

COMMENT

BLIGHT PREVENTION: THE USE OF EMINENT DOMAIN TO CONDEMN UNDERWATER MORTGAGES IN WISCONSIN

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Blight costs Wisconsin taxpayers millions of dollars. However, there is a solution to prevent blight before it occurs in this state, and that solution is based on a plan enacted by the city of Richmond, California (the Plan). There, with the help of Mortgage Resolution Partners, the city took an unprecedented step to slow the city's foreclosure rate. Using its eminent domain power, the city enacted a plan to condemn underwater mortgages. The city would then refinance the mortgages and transfer them back to the current homeowners. This Comment will assume that the Plan, although controversial, is permissible under both the Fifth Amendment's Takings Clause and the Wisconsin Constitution's similar provision.

Using the Blight Elimination and Slum Clearance Act (the Act), Wisconsin cities can and should follow Richmond's lead by condemning underwater mortgages to prevent the dissemination of blight. The purpose of the Act is to provide for the elimination and *prevention* of blight. Due to the direct correlation between underwater mortgages and foreclosure, using the Act to condemn underwater mortgages can prevent the blight associated with foreclosed homes. This Comment describes how the Act provides for the steps necessary to implement the Plan and argues the necessity of the Plan in Wisconsin cities, especially Milwaukee and Racine. This Comment concludes by describing the Plan's many benefits to homeowners, the general public, local governments, and lenders alike.

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INTRODUCTION

A person's home, and homeownership in general, is one of the cornerstones of the American Dream.¹ Homeownership is the platform from which our lives develop, the locus of our families and communities, and is a way in which we leverage capital.² In addition to serving important psychological and financial roles to individual homeowners, homeownership serves important public benefits.³ Homeowners are more likely to play active roles in local governments and schools, vote more frequently, participate in local community building, and are generally more active citizens.⁴ Furthermore, housing is a critical driver of the U.S. economy.⁵

Due to the important role of the home and homeownership, jurisdictions throughout the country have reacted to the real estate crisis by enacting various policies and legislation to reduce foreclosure rates

1. BIPARTISAN POLICY CTR., HOUSING AMERICA'S FUTURE: NEW DIRECTIONS FOR NATIONAL POLICY 10 (Feb. 2013), *available at* http://bipartisanpolicy.org/sites/default/files/BPC_Housing%20Report_web_0.pdf (examining key issues that form the basic elements of a resilient housing system and proposing new approaches to address housing concerns).

2. *Id.* at 15; Rachel D. Godsil & Davis V. Simunovich, *Protecting Status: The Mortgage Crisis, Eminent Domain, and the Ethic of Homeownership*, 77 *FORDHAM L. REV.* 949, 951, 954 (2008).

3. Godsil & Simunovich, *supra* note 2, at 954.

4. *Id.*

5. BIPARTISAN POLICY CTR., *supra* note 1, at 15 ("Statistics like 'sales of new and existing homes' and 'multifamily starts' have become key indicators of national economic performance. When these indicators are trending upward, it generally means the U.S. economy is on the march; when they are trending downward, the economy is often in trouble.").

and keep people in their homes.⁶ One jurisdiction took an unprecedented step to do just that.⁷ With the help of Mortgage Resolution Partners (MRP),⁸ the city of Richmond, California, devised a plan whereby the city will use its eminent domain power to condemn underwater mortgages.⁹ An “underwater mortgage” is a mortgage that exceeds the fair market value of the home.¹⁰ The city will offer lenders the fair market value for mortgages, reduce the loan balances, and then refinance the mortgages, resulting in lower payments for the homeowners.¹¹ Three mortgage-bond trustees have since filed suit alleging, among other things, that the proposed use of eminent domain is unconstitutional because the mortgages are not being seized for a valid public purpose.¹²

The Fifth Amendment of the U.S. Constitution provides that no private property shall “be taken for public use, without just compensation.”¹³ In defining public purpose (or public use),¹⁴ the U.S.

6. See, e.g., *Foreclosures 2013 Legislation*, NAT’L CONF. ST. LEGISLATURES <http://www.ncsl.org/research/financial-services-and-commerce/foreclosures-2013-legislation.aspx> (last updated July 22, 2014) (In 2013, 44 states introduced legislation regarding foreclosures in an attempt to “regulate[] foreclosure consultants and distressed property purchasers, amend[] the foreclosure process to address concerns regarding so-called robo-signing and protect[] tenants’ rights who are renting homes facing foreclosure.”).

7. Nick Timiraos, *Investor Group Calls Richmond, Calif., Eminent Domain Plan Unconstitutional*, WALL ST. J. (Aug. 7, 2013, 11:24 PM), <http://online.wsj.com/news/articles/SB10001424127887324522504578654690187664354> (“Mortgage Resolution Partners has led the city of Richmond into an unprecedented use of eminent domain seizure . . .”) (internal quotation marks omitted).

