September 7, 2012

FHFA Office of General Counsel
Attn: Mr. Alfred Pollard/Comments on No. 2012-N-11
400 Seventh Street SW.,
Eighth Floor, Washington, DC 20024
via email to eminentdomainOGC@fhfa.gov

Re: Comment on Use of Eminent Domain to Restructure Performing Loans, No. 2012–N–11

Dear Mr. Pollard,

The National Housing Conference (NHC) welcomes the Federal Housing Finance Agency's (FHFA) request for comment on recent proposals in several localities to use the power of eminent domain to seize and restructure performing, underwater loans. The desire for action to stem foreclosures and stabilize neighborhoods is understandable—the foreclosure crisis is severe and will not abate soon. Reducing the number of underwater borrowers could also benefit the economy as a whole. Federal policies have made some inroads, but several promising options such as targeted principal reductions by the GSEs and expansion of the Neighborhood Stabilization Program remain unused. Within that context, localities may well entertain extreme measures such as eminent domain seizure of performing loans that can have unintended negative consequences.

Government action to seize loans where the borrower is making the required payments but then compensating the lender at a reduced rate disrupts the normal channels for mortgage credit. Eminent domain is an essential tool for blight remediation and community development in other contexts. However, we fear the use of eminent domain in this specific fashion would do more harm than good for several reasons developed in more detail below:

- Fair value determinations will trigger lengthy and expensive court battles.
- Valuation risk will fall on localities, not new investors.
- Loan volume would shift unnecessarily to FHA and taxpayers.
- Local governments would outsource implementation, exacerbating problems.
- Proposals would encourage over-use of eminent domain to profit outside parties.
- Lenders may reduce lending in affected communities.

Finally and most critically, FHFA must make the consequences of eminent domain proposals clear to all by analyzing and describing the likely market reactions. If appropriate, FHFA should also describe how it would respond to eminent domain actions by localities. No locality should adopt such a sweeping change without full information as to the likely consequences. At the same time, FHFA should continue to seek other ways to respond to the foreclosure crisis, building on its good work in servicing and short-sale guidelines and reconsidering its position on targeted principal reduction.

About the National Housing Conference

The National Housing Conference (NHC) represents a diverse membership of housing stakeholders including tenant advocates, mortgage bankers, non-profit and for-profit home builders, property managers, policy practitioners, realtors, equity investors, and more, all of whom share a commitment to a balanced national housing policy. Since 1931, NHC has been dedicated to ensuring safe, decent and affordable housing for all in America—that commitment bringing together our broad-based membership has earned us a reputation as the **United Voice for Housing** engaging in nonpartisan advocacy on housing issues. This comment was prepared with the advice of NHC's Housing Mortgage Working Group (see Attachment 1), which assembles policy experts and practitioners within our members to address the pressing challenges of mortgage finance.

The Foreclosure Crisis Demands Action

More than five years after the foreclosure crisis began, homeowners and communities continue to struggle. The rate of serious delinquency (which combines the rates of foreclosure and 90+ day delinquency) is above 14% in 25 metro areas, ranging as high as 24%. It is a truly nationwide problem, as Attachment 2 illustrates by showing areas of concern in virtually every state.[1] Foreclosures not only displace families, but they can cause a cycle of disinvestment that weakens entire neighborhoods. The Center for Responsible Lending estimates that we are at best half way through this crisis, with many more years of troubled mortgages to work through.[2]

It is no surprise that localities are seeking any solution that looks remotely promising. Federal, state, and private policy actions have made inroads, but they have not relieved the burden faced by localities and some major policy actions have remained off the table:

- HAMP has resulted in more than 1 million permanent loan modifications, and FHA has completed more than 1.4 million loss mitigation interventions. Private-sector mortgage modifications by members of the HOPE Now Alliance total nearly 3 million. Yet rates of foreclosure and delinquency are only just slowing, suggesting there are millions more potentially troubled loans.[3]
- The Federal Housing Finance Agency has overseen positive actions by Fannie Mae and Freddie Mac, such as improved servicing guidelines, principal forbearance, and a streamlined short sale process. Yet it has steadfastly refused to allow Fannie Mae and Freddie Mac to consider any principal reductions, even targeted approaches such as shared appreciation modifications, to avert foreclosures.[4] Nor has it allowed significant sales of distressed notes, unlike FHA.

