Poletown area, including the owners of ten non-blighted businesses, opposed the taking because the land would be sold to GM.<sup>73</sup> They brought suit, challenging the taking as not constituting a valid public use under the Michigan Constitution because the land would be immediately transferred to a private party.<sup>74</sup> The residents also claimed that there was a difference between what constituted a valid “public use” under the Michigan Constitution versus what was a public purpose.<sup>75</sup> The City, however, contended that the proposed condemnation was for a valid public use because it would benefit the public by alleviating and preventing unemployment and “fiscal distress.”<sup>76</sup> Thus, the court faced the issue of whether the Michigan Constitution recognized a narrow or broader conception of public use.<sup>77</sup>

The Michigan Supreme Court upheld the taking as a valid public use under the state constitution, contending that the public would be the primary beneficiary and the private benefit was merely incidental.<sup>78</sup> It reasoned that the needs served by this use of eminent domain included providing an economic boost and supporting the revitalization of local industry.<sup>79</sup> As a result, the Court said that it could not narrow the definition of public use, pointing to Court precedent that “public use changes with changing conditions of society . . . [and] [t]he right of the public to receive and enjoy the benefit of the use determines whether the use is public or private.”<sup>80</sup>

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<sup>71</sup> *Poletown Neighborhood Council v. City of Detroit*, 304 N.W.2d 455 (Mich. 1981), *overruled by* *County of Wayne v. Hathcock*, 684 N.W.2d 765, 787 (Mich. 2004); Schultz, *supra* note 44, at 51.

<sup>72</sup> Economic Corporations Development Act, MICH. COMP. LAWS § 125.1602 (2001) (“There exists in this state the continuing need for programs to alleviate and prevent conditions of unemployment . . . it is accordingly necessary to assist and retain local industrial and commercial enterprises, including employee-owned corporations, to strengthen and revitalize the economy of this state and its municipalities . . . . Therefore, the powers granted in this act constitute the performance of essential public purposes and functions for this state and its municipalities.”); Schultz, *supra* note 44, at 51-52.

<sup>73</sup> *Poletown*, 304 N.W.2d at 457; Schultz, *supra* note 44, at 52.

<sup>74</sup> *Poletown*, 304 N.W.2d at 457.

<sup>75</sup> *Id.* at 457; Schultz, *supra* note 44, at 52.

<sup>76</sup> *Poletown*, 304 N.W.2d at 458.

<sup>77</sup> Schultz, *supra* note 44, at 52-53.

<sup>78</sup> *Poletown*, 304 N.W.2d at 459.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 475 (quoting *Hays v. City of Kalamazoo*, 25 N.W.2d 787, 790 (1947)).

The Court also set an unmatched, and widely criticized, precedent for a state court defining the judiciary's role in the determination of what qualifies as public use under the state constitution.<sup>81</sup> Quoting state precedent and *Berman v. Parker*, the Court held that "[t]he determination of what constitutes a public purpose is primarily a legislative function"<sup>82</sup> and a determination made by the legislature regarding a public interest is "well-nigh conclusive."<sup>83</sup> Thus, *Poletown* became an unprecedented expansion of eminent domain power and government control over private property.<sup>84</sup>

The next year the California Supreme Court upheld the right of a municipality to use the eminent domain power under the California constitution to acquire the property rights, including "intangible contractual rights," of a sports franchise contemplating relocation in *City of Oakland v. Oakland Raiders*.<sup>85</sup> In this case, the City used its eminent domain power to seize all of the business assets of the Oakland Raiders' football franchise.<sup>86</sup> The team owners had been leasing their stadium from a public nonprofit for fifteen years and, when negotiations to renew the lease failed, the team announced its intention to relocate to Los Angeles.<sup>87</sup> The City then commenced an eminent domain action to acquire the team's property rights,<sup>88</sup> "including players' contracts, team equipment, and television and radio contracts."<sup>89</sup> In response, the franchise owners brought suit on two grounds: (1) that eminent domain could not be used to take "intangible property not associated with realty,"<sup>90</sup> and (2) that the "taking contemplated by the City cannot, as a matter of law, be for any 'public use' within [the] City's authority."<sup>91</sup>

The Court first faced the issue of whether the City had the power to acquire intangible property to serve municipal uses.<sup>92</sup> It noted that "in contrast to the broad powers of general government . . . a municipal corporation has no inherent power of eminent domain and can exercise it only when expressly authorized by law."<sup>93</sup> However,

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<sup>81</sup> Schultz, *supra* note 44, at 54.

<sup>82</sup> *Poletown*, 304 N.W.2d at 459 (quoting *Gregory Marina, Inc. v. City of Detroit*, 144 N.W.2d 503, 516 (1966)).

<sup>83</sup> *Id.* at 633 (quoting *Berman v. Parker*, 348 U.S. 26, 32 (1954)).

