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Using Eminent Domain to Seize Private Mortgages

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Introduction

Dr. Robert Hockett is a professor at the Cornell University Law School in Ithaca, New York. He consults for the Federal Reserve of New York, the Occupy Cooperative and the International Monetary Fund among other organizations. He has authored several articles and actively promotes the idea that government run “markets” provide the best solution for the “collective good”.

Premise

Dr. Robert Hockett’s premise: Performing underwater homeowners will default and be foreclosed on by their lender. It is better for the homeowner and community to have the homeowner’s loan modified. (*Basic Structure of the Eminent Domain Plan, Page 5 of NY fed Current Issues 2013 diagram*)

The fact that some performing borrowers have not requested a loan modification and the lenders have not offered a loan modification is irrelevant to Dr. Hockett. The fact that some borrowers request loan modification terms the lender cannot or will not agree to, but they still honor and pay the note as originally agreed is irrelevant to Dr. Hockett. In other words, the right to private contract is irrelevant to Dr. Hockett.

Lenders who do not modify and write down the losses are recalcitrant and thwarting the “collective good” according to Dr. Hockett. The largest number of underwater loans are held by investors as a result of the securitization of loans. Because of this securitization, the loans are subject to pooling and servicing

agreements. The ability to act on behalf of the investors resides in the trustees appointed by the pooling and servicing agreements. These trustees, as with any trustee, cannot act without the instructions from the parties to the agreement.

Dr. Hockett maintains it is always financially rational to write down the performing underwater loans (1). He declares that since these privately securitized mortgage agreements are subject to the provisions of the contract, and the trustees and servicers are duty bound to act only as provided in the contract, "collective action" is difficult in regards to modifying loans and therefore a new "collective agent" must be found. That "collective agent" is the government: Federal, State and State sub-units (cities, towns, counties, and municipalities) (2).

Private Property Issues

Dr. Hockett presumes that private property is only allowable as long as government authority deems it tolerable. He proposes that eminent domain is a tool placed in the Constitution precisely to deal with a foreclosure crisis. It is the tool the government may use to sidestep private contracts, force loans to be written down to a level the government deems appropriate therefore increasing loan value, property value, reducing risk and maintaining the community tax base. This presupposes all property is

owned by the government, rights reside in the government and government will allow individuals ownership and rights as the government declares based on the "collective good".

It was the American Founder's position that private property rights reside in the people and the people permit and inform the government of its rights and duties (3). This position was based on the philosophical and theological principles that individuals own their intelligence, labor, time, gifts and talents and therefore individuals are entitled to reap the benefits of their intelligence, labor, time, gifts and talents. Because of this the presumption was that individuals are born with their rights, not given rights by Government. Individuals therefore have a right to make their own decisions and contract with others on terms all parties to the transaction agree to...a meeting of the minds.

The loan holder/investor has given personal property to the borrower in the form of money to purchase a piece of real estate, in this case a house. In exchange, the borrower has agreed to pay back that money with interest. The borrower has further agreed the loan will be secured by the house the loan is on.

The note itself has only two parts: Part I - What happens if the borrower pays back the loan in full and Part II - What happens if the borrower does not pay back the loan. When a borrower pays back the borrowed funds, the note holder agrees to convey full title, release the lien on the property and record the full payment.

When the borrower fails to pay back the loan as agreed, the default provision of

the note agreement is activated. Depending on the note, the default provisions may activate as soon as one day late, or at further failure to pay. In any case, the loan default provisions will reflect the needs of the lender and state law. Just as an individual note holder may need the loan proceeds in order to meet financial goals and obligations, so securitized note holders have needs and obligations. While it is convenient for Dr. Hockett to refer to these securitized note holders as recalcitrant investors, these investors must frequently meet Federal and State government laws and rules as well as market needs. Mutual Funds must meet the needs of their investors for profit on their invested funds. They must meet SEC regulations as well. Pension Funds must meet investment portfolio requirements and Federal/State regulations. Banks must meet requirements of the FDIC, Treasury, Federal Reserve, Comptroller of the Currency, CFPB, and other state and federal government regulators as well as stock and bond holders. These are just a few of the many types of investors holding notes. If you have an IRA or 401K invested in mortgage backed securities, you are a note holder as well. No matter if the note holder is an individual or an entity, the note holder has a right to secure his property and decide when and how to take a loss, if a loss is required.