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[1] Center for Housing Policy, foreclosure-response.org, Top 25 Metropolitan Areas by Serious Delinquency Rate, http://www.foreclosure-response.org/maps_and_data/metro_delinquency_data_March2012.html#sub4

[2] Center for Responsible Lending, Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures, November 2011. http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf

[3] HUD Housing Scorecard, July 2012, http://portal.hud.gov/hudportal/documents/huddoc?id=July_Scorecard.pdf

[4] Ethan Handelman, National Housing Conference, "FHFA rejects principal reduction but ignores shared appreciation," July 31, 2012, http://www.nhcopenhouse.org/2012/07/fhfa-rejects-principal-reduction-but.html. Center for American Progress, "Sharing the Pain and the Gain in the Housing Market,"

- Refinancing options for underwater borrowers expanded under HARP, particularly after the guidelines were revised in HARP 2.0. Volume is up—over 1.3 million HARP refinancing had closed as of May.[5] Yet refinancing is still largely a current-servicer practice, and many originators still are not tackling deeply underwater loans.
- The national mortgage settlement is generating needed resources for relief, including mortgage modifications, blight remediation, housing counseling, and more. Yet many states are redirecting settlement funds into non-housing uses, weakening the overall impact.[6]
- The Neighborhood Stabilization Program (NSP) brought nearly $7 billion of assistance to address the challenges arising from foreclosures—a small amount of assistance when compared to the nearly $7 trillion of home values erased in the housing collapse. NSP grantees around the country are renovating properties, creating rental housing, providing housing counseling and homeownership assistance, making homes more sustainable, and leveraging private capital to create jobs. Yet, Congress has yet to pass Project Rebuild to broaden and renew the efforts of NSP.

Resolving the foreclosure crisis and healing the damage already done will take much more action by all levels of government, private business, nonprofits, and millions of people maintaining homes and neighborhoods. Disrupting fragile housing markets and credit delivery channels is not part of the solution.

Seizing Performing Mortgages Does More Harm Than Good

The eminent domain proposals being considered in several localities would, if adopted, cause local government to seize performing but underwater loans deemed at-risk of default. Localities would repay affected lenders at a discount, then refinance the properties with FHA loans at presumably lower than current debt. A single private capital source would finance the acquisition of the loans and arrange the refinancing. The net economic effect of the action is to reduce one set of investors' returns in favor of another set of new investors.

Government action to seize loans where the borrower is making the required payments but then compensating the lender at a reduced rate disrupts the normal channels for mortgage credit. It creates uncertainty for homeowners who may be affected, home buyers trying to get loans in affected communities, lenders who hold loans that could be seized, guarantors of existing loans, and investors in mortgage-backed securities. For several reasons, we believe it does more harm than good:

- **Fair value determinations will trigger lengthy and expensive court battles**. While that is often a risk of eminent domain action, it is particularly one here. Determining the value of housing

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http://www.americanprogress.org/issues/housing/report/2012/03/29/11251/sharing-the-pain-and-gain-in-the-housing-market/

[5] HUD Housing Scorecard, July 2012.

[6] "$2.5 Billion: Understanding how States are Spending their Share of the National Mortgage Settlement" Enterprise Community Partners, Amanda Sheldon Roberts, Andrew Jakabovics, and Willam McHale, June 4, 2012, http://www.enterprisecommunity.com/servlet/servlet.FileDownload?file=00P3000000DRsTqEAL

assets after a major correction in prices is extremely difficult—transaction volume is down and a larger than usual share of it is distressed sales, making appraisals challenging. When that already difficult valuation challenge moves into an adversarial legal arena, potentially with political influence involved, lengthy and expensive battles are all but certain.