8. “Mortgage Resolution Partners (MRP) is a Community Advisory firm working to stabilize local housing markets and economies by keeping as many homeowners with underwater mortgages in their homes as possible.” MORTGAGE RESOL. PARTNERS, <http://mortgageresolution.com> (last visited Nov. 10, 2014).

9. Timiraos, *supra* note 7.

10. An underwater mortgage is defined as “[a] home purchase loan with a higher balance than the free-market value of the home.” *Underwater Mortgage*, INVESTOPEDIA, <http://www.investopedia.com/terms/u/underwater-mortgage.asp> (last visited Nov. 10, 2014). An underwater mortgage is also commonly referred to as a mortgage with negative equity. See CORELOGIC, CORELOGIC EQUITY REPORT: SECOND QUARTER 2014, at 3 (2014), available at <http://www.corelogic.com/research/negative-equity/corelogic-q2-2014-equity-report.pdf> [hereinafter CORELOGIC EQUITY REPORT].

11. Timiraos, *supra* note 7. At least four other cities in states including New Jersey and Washington considered using this eminent domain strategy but have since backed away. Shalia Dewan, *Eminent Domain: A Long Shot Against Blight*, N.Y. TIMES (Jan. 11, 2014), http://www.nytimes.com/2014/01/12/business/in-richmond-california-a-long-shot-against-blight.html?_r=0.

12. Dewan, *supra* note 11. U.S. District Judge Charles Breyer of the Northern District of California dismissed this suit on the grounds that the lawsuit was premature because the city of Richmond had not yet approved the plan. *Judge Rules for Richmond in Mortgage Lawsuit*, SF EXAMINER, Sept. 18, 2013, <http://www.sfexaminer.com/sanfrancisco/judge-rules-for-richmond-in-mortgage-lawsuit/Content?oid=2580906>.

13. U.S. CONST. amend. V.

Supreme Court generally gives great deference to state legislatures.¹⁵ Examples of permissible “public purposes” include blight elimination and economic development.¹⁶ As long as the exercise of eminent domain “is rationally related to a conceivable public purpose, the Court has never held a compensated taking to be proscribed by the Public Use Clause.”¹⁷ Furthermore, the Court has observed that “the government’s pursuit of a public purpose will often benefit individual private parties,” and therefore it is not per se unconstitutional to take property from one private party and transfer it to another private party.¹⁸

The Fifth Amendment applies to Wisconsin by way of the Fourteenth Amendment.¹⁹ Moreover, Wisconsin’s constitution includes a nearly identical Takings Clause: “[t]he property of no person shall be taken for public use without just compensation therefor.”²⁰ Wisconsin traditionally had a more restrictive interpretation of “public use,” meaning it is harder for the government to take private property.²¹ However, the Wisconsin Supreme Court has said that it has “no difficulty in concluding that the condemnation of property for the elimination of blight areas and the prevention of the recurrence of blight in such places is for public purpose and public use.”²²

14. For a discussion of the Supreme Court’s move from defining permissible “public use” under the Takings Clause to permissible “public purpose,” see Brent Nicholson & Sue Ann Mota, *From Public Use to Public Purpose: The Supreme Court Stretches the Takings Clause in Kelo v. City of New London*, 41 GONZ. L. REV. 81 (2005–06).

15. Olga V. Kotlyarevskaya, Comment, “Public Use” Requirement in Eminent Domain Cases Based on Slum Clearance, Elimination of Urban Blight, and Economic Development, 5 CONN. PUB. INT. L.J. 197, 202 (2006).

16. See, e.g., *Kelo v. City of New London*, 545 U.S. 469, 469 (2005) (holding that the use of eminent domain to further an economic development plan satisfies the public use requirement); *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 230 (1984) (holding that oligopoly regulation is a rational exercise of the eminent domain power); *Berman v. Parker*, 348 U.S. 26, 26 (1954) (holding that Congress may take into account aesthetic and health considerations in enacting redevelopment legislation).

17. *Midkiff*, 467 U.S. at 241.

18. *Kelo*, 545 U.S. at 485.

19. Kotlyarevskaya, *supra* note 15, at 200.

20. WIS. CONST. art. I, § 13.

21. See, e.g., *Whiting v. Sheboygan & Fond du Lac R.R. Co.*, 25 Wis. 167, 195 (1870) (“[P]ublic use . . . implies a possession, occupation and enjoyment of the land by the public, or public agencies.” (quoting JUDGE THOMAS COOLEY, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION 531 (1868))) (internal quotation marks omitted).

22. *David Jeffrey Co. v. City of Milwaukee*, 267 Wis. 559, 579–80, 66 N.W.2d 362 (1954).

