REVIEW & OUTLOOK

An Eminently Bad Idea

The housing bust has produced some terrible ideas, but now comes what may be the worst: A California county and two cities hit hard by foreclosures are thinking of using eminent domain to seize mortgages from private investors.

> Seizing private mortgages to sell to other private investors.

The idea is courtesy of Mortgage Resolution Partners, a San Francisco-based venture-capital firm that has found interest from San Bernardino County and two of its largest cities, Ontario and Fontana. MRP says it wants to stabilize housing markets by helping local communities and governments "retake control over the welfare of their neighborhoods and their fiscal solvency." This brings to mind Ronald Reagan's quip that the most terrifying words in the English language are "I'm from the government, and I'm here to help."

MRP proposes to help governments identify mortgages that are current but "underwater," or worth more than the value of the underlying home, and that have been bundled with other mortgages into a privately owned, mortgage-backed security. The government would use eminent domain to pluck the mortgage out of that pool of mortgages at a below-market cost.

The mortgage would then be refinanced using a taxpayer-backed, government guarantee, bundled with other new mortgages into a new security, and that security would be sold at a higher price to other investors. The alleged public purpose justifying eminent domain would be to reduce the number of underwater mortgages and thus stabilize local housing markets.

The appeal is obvious for politicians and MRP. The homeowner is refinanced into a mortgage equal to the current value of the home. The city avoids more foreclosures—assuming they would occur—and neighborhood blight. Taxpayers wouldn't be on the hook directly (if you forget the government refinancing guarantee) because MRP would find private investors to pay for the seized mortgage. The private investor who currently owns the mortgage gets paid and avoids the risk of default, in which case the value of the asset might be worth less. And MRP gets an undisclosed, and presumably not small, fee.

The problem is a detail known as property rights. In a normal transaction, a sales price is negotiated between a buyer and a seller. When government uses eminent domain, there is no negotiation. The government takes and determines the price.

In this instance, the government has every economic incentive to underpay the investor who owns the mortgage to cover transaction costs and boost returns for itself and MRP. Even worse in this case, the governmen would be grabbing mortgages on which th homeowner is *still paying* the monthly rent not mortgages that are i default or close to it. It's a arbitrary seizure.

If MRP's plan proceeds the consequences for housing investment won't be pretty. Investors would have to revalue mortgage pools and the accompanying value of the mortgage-backed securities based on the new possibility of government seizure. Pension funds and other mortgage investors would see the value of their securities fall. Fannie Mae and Freddie Mac also have private-mortgage portfolios which means taxpayers nationwide could suffer losses.

MRP's plan to break contracts unilaterally would also further undermine the private mortgage market. Private mortgage securitization spreads the risk of financing and lowers the cost of capital for borrowers—all at no cost to taxpayers. Compare that to government-sponsored enterprises like Fan and Fred and the Federal Housing Administration, in which taxpayers bear the risk.

Such an expansion of eminent domain also raises constitutional questions. Cherry-picking mortgage securities to snatch and deliver to a private entity is a long way from seizing a few homes to build a new thruway or bridge.

The Fifth Amendment allows governments to seize property with just compensation, but it is supposed to be for public purposes. Public anger over the Supreme Court's infamous 5-4 *Kelo* decision erupted in part because it allowed government to seize property for private benefit—for Pfizer Corp. to build a research facility. In this case, much of the benefit would also go to private parties—MRP and its investors.

MRP's political ties also deserve some scrutiny. Its executive chairman until earlier this year was Phil Angelides, the California Democrat chosen by Nancy Pelosi to chair the Financial Crisis Inquiry Commission that blamed most of the boom and bust on bankers. He resigned from MRP after Reuters reported that the company touted its political connections as its "secret formula" and boasted of its connections in "California politics."

The foreclosure problems of California's Inland Empire are serious and regrettable. (See the nearby editorial on San Bernardino's bankruptcy filing.) But if the last five years have taught anything, it's that multiple housing bailouts and political interventions introduce more uncertainty and delay the recovery. Abusing eminent domain would only compound the damage.