Right of Private Contract

American business and financial life depends on the right to private contract. Two parties, voluntarily agreeing to do business with each other, both parties understanding there is risk and reward. Both parties understanding the consequences of success and the consequences of failure, both parties diligently working to make the most positive and successful result prevail. Without the right to private contract, buyers cannot know they will own the property and lenders cannot know they will profit from lending their funds to borrowers. Without certainty of private contract, markets will stall. Few people wish to take risk without an enforceable promise as to the results.

Imagine – An 18 year old young man wishes to purchase a used car for \$2,000. The young man doesn't have the entire \$2,000. He only has \$200. So he asks the seller of the car to carry back a loan for \$1800. After much discussion the buyer and seller come to an agreement: \$200 down, \$1800 note plus \$90 in interest for a total due of \$1890, payable over 10 months. The buyer may drive and possess the car while making payments. The seller gets \$200, monthly payments of \$189 and the right to take back the car if the buyer fails to pay all the money back.

Six months into the agreement, the buyer's Dad decides the seller should no longer collect monthly payments, after all, the car's value has fallen. Dad informs the seller that no more payments will be forthcoming and the seller will need to write down the loss. Most people recognize Dad has no right to inject himself into a private contract

he is not a party to and the current market value of the car has nothing to do with the promise to pay. So it is, the government has no right to inject itself into a private contract it is not a party to and the current market value of the house has no bearing on the promise to pay.

Asset Value and Default Risk

According to Dr. Hockett; “They (the government) can then write down the loans, reducing default risk and raising expected values in the process” (4).

While Dr. Hockett’s assertion seems like the easy and fast solution to a nagging problem, in reality it will author further diminution of values and further undercut private property rights. Just imagine if you were a buyer of a house and all around you people who had paid \$200,000 for their house and taken out a \$150,000 loan to purchase that house were all of a sudden absolved from paying back that loan. Would you be inclined to think of that house value as increasing? Now think about being a lender. If a city or state routinely intervened in your private loan contracts, seizing your note and forcing you to take a loss when no loss was forthcoming, would you loan your money in that city or state? Probably not. Why loan to people who can go to government and legally steal your money? So with the advent of Dr. Hockett’s fast solution, the lending market will cease to exist. Values do not

generally increase when people must pay 100% cash for their house. For starters few people can come up with that much cash. This would appear to be one way to stabilize housing prices, but to what affect?

There are other forms of financing real estate, among them: contracts for deed, lease/purchase, and owner carry backs. Under the Dodd/Frank rules, as promulgated by the CFPB (Consumer Finance Protection Bureau), these seller backed finance tools are considered types of loans. Once government “forgives” and takes over one type of loan it is only a matter of time before they do the same to all forms of lending. This is best illustrated in this quote from Dr. Hockett *“federal, state, and/or local government instrumentalities, partly financed by current RMBS holders, would effectively “make” residential mortgage refinance markets via compulsory purchase of underwater mortgage loans...”* (5)

Footnotes:

(1) - www.newyorkfed.org/research/current_issues, page 3

(2) - www.newyorkfed.org/research/current_issues, page 4

(3) – The reader is directed to read the Declaration of Independence, particularly the grievances. The US Constitution including the Bill of Rights and the writings of James Madison during the Constitutional Convention.

(4) - www.newyorkfed.org/research/current_issues, page 4

(5) *“Private” Means to “Public” Ends: Government as Market Actors*, Dr. Robert Hockett, Cornell Law Library, 1-2014, page 23 &24

WeMAR White Papers, February 6, 2014:

***Eminent Domain and Private Property Rights
Acknowledgment & Declaration of Private Property Rights***