In response to the federal Housing Act of 1949,²³ Wisconsin passed the Blight Elimination and Slum Clearance Act (the Act) in 1958.²⁴ At the time, “[b]light elimination and slum clearance had become a growing statewide concern.”²⁵ Wisconsin addressed this concern by passing the Act to combat “the existence of substandard, deteriorated, slum and blighted areas and blighted properties.”²⁶ The purposes of the Act “are to provide for the elimination and *prevention* of . . . blighted areas and blighted properties.”²⁷ The Act is implemented through cities’ redevelopment authorities, which are authorized under Wisconsin’s eminent domain statute²⁸ to condemn properties that meet the Act’s blighted area²⁹ or blighted property³⁰ definition.³¹

This Comment argues that by using the procedures set forth in the Act, Wisconsin cities can and should follow Richmond’s lead and use their eminent domain powers to condemn underwater mortgages in order to prevent dissemination of blight. Even though the real estate crisis did not affect Wisconsin as severely as other states,³² cities including Milwaukee and Racine continue to see excessive underwater mortgage

23. Housing Act of 1949, 42 U.S.C. § 1441 (1949). Focusing on urban development, the Housing Act “was the first federal legislation that authorized the use of federal funds to assist local communities with slum clearance and urban renewal.” Peter Ouchakof, *The Legal and Social Framework of Wisconsin Redevelopment Authorities* 6 (Univ. of Wis.–Madison/Extension Dep’t of Urban & Reg’l Planning, Working Paper No. 2013-04, 2013), available at <http://urpl.wisc.edu/extension/reports/The%20Legal%20and%20Social%20Framework%20of%20Wisconsin%20Redevelopment%20Authorities%202013-04.pdf>.

24. WIS. STAT. § 66.1333 (2011–12); see also Ouchakof, *supra* note 23, at 7. Prior to passing the Act, in 1945 Wisconsin passed the Blighted Area Law. § 66.1331; Ouchakof, *supra* note 23, at 6. The Blighted Area Law delegates responsibility and sets parameters for a city to “exercise all powers necessary or convenient to carry out and effectuate the purposes and provisions of this section.” § 66.1331(4)(a); see also Ouchakof, *supra* note 23, at 6. The key differences between the Blighted Area Law and the Act are that: (1) the Act grants powers to redevelopment authorities, and (2) the Act can be used to condemn individual properties. Compare § 66.1333(3), and § 66.1333(2m)(bm), with § 66.1331(4), and § 66.1331(3)(a).

25. Ouchakof, *supra* note 23, at 7.

26. § 66.1333(2).

27. *Id.* (emphasis added).

28. WIS. STAT. § 32.02(11) (2011–12) (authorizing redevelopment authorities created under section 66.1333 to “acquire by condemnation any real estate . . . or interest therein”).

29. § 66.1333(2m)(b).

30. *Id.* § 66.1333(2m)(bm).

31. *Id.* § 66.1333(5)(a)3.

32. At the end of the second quarter in 2014, 10.9% of residential properties with a mortgage in Wisconsin were underwater, as compared to 10.7% nationwide. CORELOGIC EQUITY REPORT, *supra* note 10, at 3, 13. At 26.3%, Nevada had the highest percentage of underwater mortgages. *Id.*

rates.³³ The adoption of such a plan would not only help individual homeowners, but it would also benefit local governments and the general public.³⁴

Part I of this Comment explains the implementation of the Plan, the federal constitutional backdrop of using eminent domain in such a manner, and Wisconsin's historical and current use of the Act. Part II—the core of this Comment—argues that condemning underwater mortgages is permissible under the Act and under Wisconsin's eminent domain statute. Finally, Part III explores the Plan's potential benefits and argues that the plan would benefit Wisconsinites.

I. THE PLAN AND WISCONSIN'S BLIGHT PREVENTION ACT

The Plan is a response to the social and economic conditions generated by the financial crisis of 2008. Before the crisis, subprime mortgage loans were often “made to borrowers with poor credit ratings, no down payment on the home financed, and/or no verification of income or assets.”³⁵ As a result, when the housing bubble burst, homeowners were unable to make their monthly payments, causing a dramatic increase in foreclosure rates.³⁶ Recognizing the correlation between underwater mortgages and foreclosure rates, MRP began working with cities like Richmond to implement the Plan.³⁷

33. See *The U.S. Housing Crisis: Where Are Home Loans Underwater?*, ZILLOW, <http://www.zillow.com/visuals/negative-equity/#10/42.7248/-87.7911> (last visited Nov. 10, 2014) [hereinafter *Where Are Home Loans Underwater?*]. This information is based on Zillow's first quarter 2014 data. *Id.* For further discussion on the percentage of underwater mortgages in Milwaukee and Racine and its impact on the economy of these cities, see *infra* Part III.

34. See *infra* Part III.

35. James F. Davis, *The Cause of the 2008 Financial Crisis*, ACCURACY MEDIA (Oct. 14, 2008), <http://www.aim.org/guest-column/the-cause-of-the-2008-financial-crisis> (arguing that the dramatic increase in these types of loans led to the 2008 financial crisis).

