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Richmond Mayor Says Lawsuit Won't Deter Loan Seizures

ByNick Timiraos

Gayle McLaughlin, the mayor of Richmond, Calif., says she's not deterred from moving ahead with the city's plan to forcibly purchase mortgages from bondholders using the city's power of eminent domain despite a court challenge and the possibility of additional action by a federal regulator.

"We feel strongly that we're on legal ground," she said in an interview with Developments. "We're not afraid of going into the courtroom. We believe our legal reasoning will prevail."

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Trustees representing a group of bondholders that includes BlackRock Inc., Fannie Mae, Freddie Mac and Pacific Investment Management Co. filed suit Wednesday in federal court in San Francisco alleging that the seizing loans with the aim of modifying them is unconstitutional.

On Thursday, the federal regulator for Fannie and Freddie said it would mull further action to protect the government-controlled mortgage giants from potential disruptions, including halting loan purchases in cities that enact the plan. The FHFA said that after a yearlong review of proposal, it had "serious concerns" with the program and that it had "determined such use presents a clear threat to the safe and sound operations" of Fannie and Freddie.

"We think it's outrageous that they would threaten to do this," said Ms. McLaughlin, who said such a step by the Federal Housing Finance Agency would be illegal.

City leaders in Richmond, a working-class suburb of around 100,000 on the San Francisco Bay, began sending letters last week to mortgage companies seeking to purchase loans on 624 properties at prices determined by the city and threatening to force sales via eminent domain if investors resisted. The city is teaming up with Mortgage Resolution Partners, a private investment firm based in San Francisco, which was also named a defendant in Wednesday's lawsuit.

Bondholders don't like the eminent domain plan because they're concerned that they'll be shortchanged when cities purchase those loans, and they have pushed back against the idea that cities are acting in good faith by offering to buy the loans before seizing. "Our sense is that so-called voluntary loan sales would not be very voluntary. They are loan sales under pressure," said William McDavid, general counsel of Freddie Mac, on a conference call with reporters Wednesday.

Representatives from MRP said Thursday that the actions being considered by the FHFA to curtail loan purchases would violate federal antitrust statutes. "The FHFA was created to be independent of the mortgage industry that it regulates. But instead it has been in bed with the mortgage industry for over a year to oppose this solution to the mortgage crisis," said John Vlahoplus, the chief strategy officer for MRP.

Supporters say their plan would help not only specific homeowners but also the broader community by reducing foreclosures that are hurting property values and eroding the tax base. Of the loans that Richmond wants to buy, more than two-thirds, or 444, are current on their payments.

Investors have said taking those profitable loans out of their trusts would significantly degrade the value of their bonds, which are owned by banks, pension funds, and other investors. If the plan moves ahead lenders will require significant down payments or higher rates in communities where the threat of loan-seizures exists—much the way a sovereign-debt default can raise borrowing costs for a country.

"You cannot invest where your money is going to be expropriated—that's a key tenet of investing," said Jonathan Lieberman, head of residential mortgage investing at Angelo Gordon & Co., an investment adviser.

The eminent domain proposal first surfaced last year in San Bernardino, Calif., but local municipalities voted against moving ahead with the plan. It received a fresh look this year from a handful of California cities amid stronger backing from community activists and labor unions.