<sup>84</sup> Schultz, *supra* note 44, at 54.

<sup>85</sup> *City of Oakland v. Oakland Raiders*, 646 P.2d 835 (Cal. 1982).

<sup>86</sup> *Id.* at 837.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> Schultz, *supra* note 44, at 55.

<sup>90</sup> *Oakland Raiders*, 646 P.2d at 837; Schultz, *supra* note 44, at 55.

<sup>91</sup> *Oakland Raiders*, 646 P.2d at 837.

<sup>92</sup> Schultz, *supra* note 44, at 56.

<sup>93</sup> *Oakland Raiders*, 646 P.2d at 838.

California's eminent domain statutes provided that "a city may acquire by eminent domain *any property* necessary to carry out any of its powers or functions" (emphasis added).<sup>94</sup> Thus, the Court found that the City of Oakland did have the power to acquire the Oakland's Raiders property, establishing the precedent that "intangible assets are subject to condemnation" under eminent domain.<sup>95</sup>

The Court then focused on whether the City's actions were within the state constitutional requirement that eminent domain acquisitions serve a "public use."<sup>96</sup> It defined public use as "a use which concerns the whole community or promotes the general interest in its relation to any legitimate object of government."<sup>97</sup> However, the Court also noted state precedent, asserting that "[i]t is not essential that the entire community, or even a considerable portion thereof, shall directly enjoy or participate in an improvement in order to constitute a public use."<sup>98</sup> The City argued that the acquisition of the assets served a public use because of "the factual circumstances surrounding the construction of the Oakland Coliseum and the integration of the past use of the stadium with the life of the City of Oakland in general."<sup>99</sup> In considering the City's argument for its untraditional use of eminent domain, the Court noted the broad common law application of public use and its evolving nature in California.<sup>100</sup> Thus, the Court held that the "acquisition, and . . . operation of a sports franchise may be an appropriate municipal function."<sup>101</sup> The City met the public use requirement because the community as a whole could benefit economically and culturally from the acquisition.<sup>102</sup>

However, not all state courts have agreed with a broad interpretation of public use. In the recent landmark case of *County of Wayne v. Hathcock*,<sup>103</sup> the Michigan Supreme Court held that a more narrow construction of public use was necessary under the Michigan State Constitution.<sup>104</sup> At issue in *Hathcock* was a plan by Wayne County to condemn several parcels of private property near the Metro-

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<sup>94</sup> *Id.* at 838 (quoting CAL. GOV'T CODE § 37350.5 (West 1975)).

<sup>95</sup> *Id.* at 840, 843; Schultz, *supra* note 44, at 56.

<sup>96</sup> Schultz, *supra* note 44, at 55.

<sup>97</sup> *Oakland Raiders*, 646 P.2d at 841 (quoting *Bauer v. County of Ventura*, 289 P.2d 1 (1955)).

<sup>98</sup> *Id.* at 841.

<sup>99</sup> *Id.* at 844; Schultz, *supra* note 44, at 57.

<sup>100</sup> *Oakland Raiders*, 646 P.2d at 842 (noting that the commission revising California's eminent domain laws had specifically recommended against the retention of the list of possible public uses in the new law).

<sup>101</sup> *Id.* at 843; Schultz, *supra* note 44, at 55.

<sup>102</sup> Schultz, *supra* note 44, at 56.

<sup>103</sup> *County of Wayne v. Hathcock*, 684 N.W.2d 765 (2004).

<sup>104</sup> *Hathcock*, 684 N.W.2d at 780; Schultz, *supra* note 44, at 73.

politan Airport.<sup>105</sup> As part of the expansion of the airport and the construction of a nearby business and technology park, the County sought to obtain several properties that would be subject to increased noise and traffic.<sup>106</sup> When the owners of nineteen parcels refused to sell, the county initiated condemnation proceedings under Michigan's Uniform Condemnation Procedures Act.<sup>107</sup> The owners then brought a claim in Michigan state court, contending that the condemnation violated both Michigan Compiled Laws section 213.23, and Article 10, Section 2 of the Michigan Constitution.<sup>108</sup>

On appeal, the Michigan Supreme Court held that "the taking of property from one private owner and transferring it to another private owner to encourage economic development or alleviate unemployment was not a valid public use under . . . the Michigan Constitution."<sup>109</sup> The Court stated that transfer of condemned private property from one owner to another private owner was only permitted in three situations.<sup>110</sup> First, it recognized condemnations in which private land was constitutionally transferred by the condemning authority to a private entity that involved "public necessity of the extreme sort otherwise impracticable."<sup>111</sup> The second circumstance was when the private entity remains accountable to the public in its use of that property.<sup>112</sup> Lastly, condemned land could be transferred to a private entity when the selection of the land to be condemned is itself based on "facts of independent public significance."<sup>113</sup> By narrowing the public use definition in this manner, the Court also overruled *Poletown*,<sup>114</sup> invalidating a major legal precedent cited in many jurisdictions to support the use of eminent domain for economic development purposes.<sup>115</sup>

Opponents of the San Bernardino proposal have cited similar concerns to the court in *Hathcock* with regards to municipalities seiz-

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<sup>105</sup> *Hathcock*, 684 N.W.2d at 769.