36. Stephanie Amour, *2008 Foreclosure Filings Set Record*, USA TODAY (Feb. 3, 2009, 2:45 AM), http://usatoday30.usatoday.com/money/economy/housing/2009-01-14-foreclosure-record-filings_N.htm (noting that the 2008 foreclosure rate was up 81 percent from 2007 and 225 percent from 2006).

37. MORTGAGE RESOL. PARTNERS, *supra* note 8 (“[M]ore than eleven million families are now underwater. Nearly three million of these families are in default and on their way to foreclosures that will depress home prices further, causing still more foreclosures. MRP seeks to stem this tide.”).

A. Implementation of the Plan

Principal reduction is recognized as an effective way to reduce foreclosures and may serve the best interests of all involved parties.³⁸ In order to reduce the principal on underwater mortgages, MRP designed a plan that proceeds in several steps.³⁹ First, a private firm will assist the local government in creating new loan securitization trusts.⁴⁰ The local government will then raise money from private investors.⁴¹ Next, using the private investors' money, the local government will identify eligible mortgages⁴² and, with the homeowner's approval,⁴³ take control of such mortgages by using its eminent domain power.⁴⁴ The local government will use the private investors' money to pay just compensation to the old trusts.⁴⁵

38. JOHN GRIFFITH & JORDAN EIZENGA, CTR. FOR AM. PROGRESS, SHARING THE PAIN AND GAIN IN THE HOUSING MARKET 1–3 (2012), available at http://cdn.americanprogress.org/wp-content/uploads/issues/2012/03/pdf/principal_reductions_into.pdf (“Principal reductions are particularly effective for deeply underwater borrowers that are facing long-term economic hardships, such as a permanent reduction in wages or long-term increases in unavoidable spending.”).

39. Katharine Roller, Note, *The Constitutionality of Using Eminent Domain to Condemn Underwater Mortgage Loans*, 112 MICH. L. REV. 139, 146 (2013).

40. *Id.* A securitization trust involves the purchase of “a large amount of unrelated but similar mortgages” that are then sold to a trust. PHIL KOBIEROWSKI, INDEXING PARTIES FROM SECURITIZATION TRUSTS AND MORTGAGE-BACKED CERTIFICATES INTO LAND RECORD INDEXES IN THE STATE OF GEORGIA 4 (2008), available at https://www.gscca.org/docs/deed-lien-plat-documents/indexing_securitization_trust_instruments.pdf?sfvrsn=2. “Public Investors then buy bonds from the trust,” and “[i]n return, the Investors receive the monies from the monthly mortgage payments made by the property owners.” *Id.*

41. Roller, *supra* note 39, at 146.

42. The Plan only targets private-label mortgages, meaning mortgages not guaranteed by Fannie Mae and Freddie Mac. M. Hampton Foushee, Comment, *Eminent Domain, Mortgage Backed Securities, and the Limits of the Takings Clause*, 8 N.Y.U. J. L. & LIBERTY 66, 73 (2013). The Plan avoids these mortgages because the Federal Housing Finance Agency (FHFA) forbids local governments from engaging in mortgage-principal reduction due to its belief that such an exercise would threaten the safe and sound operation of Fannie Mae and Freddie Mac. *Id.* at 73–74; see also *FHFA Takes Strong Position Against Eminent Domain Plans*, [Regulatory Developments] Fed. Banking L. Rep. Online (CCH) ¶¶ 152–599 (Aug. 8, 2013). The mortgage must also be held by a mortgage-securitization trust, not directly on a bank balance sheet. Foushee, *supra*, at 74.

43. Participation in the Plan is voluntary—“the program does not affect homeowners who choose not to refinance.” Rick E. Rayl, *Eminent Domain and Underwater Mortgages: Framing the Debate, Part 1*, CAL. EMINENT DOMAIN REP. (July 25, 2012), <http://www.californiaeminentdomainreport.com/2012/07/articles/articles/eminent-domain-and-underwater-mortgages-framing-the-debate-part-1/>.

44. Foushee, *supra* note 42, at 74.

45. *Id.* at 74–75, 93.

Once the mortgages are in the hands of the local government, the government will create equity for the homeowner by writing down the principal to an amount below the home's fair market value.⁴⁶ Finally, the government will transfer the refinanced loans to the newly created securitization trusts and repay private investors in shares of the securities backed by the refinanced loans.⁴⁷ The process results in lowered monthly payments, increased equity, and a new principal balance for the homeowner.