- **Valuation risk will fall on localities, not new investors**. Consider the hypothetical: a locality seizes a loan, compensates the lender at the locality's determination of fair value, then sells the loan to a new third party investor. A court battle over fair value ensues. If the court determines that fair value is in fact higher, the cost falls on the locality to compensate the original lender. That is a substantial, and largely uncontrollable, risk for localities to bear. It also motivates new investors to push for broad use of eminent domain power to maximize profit.
- **Loan volume would shift unnecessarily to FHA and taxpayers**. Refinancing the seized loans with new FHA debt would increase the federal government's share of the mortgage market using a channel that, for all its strengths, puts virtually all of the risk on the federal government and ultimately taxpayers. Moreover, this would be adversely selected risk, since the mortgages selected would all be at-risk by definition and in communities driven to desperate measures.
- **Local governments would outsource implementation, exacerbating problems**. Localities are already stretched thin responding to the challenges of neighborhood stabilization, shrinking federal resources, and weak local economies. They lack the asset management and loan restructuring expertise at the scale needed to make these eminent domain proposals work. The proposals being offered would outsource virtually all of the implementation to private parties, which exacerbates the problems of over-use and misplaced incentives described below.
- **Proposals would encourage over-use of eminent domain to profit outside parties.** Loan modifications are, by necessity, a retail exercise. Each borrower's situation has to be evaluated for an appropriate modification selected that will have the best chance of keeping the family in the home and the mortgage loan current. Yet the eminent domain proposals would set the consultant's compensation on a flat per loan basis that discourages screening beyond the simple broad-brush criteria of performing but underwater loans, ironically, doing nothing for loans already in distress. Every loan seized and then repriced would create opportunity for profit. Localities using eminent domain in this fashion would be far too likely to exercise their powers in sweeping, untargeted fashion, potentially seizing many loans that are not at-risk.
- **Lenders may reduce lending in affected communities.** Seizing performing loans with eminent domain adds a disruptive new risk element, one that lenders and secondary market investors have not priced into their risk models. Whether or not one believes that this particular use of eminent domain power should have been anticipated, mortgage lending and securitization markets have not thus far included it in pricing. If use of eminent domain power to seize performing mortgages comes into practice, we should expect a sudden and significant increase in mortgage costs. At the extreme, some credit providers may simply stop lending in affected communities, making the overall neighborhood stabilization problem far worse.[7]

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[7] Comment letter by the American Securitization Forum, July 13, 2012, http://www.americansecuritization.com/uploadedFiles/ASF_Eminent_Domain_Letter_7_13_12.pdf

Credit availability is essential to a housing recovery. If home-buyers, particularly first-time home-buyers, have difficulty getting mortgages, the first link in the value chain weakens. It becomes even harder to break out of the cycle of disinvestment created by foreclosures. Short-term steps like eminent domain seizures may unintentionally deepen the crisis by reducing access to credit.

FHFA Should Make the Consequences Clear

As conservator of Fannie Mae and Freddie Mac, FHFA is uniquely placed to analyze the potential impact of eminent domain seizures of mortgages and to make the results of such intervention clear to all concerned. NHC recommends that FHFA draw on its own resources and those of the GSEs to analyze and describe the likely consequences, with particular attention to:

- The number of mortgages potentially affected
- The difficulties of identifying which mortgages are truly at-risk
- The impact on credit availability and mortgage rates
- The wide range of values that could be assigned to a mortgage seized by eminent domain
- The cost to Fannie Mae, Freddie Mac, and by extension, American taxpayers that could result from localized or widespread use of eminent domain powers
- The potential increase in FHA loan volume and risk as a result

Should FHFA deem it appropriate to inform localities of its likely response should eminent domain proposals be adopted, NHC would welcome that. No locality should adopt such a sweeping change without full information as to the consequences.

The National Housing Conference appreciates FHFA's interest in this pressing issue, and we welcome further opportunities to discuss avenues for constructive policy change.

Sincerely,

Chris Estes
President and CEO

Attachment 1
NHC's Housing Mortgage Working Group

NHC's Housing Mortgage Working Group (HMWG) brings together housing finance practitioners from our broad membership to develop policy for the finance of affordable housing. Members participate based on their own expertise and with NHC's mission at the forefront rather than as representatives of particular organizations.

Members of the group who helped to develop this comment letter:

