The housing crisis in Richmond, California and the debate over "eminent domain"

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Last Tuesday, the City Council in Richmond, California approved, by a vote of 4-3, a plan to take over the mortgages of a small section of the city's population, organize a reduction of the principal and refinance the loans under the auspices of another private company.

The move has been combined with a push to utilize the government's eminent domain powers to seize mortgages with the ostensible purpose of keeping families in danger of foreclosure from losing their homes. The city will need a 5-2 vote in order to actually begin exercising eminent domain over mortgages.

On Thursday, September 12, US District Judge Charles Breyer granted the city's motion to dismiss a lawsuit by mortgage bond trustees Wells Fargo and two units of Deutsche Bank on the grounds that it was "unripe." However, there can be little doubt that if the program goes forward, more lawsuits by the banks will be forthcoming.

The determination of the banks and financial institutions to scuttle the city's plan points to their intransigent opposition to any measure that involves a reduction in the principal (the overall amount owed) on mortgages to distressed homeowners in the US. However, the city's plan itself is a token measure that will do nothing to remedy the housing crisis, even if the eminent domain component goes forward.

The idea of using a city government's eminent domain power in this way belongs to Cornell University Law School Professor Robert Hockett. However, its proliferation is most strongly associated with the San Francisco-based Mortgage Resolution Partners LLC (MRP). Beginning last year, MRP has consulted city governments in various parts of California and other states, offering partnership agreements for the administration of eminent domain programs based on Hockett's approach. Richmond is the first city to execute such an agreement with MRP.

MRP's proposed plan, which the city government has titled Richmond CARES (Richmond Community Action to Restore Equity and Stability), is for the city to seize at-risk mortgages, compensate the mortgage holders (the mortgage-security firms) based on the fair market value of the loans, and then make refinancing arrangements that would be more manageable for homeowners. MRP, in addition to gaining a fee of $4,500 per house, is to split the profits from the refinancing with the city.

On July 31, Richmond City Manager William Lindsay sent out a letter to the mortgage holders of 624 residences offering to purchase the mortgages for their fair market value (minus 20 percent representing the estimated costs of foreclosure). He warned that those mortgages whose holders refuse this offer would be subject to seizure through eminent domain, which would provide a "fair" amount of compensation based on a court-approved valuation. The letter requested a response by August 13.

Not only were none of those offers accepted, but Wells Fargo and Deutsche Bank filed a lawsuit seeking injunctions against the proposed eminent domain program. In the lawsuit, the two banks acted under the direction of a group of investors including Pacific Investment Management Co. (Pimco), BlackRock Inc., DoubleLine Capital, as well as the government-supported mortgage loan insurance companies Fannie Mae and Freddie Mac

On August 8, the Federal Housing Finance Agency, which regulates Fannie Mae and Freddie Mac, declared that the agency would instruct those companies to "limit, restrict or cease business activities" in any jurisdiction that uses eminent domain to seize mortgages. This directive from the Obama administration significantly undercut the proposed program, as the city could not possibly afford to handle being abandoned by these companies, which provide insurance for mortgage loans.

In August, when the city of Richmond tried to refinance $34 million of its bonds, it failed to find willing purchasers on the markets. Apparently, investors decided to forgo purchasing the bonds as payback for the mortgage proposal, which failed to toe the line dictated by the financial elite.

The city of Richmond, a largely working class city north of San Francisco, is experiencing some of the worst consequences of the subprime mortgage crisis that began in 2007-2008. Despite a recent modest recovery in property values, some 4,600 homeowners, or about 50 percent of the mortgages in the city, are still “underwater,” meaning that the current balance on their mortgage loans is greater than the houses’ respective fair market values. The average mortgage debt is 45 percent of the property’s value.

The limited nature of the proposed eminent domain program becomes clear in light of the above numbers. MRP has selected 624 residences for the program—less than 15 percent of the city’s residences with underwater mortgages. Even more telling are the criteria by which the residences were selected. Over 70 percent of those selected are current on their payments, and those that are not current have, for the most part, missed only one or two payments.

MRP deliberately selected loans that were not at risk of default. Rather, it chose loans where the borrowers have a high likelihood of avoiding default and qualifying for new loans that could be sold to a new securitized trust. The other criterion that MRP followed was that it selected only mortgages held by “private label” mortgage-backed security trusts, and excluded mortgages held directly by banks and/or guaranteed by Freddie Mac and Fannie Mae. None of these criteria have anything to do with protecting homeowners from foreclosure and have everything to do with MRP’s own business strategy.

The proposed eminent domain program has been the subject of extensive commentary in the media, with the majority of commentators opposing the program. However, the debate has generally been framed in terms of potential impacts on investors and markets, with no concern shown for the countless millions of victims of the ongoing housing crisis who cannot afford to refinance their homes, not to speak of the broader housing crisis in the US.

Although there is no question that the big banks and investors that are driving the lawsuits and media campaign against the proposed program represent America’s financial aristocracy, opponents of the program have also made the legitimate criticism that investors in the mortgage-backed securities under threat of seizure include “public and private pension plans, college savings plans, 401(k) plans, insurance companies, mutual funds, university endowments, and government-sponsored enterprises” (quoting the Wells Fargo/Deutsche Bank complaint). In other words, a program that may help some remain in their homes could leave others with less retirement savings and smaller pensions than they thought they had, and for still others make college education even less affordable than before.

Essentially, the conflict between the banks and Richmond and MRP is a fight between two factions within the ruling capitalist class. On the one side are those banks that act as trustees for the possessors of mortgage-backed securities. They have profited from subprime lending and other shady policies that victimize individual borrowers, as well as the fraudulent overvaluation of the securities created out of the resulting debts. These were the criminal processes carried out on a massive scale that culminated in the financial market crash of 2008, for which no one has been held accountable to this day.

On the other side are MRP and other financial institutions, which stand to profit from the refinancing of mortgages. In other words, having recognized the social devastation wrought by the financial and economic crisis, they have developed an approach that will allow them to rearrange the debts of a small percentage of the lesser-affected victims for their own benefit while contributing to the creation of a new housing bubble. Richmond has become their testing ground. If the program is successfully implemented there, they aim to secure the adoption of similar programs throughout the country.

MRP has won the support of Richmond Mayor Gayle McLaughlin, a member of the Green Party who postures as a “left.” McLaughlin participated in Occupy protests and collaborated with the Service Employees International Union (SEIU) and various “antiwar” organizations. On August 15, she led a group of about 50 protesters to the Wells Fargo corporate headquarters in San Francisco in a phony display of defiance that can only serve to disorient and demoralize those who suffer the brunt of the banks’ rapacity. She has also won the backing of pseudo-left groups like the International Socialist Organization.

That McLaughlin’s plan can be presented as “left” only underscores the fact that the Obama administration has done absolutely nothing to assist homebuyers. Its mortgage programs have been based on the banks voluntarily agreeing to restructure loans for small sections of the population, with no reduction in principal. The administration has worked closely with the banks to minimize their liability for their fraudulent and criminal practices that have already led millions to lose their homes.

A real solution to the housing crisis in America must necessarily proceed from a recognition that housing is a social right, and that the realization of that right requires the expropriation of the banks and other financial institutions whose criminal practices caused the crisis but continue unchecked. Such a policy can be effected only as part of a revolutionary socialist program.