Although Richmond has yet to fully proceed with MRP's plan, in August 2013 the city began sending letters to mortgage companies seeking to purchase loans on 624 properties and threatening to force sales through eminent domain if investors resisted.⁴⁸ The mortgage companies filed a lawsuit arguing that the proposed use of eminent domain is unconstitutional because the loans are not being seized for a valid public purpose.⁴⁹ This lawsuit was dismissed on the ground that the lawsuit was premature as the city had yet to approve the Plan;⁵⁰ however, the constitutional validity of the Plan has yet to be determined.⁵¹

46. *Id.* at 70. The old securitization trusts (i.e., the mortgage creditors) "receive compensation of up to 85% of the market value of the underlying home, regardless of the original debt owed to the lender under the term of the mortgage note." *Id.* at 70–71 (citing Robert C. Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Economic Recovery* 32 (Cornell Law Sch., Research Working Paper No. 12-12, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2038029).

47. *Id.* at 75. Private investors are repaid a price equivalent to 95 percent of the home's market value. *Id.* at 71.

48. Timiraos, *supra* note 7.

49. *Id.*

50. *Judge Rules for Richmond in Mortgage Lawsuit*, *supra* note 12. Since Richmond has not yet implemented the Plan, the mortgage companies withdrew appeals of Judge Breyer's dismissal but noted that the "lawsuit would be 'immediately re-filed' if . . . Richmond . . . took steps toward adopting the plan." Sam Forgione, *Investors Withdraw Appeals Against California Eminent Domain Plan*, REUTERS (May 16, 2014, 8:29 PM), <http://www.reuters.com/article/2014/05/17/us-mortgages-investing-eminentdomain-idUSBREA4G00A20140517> (quoting John Ertman, lawyer for mortgage trustees Wells Fargo and Deutsche Bank).

51. Due to the vast literature on the subject, this Comment elects not to discuss the Plan's constitutionality in detail. It instead presumes that the Plan results in a constitutional taking. See *infra* Part I.B. For further discussion on the Plan's constitutionality, see M. Langdon, *The Importance of a Promise: Underwater Mortgages and a Municipal Rescue Attempt Through Eminent Domain*, 45 URB. LAW. 571, 612–13 (2013) (arguing that MRP's Plan satisfies the public use requirement but fails to provide just compensation without important changes); Alexandra M. Perry, *Eminent Domain: A Solution to the Mortgage Crisis?*, 86 TEMP. L. REV. 181, 201–06 (2013) (arguing that MRP's plan meets the public use requirement and satisfies just compensation); Foushee, *supra* note 42, at 78–107 (arguing that MRP's public policy justifications and just compensation pose major constitutional problems under the Fifth Amendment); Joel

B. The Federal Constitution's Eminent Domain Backdrop

The Fifth Amendment's Takings Clause says that private property shall not "be taken for public use, without just compensation."⁵² There are two requirements of a constitutional taking: it must be for a "public use," and just compensation must be paid to the property owner in exchange for the taken property. If the taking serves a permissible "public purpose," the taken property does not literally need to be open to "use by the public."⁵³ In addition, the law does not draw a distinction between what types of property can be taken through eminent domain;⁵⁴ intangible property including mortgage loans and liens have been permissibly seized.⁵⁵ The Supreme Court has "defined [public purpose] broadly, reflecting [its] longstanding policy of deference to legislative judgments in this field."⁵⁶ The Supreme Court believes that "[j]udicial deference is required because, in our system of government, legislatures

Anne T. T. Jensen, Comment, *Eminent Domain: The Solution to the Foreclosure Crisis or Overstepping Government Boundaries?*, 12 RICH. J. GLOBAL L. & BUS. 543, 547–59 (2013) (arguing that MRP's plan satisfies both state and federal "public use" requirements); Jacob J. Lantry, Note, *Municipal Lifeguards: The Constitutionality of Condemning and Refinancing Underwater Mortgages*, 62 DRAKE L. REV. 243, 260–66 (2013) (arguing that more than five decades of precedent weighs in favor of the Plan's constitutionality under the Takings Clause); Andrew Peace, Note, *Coming Up for Air: The Constitutionality of Using Eminent Domain to Condemn Underwater Mortgages*, 54 B.C. L. REV. 2167, 2193–203 (2013) (arguing that the MRP's plan satisfies the public-use requirement but does not provide just compensation); Jourdain B. Poupore, Note, *Mortgage Takings and Municipal Finance: A Solution for Preserving Home Ownership*, 8 BROOK. J. CORP. FIN. & COM. L. 187, 213–14 (2013) (arguing that due to the possibility of including mortgagees who are nonresidents of a forum, MRP's plan may violate the Commerce Clause due to the Plan's impact on interstate commerce); Roller, *supra* note 39, at 148–55 (arguing that MRP's plan is constitutional under the Takings Clause but would not be permissible under the Contracts Clause).

52. U.S. CONST. amend. V.

53. See *Kelo v. City of New London*, 545 U.S. 469, 478–80 (2005) (stating that the Court has "repeatedly and consistently rejected" the narrow "use by the public" test and has instead "embraced the broader and more natural interpretation of public use as 'public purpose'").

54. Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt*, 19 CURRENT ISSUES ECON. & FIN., no. 5, 2013, at 1, 6 ("Forms of intangible property that have been purchased in eminent domain include bond tax exemption covenants, insurance policies, corporate equities, other contract rights, businesses as going concerns, and even sports franchises.").