Doug Bibby, President, National Multi Housing Council
Barbara Burnham, Vice President for Federal Policy, Local Initiatives Support Corporation
Conrad Egan, Senior Advisor, Affordable Housing Institute
Chris Estes, President and CEO, National Housing Conference
Renée Glover, President and CEO, Atlanta Housing Authority
Bill Goldsmith, President, Mercy Portfolio Services & Mortgage Resolution Fund, LLC, Mercy Housing
Kimberly Jackson, SVP, Executive Director, Wells Fargo Housing Foundation
Carol Lamberg, Executive Director, Settlement Housing Fund
Denise Muha, President, National Leased Housing Association
Shekar Narasimhan, Managing Partner, Beekman Advisors
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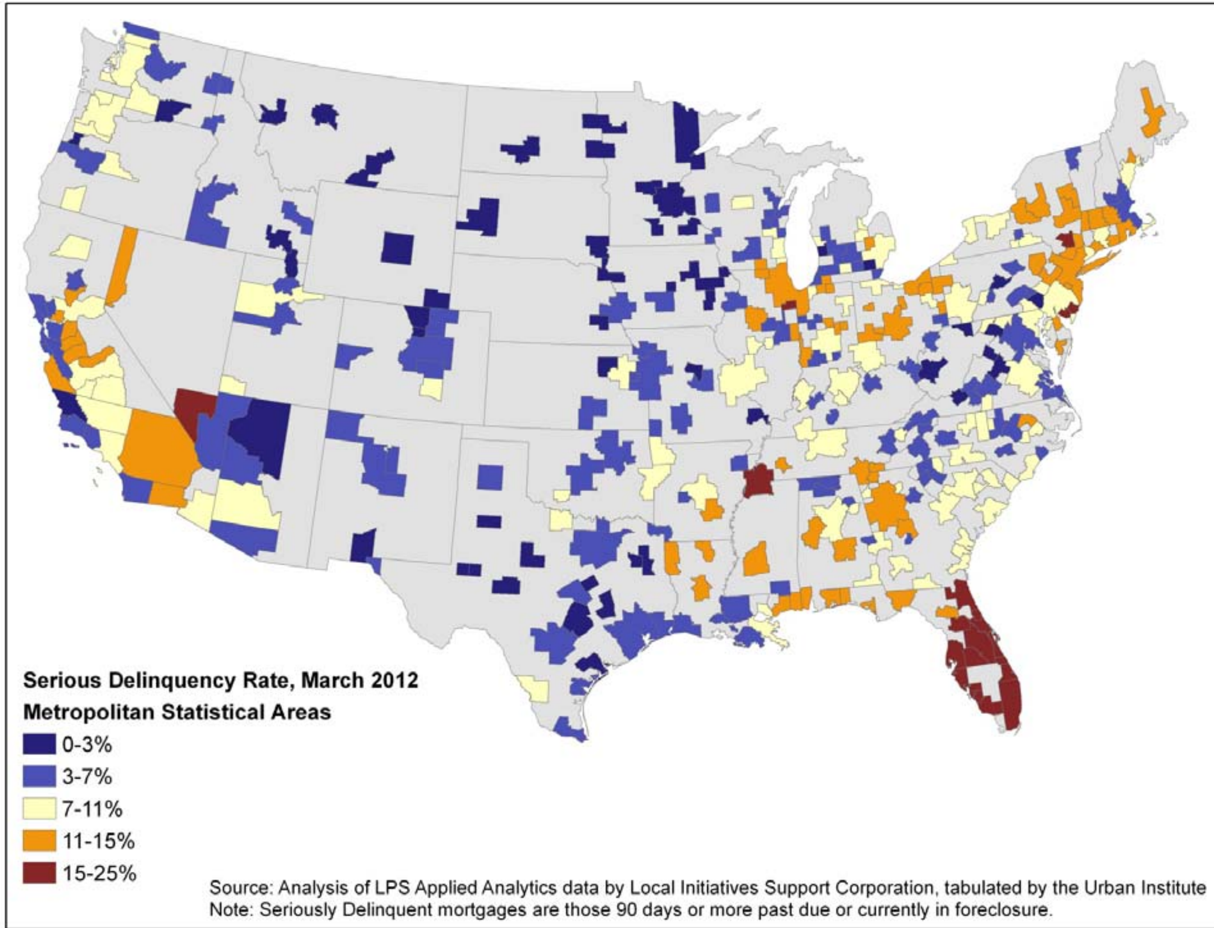
Kent Watkins, CEO, Institute for Housing Innovations
Mark Willis, Resident Research Fellow, NYU Furman Center for Real Estate and Urban Policy
Barry Zigas, Director of Housing Policy, Consumer Federation of America

Attachment 2

The nationwide foreclosure crisis: serious delinquency in metro areas



Map and underlying data available at foreclosure-response.org, a joint effort by the Center for Housing Policy, Local Initiatives Support Corporation, and the Urban Institute.