The Heritage Foundation
LEADERSHIP FOR AMERICA

ISSUE BRIEF

No. 3666 | JULY 16, 2012

San Bernardino Mortgage Seizure Plan Raises Serious Constitutional Concerns

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San Bernardino County's reported attempt to use eminent domain to expropriate mortgages could be struck down by the courts as inconsistent with the requirements of the Fifth Amendment's Takings Clause. Although weakened by decades of court decisions ignoring its original meaning, the clause remains a vital protection of private property rights, particularly where the government seeks to seize property from one private party for the narrow benefit of another.

Not only does the San Bernardino plan run afoul of that limitation, but it is also structured so as to deny mortgage owners the full degree of "just compensation" to which they are entitled by the Takings Clause.

Any attempt to seize mortgages from their owners would inevitably be met with litigation that could drag on for years, substantially undermining any benefit the county may hope to achieve. County officials would be reckless to discount these concerns.

Secret Plotting over Property. San Bernardino County, and several cities within it, have apparently been in secret negotiations with a private firm, Mortgage Resolution Partners (MRP), to use the government's power of eminent domain to seize underwater mortgages and transfer them to MRP.[1] MRP would then restructure the mortgages on terms to reduce homeowners' payments while ensuring a profitable return for itself. Anticipating the controversy that would ensue were its plans disclosed, MRP asked its negotiating partners to sign non-disclosure agreements, but word has nonetheless leaked.[2]

MRP was right to fear public scrutiny, because any plot to seize property raises serious concerns regarding Americans' constitutional rights. The Takings Clause provides that "private property [shall not] be taken for public use, without just compensation."

As a matter of original meaning, the clause imposes two substantive limitations on the use of eminent domain: (1) Any taking must be for a "public use," and (2) the government must provide the property's owner "just compensation."[3] Its overriding purpose, the Supreme Court has explained, is "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[4] The San Bernardino proposal violates this principle wholesale.

The Public Use Requirement. Due to the public use requirement, "it has long been accepted that the sovereign may not take the property of A for the sole purpose of transferring it to another private party B, even though A is paid just compensation."[5] The only relevant exception recognized by the courts to this rule is if, in the transfer itself, there is some broader public purpose, such as alleviating blight[6] or monopolization of land resources.[7]

But that purpose must be real and substantive and may not be a pretext. In *Kelo v. New London* (2005), a five-justice majority of the Supreme Court held that a municipality could use eminent domain to seize property in an area that it had designated as "distressed" to facilitate a redevelopment project. This plan, held the Court, was comprehensive and by no means a pretext for unlawful taking for private benefit; by contrast,

This paper, in its entirety, can be found at **http://report.heritage.org/ib3666**

Produced by the Center for Legal & Judicial Studies

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the Court explained, "a one-to-one transfer of property, executed outside the confines of an integrated development plan ... would certainly raise a suspicion that a private purpose was afoot," notwithstanding any proffered public purpose.[8]

Because the San Bernardino proposal addresses properties one at a time (rather than in a comprehensive fashion) and provides a substantial but narrow benefit to an ascertainable private party (i.e., MRP), it arguably falls outside the scope of activity approved by the Court in *Kelo*, which is recognized as the high-water mark of government's eminent domain power. This casts serious and substantial doubt on its constitutionality. Indeed, even after *Kelo*, the courts have continued to take seriously their duty to sniff out claims of pretextual purpose.[9]

Unjust Compensation. Moreover, the proposal may also violate the Takings Clause's "just compensation" requirement. The appropriate measure of compensation for a taking is fair market value, or "what a willing buyer would pay in cash to a willing seller at the time of the taking."[10] The courts have also recognized that *current* market value may provide inadequate compensation when it would fail to indemnify the owner for the full extent of his loss, such as where nearby properties that have been sold are not properly comparable.[11]

