AFSCME

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September 7, 2012

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW
Eighth Floor
Washington DC 20024
VIA EMAIL: eminentdomainOGC@fhfa.gov

RE: Use of Eminent Domain to Restructure Performing Loans

Dear Mr. Pollard:

The American Federation of State, County and Municipal Employees ("AFSCME") is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. We are pleased to have the opportunity to provide input on the use of eminent domain to address the crisis in housing finance that plagues the United States. AFSCME applauds the initiatives of local governments to resolve the overhang of housing debt and restore equilibrium to the housing market and the economy. We view any effort by the FHFA to interfere with the exercise of eminent domain by local governments as inappropriate.

AFSCME members are public service workers. This segment of the US workforce has lost 642,000 jobs since 2009. In addition, over half a million new public sector workers should have been added to keep pace with population growth since 2009. The combined effect of layoffs and failure to hire is that over a million public service jobs are missing from the US labor market.

The missing jobs in state and local government are an effect of the crisis in housing finance, but public service jobs are not the only negative repercussion of the crisis. State and local economies – and their citizens - continue to suffer serious harm from the housing finance bubble in many ways. Residents who are in foreclosure, or who are perilously close to foreclosure, do not spend in the local economy. Businesses do not hire where there are no customers, nor do they invest in locations surrounded by foreclosed homes. Local governments generate 29% of their general revenue from property taxes[i], but sales and income tax revenue has also decreased due to the wealth effects of the unresolved housing finance crisis.

It is our understanding that the mandate of the Federal Housing Finance Agency (FHFA) is to "ensure...that the operations and activities of each [Government Sponsored Enterprise] foster liquid, efficient, competitive, and resilient national housing finance markets.[ii]" Furthermore, the Emergency Economic Stabilization Act requires FHFA, when the federal government purchases troubled assets, to "maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer, to take advantage of...available programs to minimize foreclosures.[iii]" As such, we are pleased that the FHFA is reviewing the alternatives to help the housing market recover.

According to Zillow, over 30 percent of US homeowners with a mortgage are "underwater" – the mortgage debt exceeds the market value of the house. Estimates of the number of underwater, but performing, mortgages in securitized private label trusts range from 532,000 to 2.29 million. Mortgage experts Amherst Securities have demonstrated that combined loan-to-value (CLTV) ratios are the single most important factor in predicting default: while mortgages with a CLTV of less than 80 percent have a default rate of 2.5 percent, the default rate surges to 16 percent for mortgages with a CLTV of 140 percent or more.[iv] Addressing this segment of mortgages is a critical component to restore equilibrium to the housing market.

The collective action problems that have impeded the resolution of underwater mortgages are well documented: theoretical free-rider advantages for those lenders who write down principal last, since write-downs help property prices; fragmentation of ownership interests in mortgage pools and the mortgages themselves; conflicts among tranches of mortgage pool participants; pooling and servicing agreements that limit the ability of servicers to modify or sell loans, and provide financial disincentives to servicers for loan modifications; the conflicts between first and second lien holders; and the fact that many servicers of first lien pools are also the holders of second liens on the same home.[v]

American workers can ill afford to continue waiting for the overhang of underwater mortgages to miraculously disappear. Private investors who hold the securities backed by these mortgages have marked them to market. There do not appear to be comprehensive solutions forthcoming to this pressing problem. AFSCME supports the efforts of local governments to explore all lawful options which may alleviate their economic woes.

The possible use of eminent domain would not involve the use of government power to alter financial contracts. Rather, governments would use eminent domain to purchase contracts at fair market value and to serve a clear public purpose; alleviating the housing crisis and encouraging economic development. The U.S. Supreme Court has held that the taking of property to support a program of economic rejuvenation and to provide appreciable benefits to the community, including increased tax revenue is within the sovereign power of eminent domain, which when applied properly, the Contract Clause of the U.S. constitution does not apply. As the FHFA knows, as a matter of course and legal procedure, courts determine the constitutionality of condemnations under eminent legal procedure, courts determine the constitutionality of condemnations under eminent domain powers, not federal agencies. The constitutionality of the use of eminent domain to purchase mortgage loans from private label securitization trusts, if challenged, will also be decided in courts.

Any action taken by local governments would be purely local, and would not require any federal resources. We understand that the FHFA seeks to protect the balance sheets of the Government Sponsored Enterprises (GSEs) and Federal Home Loan Banks, and the FHFA has raised the same concerns as other bondholders in these trusts. We are confident that state and local governments will respect the FHFA's sovereignty over GSE and Federal Home Loan Bank assets, and we expect that the FHFA will, after due consideration, respect state and local sovereign powers of eminent domain over private property within their jurisdictions.

We applaud the FHFA's concerns about consumer protection laws. Americans have been targets for predatory lenders for too long, and it is past time for the erosion of scarce household assets – particularly in communities of color – caused by predatory lenders to be stopped. We urge the FHFA to ensure that market participants, including members of the Securities Industry and Financial Markets Association and the American Securitization Forum, comply with these laws and do not redline any communities whose governments use their authority to mitigate the mortgage crisis. AFSCME urges the FHFA to allow local governments to apply eminent domain to private label mortgages without interference, and to allow local courts to resolve any disputes.

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We appreciate the opportunity to share our views with the FHFA on this important issue. If you have any questions, or need additional information, please do not hesitate to contact the undersigned at (202) 429-1275.

Sincerely,

Lisa Lindsley
Director, Capital Strategies

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[i] US Census, 2009. Available at http://www.census.gov/govs/estimate/.
[ii] Housing and Economic Recovery Act of 2008, Public Law No. 110-289, 122 Stat. 2654 (30 July 2008).
[iii] Emergency Economic Stabilization Act of 2008, Public Law No. 110-343, 122 Stat. 3765(3 October 2008)
[iv] Goodman, Laurie et al; "The Case for Principal Reductions," The Journal of Structured Finance, Fall 2011.
[v] Hockett, Robert C., "It Takes a Village: Municipal Condemnation Proceeding and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Economic Recovery." Cornell Law School research paper 12-12, available at http://ssrn.com/abstract=2038029.