55. See, e.g., *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 602 (1935) ("If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.").

56. *Kelo*, 545 U.S. at 480.

are better able to assess what public purposes should be advanced by an exercise of the taking power.”⁵⁷

In *Berman v. Parker*,⁵⁸ the Supreme Court unanimously held that Washington D.C.’s use of eminent domain to eliminate blight, pursuant to the District of Columbia Redevelopment Act, was constitutional.⁵⁹ In *Berman*, the appellees sought to condemn the appellant’s property, which was located in a blighted area.⁶⁰ Appellants argued that it was an unconstitutional taking because it was not taken for a public use.⁶¹ The Court indicated that the judiciary plays a limited role in determining public purpose and found that maintaining public welfare fits this definition, and that blight elimination through the eminent domain power is a permissible means to maintain public welfare.⁶² Furthermore, the Court found that despite the fact that the property was effectively taken “from one businessman for the benefit of another businessman,” it could not “say that public ownership is the sole method of promoting the public purposes.”⁶³

C. Eminent Domain in Wisconsin and How the Act Is Used

In *David Jeffrey Co. v. City of Milwaukee*,⁶⁴ the Wisconsin Supreme Court affirmed its traditional adherence to a stricter interpretation of “public use.”⁶⁵ However, in doing so, the court displayed a similar deference to the legislature in saying that the “determination of what constitutes a public municipal purpose is primarily a function of the legislative body, subject to review by the courts.”⁶⁶ The court indicated that it would only overrule such a determination if it is “manifestly arbitrary or unreasonable.”⁶⁷ The court concluded that condemnation for elimination and prevention of blight is a valid public purpose.⁶⁸

The Wisconsin Supreme Court has since remarked that the cities certainly “have the power to eliminate blight by acquiring land by condemnation, but in order to exercise that power [the cities] must proceed under the specific statute authorizing condemnation for that

57. *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 244 (1984).

58. 348 U.S. 26 (1954).

59. *Id.* at 36.

60. *Id.* at 30–31.

61. *Id.* at 31.

62. *Id.* at 32–33.

63. *Id.* at 33–34.

64. 267 Wis. 559, 66 N.W.2d 362 (1954).

65. *Id.* at 571–73.

66. *Id.* at 579.

67. *Id.*

68. *Id.* at 579–80.

purpose.”⁶⁹ In situations involving blight elimination and prevention, the specific authorizing statute is the Act. The Act is liberally construed and has thus been used in numerous scenarios.⁷⁰ For example, in *Grunwald v. Community Development Authority of West Allis*,⁷¹ even though the plaintiff’s property was not blighted, the court determined that because his property was located in a blighted area, the property was properly condemned under the Act, as its taking was necessary for successful redevelopment of the area.⁷²

Nonetheless, in response to the U.S. Supreme Court’s decision in *Kelo v. City of New London*,⁷³ the Wisconsin Legislature revised Wisconsin’s eminent domain statute to prohibit government agencies from acquiring unblighted private property if the condemnor intends to convey the acquired property to a private entity.⁷⁴ This response suggests that if these changes were made before the decision in *Grunwald*, that case would have had a different outcome.⁷⁵ However, because the eminent domain statute was changed, not the Act, it remains unclear if and how the Wisconsin Legislature’s changes will affect the Act’s liberal construction.⁷⁶

II. CONDEMNING UNDERWATER MORTGAGES IN WISCONSIN: A HOW-TO GUIDE

This Part will explain the process by which Wisconsin cities can use their eminent domain power to condemn underwater mortgages. First, it describes how this process is permissible under the Act. Second, it describes how this process is also permissible under Wisconsin’s eminent domain statute. Together, these Sections provide a path for implementation of the Plan in Wisconsin.

69. *Sigma Tau Gamma Fraternity House Corp. v. City of Menomonie*, 93 Wis. 2d 392, 402, 288 N.W.2d 85 (1980).

70. *See, e.g., Exxonmobil Oil Corp. v. Redevelopment Auth. of La Crosse*, 2005 WI App 193, ¶¶ 1, 3, 287 Wis. 2d 132, 703 N.W.2d 383 (permitting condemnation of Exxon’s property, which the defendant declared blighted under the Act).

71. 202 Wis. 2d 471, 551 N.W.2d 36 (Ct. App. 1996).

72. *Id.* at 487–90.

73. 545 U.S. 469 (2005).

74. WIS. STAT. § 32.03(6)(b) (2011–12); Hugh R. Braun, *Wisconsin’s Response to Condemnation for Economic Development*, WIS. LAW., Sept. 2007, at 15.

75. Braun, *supra* note 74, at 63 (arguing that the changes “would have prohibited West Allis from acquiring Grunwald’s seven-year-old unblighted property”).