<sup>106</sup> *Id.* at 769-70.

<sup>107</sup> *Id.* at 771.

<sup>108</sup> *Id.*

<sup>109</sup> Schultz, *supra* note 44, at 73-74.

<sup>110</sup> *Hathcock*, 684 N.W.2d at 773.

<sup>111</sup> *Id.* at 781.

<sup>112</sup> *Id.* at 782.

<sup>113</sup> *Id.* at 782-83.

<sup>114</sup> *Id.* at 786 ("To justify the exercise of eminent domain solely on the basis of the fact that the use of that property by a private entity seeking its own profit might contribute to the economy's health is to render impotent our constitutional limitations on . . . eminent domain. *Poletown's* 'economic benefit' rationale would validate practically any exercise of the power of eminent domain on behalf of a private entity.").

<sup>115</sup> Schultz, *supra* note 44, at 75.

ing private loans and selling them to another private party.<sup>116</sup> While those opponents may have *Hathcock* precedent on their side in questioning the constitutionality of the proposal, the overwhelming majority of both federal and state courts have agreed that a broad interpretation of public use is constitutional. Furthermore, *Hathcock* applied only to the Michigan State Constitution, and, while it did overrule the existing precedent of broad interpretation in that state, *Poletown* had already been recognized by many as an overzealous expansion of eminent domain power.<sup>117</sup>

*Kelo*, *Midkiff*, *Berman*, and other federal court decisions,<sup>118</sup> on the other hand, illustrate the wide-ranging interpretation now given to the public use requirement on the federal level.<sup>119</sup> As the court in *Kelo* pointed out, it no longer matters if property is taken from one private party and given to another, as long as there is no motive for private benefit.<sup>120</sup> These courts have also all suggested that the judiciary should have a limited role in questioning the advisability of eminent domain decisions by legislatures.<sup>121</sup> Though these decisions have not been without their critics,<sup>122</sup> if the proposal was challenged in federal court, a court would be likely to follow precedent and rule in favor of San Bernardino County. The County could easily argue that the taking of mortgages is intended to bestow an economic benefit on the citizens of San Bernardino by lowering the foreclosure rates.

Furthermore, the analogous facts in the *Oakland Raiders* case demonstrate that a mortgage taking under eminent domain would probably not be in violation of the California Constitution. The seizure of business assets, despite their intangible quality, was found to be

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<sup>116</sup> California Association of Realtors Letter, *supra* note 40.

<sup>117</sup> See generally Timothy Sandefur, *A Gleeeful Obituary for Poletown Neighborhood Council v. Detroit*, 28 HARV. J.L. & PUB. POL'Y 651, 661-65 (2005) (summarizing numerous criticisms of the *Poletown* decision).

<sup>118</sup> See, e.g., *People of Puerto Rico v. E. Sugar Assocs.*, 156 F.2d 316, 325 (1st Cir. 1946) (upholding an agrarian reform measure that broke up large tracts of land and redistributed it into smaller parcels to private individuals); Schultz, *supra* note 44, at 50.

<sup>119</sup> Schultz, *supra* note 44, at 50.

<sup>120</sup> *Kelo v. City of New London*, 545 U.S. 469, 478-79 (2005).

<sup>121</sup> *Id.* at 482-83.

<sup>122</sup> See Kristi M. Burkard, *No More Government Theft of Property! A Call to Return to A Heightened Standard of Review After the United States Supreme Court Decision in Kelo v. City of New London*, 27 HAMLINE J. PUB. L. & POL'Y 115 (2005) (reasons that the *Kelo* Court misconstrued the public use requirement under the Fifth Amendment and wrongly applied the legislative deference standard of judicial review to disputes over fundamental private property rights when it requires a strict scrutiny standard of review.).

valid in *Oakland Raiders*,<sup>123</sup> so seizing securitized mortgages, which are tangible, would likely be considered lawful in this case as well. Additionally, the *Oakland Raiders* court ruled that public use is a “use which concerns the whole community or promotes the general interest.”<sup>124</sup> So, even though the entire county of San Bernardino may not be under water on their mortgages, a large percentage are, and it would benefit the general interest (i.e. the home values) of the entire community to have less foreclosures.<sup>125</sup> Thus, a California court would almost certainly find in favor of the County on the state constitutionality of its use of eminent domain.