Yet the San Bernardino proposal invites this kind of systematic under-compensation by targeting only mortgages that are up to date in areas where others are in default or even foreclosure, such that there may be no properly comparable sale prices. Cornell Law School Professor Robert Hockett, whom MRP hired to provide a legal analysis supporting its proposal, acknowledges this problem in a roundabout way when he observes that, due to structural features of the local real estate markets at issue, fair market value "might even exceed current market value."[12] This is in tension with his suggestion, made more prominently in the proposal, that compensation could be "determined up front via municipality-procured appraisals," which would be unlikely to reflect anything beyond current value.[13]

In short, even assuming that seizing mortgages satisfies the "public use" requirement, municipalities would still face an unattractive choice: pay current market value and face an even greater litigation risk or fully compensate mortgage owners

1. See David C. John, "San Bernardino County's Loan Seizures Would Destroy Its Mortgage Market Just as Housing Starts to Recover," Heritage Foundation *Issue Brief* No. 3665, July 13, 2012, http://www.heritage.org/research/reports/2012/07/san-bernardino-county-s-loan-seizures-would-destroy-its-mortgage-market.
2. Matthew Goldstein and Jennifer Ablan, "California County Began Eminent Domain Talks in Secret," Reuters, July 14, 2012, http://in.reuters.com/article/2012/07/13/sanbernardino-eminentdomain-idINL2E8ICBUJ20120713 (accessed July 16, 2012).
3. See Douglas W. Kmiec, "Takings Clause," *The Heritage Guide to the Constitution*, http://www.heritage.org/constitution/#!/amendments/5/essays/151/takings-clause.
4. *Armstrong v. United States*, 364 U.S. 40, 49 (1960).
5. *Kelo v. New London*, 545 U.S. 469, 487 (2005).
6. See, e.g., *Berman v. Parker*, 348 U.S. 26 (1954).
7. See *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984).
8. Ibid., 487. See also *Kelo*, 491 (Justice Anthony Kennedy, concurring): "A court applying rational-basis review under the Public Use Clause should strike down a taking that, by a clear showing, is intended to favor a particular private party, with only incidental or pretextual public benefits." Further, Justice Kennedy, who joined the *Kelo* majority, may nonetheless support a categorical bar on takings such as those in the San Bernardino proposal. See *Hawaii Housing Authority*, 493, acknowledging that "[t]here may be private transfers in which the risk of undetected impermissible favoritism of private parties is so acute that a presumption (rebuttable or otherwise) of invalidity is warranted under the Public Use Clause."
9. E.g., *Rhode Island Economic Development Corp. v. The Parking Co., L.P.*, 892 A.2d 87, 106 (R.I. 2006), holding that a targeted taking outside a comprehensive redevelopment plan "bears little resemblance to the comprehensive and thorough economic development plan that was undertaken and upheld by the United States Supreme Court in *Kelo*"; *Mayor and City Council of Baltimore City v. Valsamaki*, 916 A.2d 324, 344–345 (Md. 2007); and *Middletown Tp. v. Lands of Stone*, 939 A.2d 331 (Pa. 2007), finding that taking was pretextual.
10. *U.S. v. 564.54 Acres of Land, More or Less, Situated in Monroe and Pike*, 441 U.S. 506, 511 (1979).
11. Ibid., 512–514.
12. Robert Hockett, "Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery," Cornell Law School, p. 30, note 99, http://www.lawschool.cornell.edu/spotlights/upload/Memorandum-of-Law-and-Finance-21-April-Municipal-Plan.pdf (accessed July 16, 2012).
13. Ibid., p. 32.

for the possibility of future appreciation, dramatically increasing the cost of the intervention.

Property Rights Are Not the Problem. The fundamental flaw underlying the San Bernardino proposal is the mistaken assumption that violating the property rights of unpopular parties—those holding mortgage-backed securities—can somehow strengthen the real estate market without causing massive collateral damage. But the reality is that weakening property rights ultimately increases uncertainty, undermines markets, and often fails to accomplish the government's goals: For example, the redevelopment project for which homes were seized in *Kelo* never came to be.

If San Bernardino moves forward with its mortgage-seizure proposal, the only guarantee is that it will face massive litigation at substantial cost that could drag on for years while doing nothing to improve the housing market. Violating constitutionally protected property rights, which Americans regard as sacrosanct, can hardly be worth the cost.

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