76. *Id.* (noting that it is unclear whether the changes to the eminent domain statute are intended to overrule the Act’s broad construction).

*A. Condemning Underwater Mortgages Is Permissible Under
Wisconsin's Blight Elimination and Slum Clearance Act*

The Wisconsin Supreme Court indicated that cities can use their eminent domain power to eliminate blight, but “in order to exercise that power [the cities] must proceed under the specific statute authorizing condemnation for that purpose.”⁷⁷ Therefore, in order to implement the Plan, Wisconsin municipalities must proceed under a specific statute. This is where the Act comes in. This Section demonstrates that the Act allows for the condemnation of underwater mortgages because it provides for the prevention of blight, properties with underwater mortgages fit within the Act’s definition of “blight,” and the Act provides for the necessary procedures to implement the Plan.

1. THE ACT PROVIDES FOR THE PREVENTION OF BLIGHT

Under section 66.1333(2), the Act’s purposes “are to provide for the elimination *and prevention* of substandard, deteriorated, slum and blighted areas and blighted properties.”⁷⁸ Permitting actions to prevent blight is not a Wisconsin anomaly, as many states’ blight statutes permit the prevention of future blight in addition to the elimination of current blight.⁷⁹ However, the majority of Wisconsin cases invoking the Act involve blight elimination, not prevention.⁸⁰ Nonetheless, under the Act, the legislature “created municipal redevelopment authorities and charged them with the responsibility to prevent and eliminate slums and blighted areas,”⁸¹ and nothing in the Act suggests that it is impermissible to invoke it for the prevention of future blight.⁸²

77. *Sigma Tau Gamma Fraternity House Corp. v. City of Menomonie*, 93 Wis. 2d 392, 402, 288 N.W.2d 85 (1980).

78. WIS. STAT. § 66.1333(2) (2011–12) (emphasis added).

79. *See, e.g.*, 315 ILL. COMP. STAT. ANN. 5/3(k) (West 2012) (“[I]ncluding undertakings and activities . . . for the elimination and for the prevention of the development or spread of slums and blight . . .”); IOWA CODE ANN. § 403.17(25) (West 2011) (“‘Urban renewal project’ may include undertakings and activities of a municipality . . . for the elimination and for the prevention of the development or spread of slums and blight . . .”); MINN. STAT. ANN. § 469.002, subd.14(1) (West 2014) (“‘Redevelopment project’ means any work or undertaking to acquire blighted areas and other real property for the purpose of removing, preventing, or reducing blight . . .”).

80. *See, e.g., Sondag v. Dave Kohel Agency, Inc.*, 2006 WI 92, ¶ 7, 292 Wis. 2d 458, 718 N.W.2d 631 (noting that plaintiff’s property was located within “a proposed ‘master land use plan’ to eliminate blight and redevelop properties”); *Sigma Tau Gamma*, 93 Wis. 2d at 398 (noting that the city declared “the taking of plaintiff’s property necessary ‘for the purpose of elimination of blighted and slum areas’”).

81. *Grunwald v. Cmty. Dev. Auth. of West Allis*, 202 Wis. 2d 471, 481, 551 N.W. 2d 36 (Ct. App. 1996).

82. *See* § 66.1333.

The “prevention” element of the Act is crucial to implementing the Plan because properties with underwater mortgages do not constitute blight in the traditional sense.⁸³ Traditionally, redevelopment policies were “intended to address unsafe or insufficient urban housing.”⁸⁴ Homes with underwater mortgages are not necessarily unsafe or insufficient; however, underwater mortgages often lead to foreclosure,⁸⁵ and foreclosed homes regularly become blighted in the traditional sense.⁸⁶ By allowing for the prevention of blight, the Act can stop blight before it occurs, which in turn can save cities millions and can save homeowners from the heartache of homeownership loss.⁸⁷

2. PROPERTIES WITH UNDERWATER MORTGAGES MEET THE ACT’S BLIGHT DEFINITION

Even though the Act provides for the prevention of blight, a city may not condemn an underwater mortgage unless the associated property fits within the Act’s “blight” definition.⁸⁸ The Act, like other states’ blight statutes,⁸⁹ contains a section that lists the factors to be considered

83. Colin Gordon, *Blighting the Way: Urban Renewal, Economic Development, and the Elusive Definition of Blight*, 31 FORDHAM URB. L.J. 305, 307–08 (2004). If homes with underwater mortgages go into foreclosure, such “unsafe or insufficient” conditions may occur, which is why the Plan’s ability to prevent these conditions from occurring in the first place is so important. *Id.* at 307; *see infra* Part II.A.2.

84. Gordon, *supra* note 83, at 307. Redevelopment policies addressed “[i]amentable urban conditions” including “the encroachment of commercial or industrial properties on residential neighborhoods, the inadequacy of basic public services, and the threat of moral decay, fire, and disease posed by tenement housing of urban working families.” *Id.* at 308.