#### V. EFFECT ON BORROWERS AND LENDERS

Constitutional implications aside, the proposal also has its fair share of critics in the mortgage industry. Those opponents to the proposal predict that, not only will it not result in a market revitalization, it may actually have a negative effect on the housing market going forward. Many argue that this type of debt relief for a select group of borrowers would threaten the relationship between borrowers and lenders.<sup>126</sup> They believe other borrowers who were making their payments on time may find defaulting to be a more attractive option if they can have the principal of their loan reduced.<sup>127</sup>

Other industry specialists have argued that the use of eminent domain in this situation could result in reduced access to credit for borrowers. The Securities Industry and Financial Markets Association (“SIFMA”) issued a statement to that effect, writing, “We believe using eminent domain would reduce access to credit for borrowers and

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<sup>123</sup> *City of Oakland v. Oakland Raiders*, 646 P.2d 835, 843 (Cal. 1982).

<sup>124</sup> *Oakland Raiders*, 646 P.2d at 841 (quoting *Bauer v. County of Ventura*, 289 P.2d 1, 1).

<sup>125</sup> See generally Mary Ellen Podmolik, *A New Take on Impact of Foreclosures on Home Values*, CHICAGO TRIBUNE (Aug. 23, 2012), [http://articles.chicagotribune.com/2012-08-23/classified/ct-mre-0826-podmolik-homefront-20120824\\_1\\_distressed-home-values-distressed-property](http://articles.chicagotribune.com/2012-08-23/classified/ct-mre-0826-podmolik-homefront-20120824_1_distressed-home-values-distressed-property) (discussing the adverse effect that numerous homes in foreclosure can have on neighboring property values); Daniel Hartley, *The Impact of Foreclosures on the Housing Market*, FEDERAL RESERVE BANK OF CLEVELAND (Oct. 27, 2010) <http://www.clevelandfed.org/research/commentary/2010/2010-15.cfm> (noting that foreclosed properties add to the supply of homes on the market and diminish the desirability of a neighborhood resulting in lower property values).

<sup>126</sup> Hallman, *supra* note 3.

<sup>127</sup> “Edward DeMarco, the acting director of the Federal Housing Finance Agency, has said that giving debt relief to some borrowers would threaten the covenant between borrowers and lenders, and encourage those making their payments on time to default and cash in.” *Id.*

would, at a minimum, result in lengthy and costly litigation.”<sup>128</sup> The FHFA has echoed those concerns, stating that it “has significant concerns with programs that could undermine and have a chilling effect on the extension of credit to borrowers seeking to become homeowners and on investors that support the housing market.”<sup>129</sup>

Mortgage investment groups also believe that San Bernardino’s use of eminent domain could have an adverse effect.<sup>130</sup> Investment analysts have predicted that this type of precedent could push national mortgage interest rates up as much as 10 percent.<sup>131</sup> There is also concern that the ability of the government to seize underwater mortgages means that mortgage investors would view new loans as only partially secured,<sup>132</sup> creating a domino effect on the rest of the mortgage industry.

Thus, while an end to the housing crisis would be a welcome relief for many, the MRP proposal would likely only exacerbate the problem by deepening the rift between lenders and borrowers.

## VI. CONCLUSION

In conclusion, the San Bernardino proposal would likely be upheld by courts as a valid use of the power afforded to municipalities by the Fifth Amendment and state constitutions, because it serves a legitimate public purpose through its potential to economically benefit over half of the County’s homeowners. In spite of this, the long-term risks of the plan may prevent it from ever getting off the ground. Experts on both sides of the issue can see that government interference may have a negative effect on the lending market, and that the risks likely outweigh the possible benefits<sup>133</sup> of immediate relief for San Bernardino. Thus, the San Bernardino proposal would simply be applying a band-aid to a broken bone - providing no lasting solution to the housing crisis.

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<sup>128</sup> *Id.*

<sup>129</sup> Notice of Input Accepted on Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 154 (Aug. 9, 2012), available at [http://fhfa.gov/webfiles/24147/77\\_FR\\_47652\\_8-9-12.pdf](http://fhfa.gov/webfiles/24147/77_FR_47652_8-9-12.pdf).

<sup>130</sup> “We think it’s a disastrous idea and would be a horrible precedent for the market,” Stephen Walsh, [said] chief investment officer of Western Asset Management Co. . . . ‘What might bring isolated benefit to a particular city across the board could be very negative for housing financing going forward in the United States,’ he said.” Forgione, *supra* note 1.

<sup>131</sup> Hallman, *supra* note 3.

<sup>132</sup> *Id.* (quoting Edwin Groshans, analyst at investment advisory group Height Analytics).

<sup>133</sup> Forgione, *supra* note 1 (quoting Edward DeMarco, acting director of the FHFA).