85. *See infra* Part II.A.2.

86. *See infra* Part II.A.2.

87. Georgia Pabst, *Tom Barrett Names Staffers to Head Effort Targeting Blighted Homes*, MILWAUKEE J. SENTINEL (Jan. 8, 2014), <http://www.jsonline.com/news/milwaukee/tom-barrett-names-staffers-to-head-effort-targeting-blighted-homes-b99180458z1-239328541.html> (The mayor of Milwaukee named two city staffers “to lead the \$11.7 million effort to focus on city-owned vacant and abandoned property and reduce the impact of blighted homes brought on by the foreclosure crisis.”).

88. ROBINSON & COLE, URBAN BLIGHT: AN ANALYSIS OF STATE BLIGHT STATUTES AND THEIR IMPLICATIONS FOR EMINENT DOMAIN REFORM 1 (2007), *available at* <http://www.ocpa-oh.org/Foreclosures%20and%20Crime/Urban%20Blight%20-%20An%20Analysis.pdf> (“If the area cannot be considered a ‘blighted area,’ as the term is defined in the applicable urban renewal statute, then the government cannot condemn property in that area.”).

89. *See, e.g.*, 315 ILL. COMP. STAT. ANN. 5/3(j) (West 2010) (“‘Slum and Blighted Area’ means”); IOWA CODE ANN. § 403.17(5) (West 2011) (“‘Blighted area’ means”); MINN. STAT. ANN. § 469.002, subd.14(10) (West 2014) (“‘Blighted area’ means”).

when determining whether the property is blighted.⁹⁰ Through proper application of the Act's blight factors, the government can use its eminent domain power to condemn blighted areas or individual blighted properties for the purpose of blight elimination or prevention.⁹¹

The Act's blight definition covers both blighted areas and blighted properties.⁹² Because an underwater mortgage can only be condemned if its associated property is "blighted," the definition of "blighted property" is more relevant. The pertinent portion of that definition is as follows:

"Blighted property" means any property within a city,⁹³ whether residential or nonresidential, which by reason of dilapidation, deterioration, age or obsolescence . . . or the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, is conducive to ill health, transmission of disease . . . juvenile delinquency or crime . . . substantially impairs or arrests the sound growth of a city, retards the provisions of housing accommodations or constitutes an economic or social liability and is a menace to the public health, safety, morals or welfare in its present condition and use.⁹⁴

The factors enumerated in this definition fall into two categories: (1) cause factors (i.e., factors that cause property to be blighted) and (2) effect factors (i.e., factors that describe the effects stemming from the conditions of blight).⁹⁵ The Act's cause factors include: dilapidation,

90. WIS. STAT. § 66.1333(2m)(b)–(bm) (2011–12).

91. ROBINSON & COLE, *supra* note 88, at 15 ("The workhorse of most [urban renewal] statutes can be found in the specific statutory sections that enumerate the factors which should be considered when determining whether a particular parcel of land is blighted. It is in the application of these factors that a particular parcel of land can be subjected to the governmental power of eminent domain . . .").

92. § 66.1333(2m)(b)–(bm).

93. It is important to note that this definition limits its application to blighted property located within cities, as opposed to villages or other municipalities; therefore, the application of the procedure defined in this Comment is limited to Wisconsin cities. The difference between a city and a village involves its form of executive organization and its size. WIS. LEGISLATIVE REFERENCE BUREAU, STATE OF WISCONSIN 2009 – 2010 BLUE BOOK 249 (2009–10), *available at* <http://legis.wisconsin.gov/lrb/bb/09bb/pdf/243-252.pdf>. Generally, the minimum population for incorporation of villages is 150 residents for isolated villages and 2,500 for metropolitan villages. *Id.* The minimums for cities are 1,000 and 5,000, respectively. *Id.* For a list of Wisconsin cities, villages, townships, and unincorporated places, see WIS. STATE VITAL RECORDS OFFICE, WIS. DEP'T OF HEALTH SERV., WISCONSIN CITIES, VILLAGES, TOWNSHIPS AND UNINCORPORATED PLACES LISTING (2014), *available at* <http://www.dhs.wisconsin.gov/vitalrecords/pdf/cvt.pdf>.

94. § 66.1333(2m)(bm).

95. ROBINSON & COLE, *supra* note 88, at 15 ("The blight factors can be divided into two categories: (1) those factors that are indicative of a blighted area, or can be seen

deterioration, age or obsolescence, conditions that endanger life or property by fire and other causes, ill health, transmission of disease, juvenile delinquency, and crime.⁹⁶ The Act's effect factors include: substantially impairs the sound growth of the city; retards the provisions of housing accommodations; economic or social liability; and is a menace to the public health, safety, morals, or welfare in its present condition and use.⁹⁷

Properties with underwater mortgages meet the “blighted property” definition in both cause and effect, because there is a direct correlation between underwater mortgages and foreclosure—“[a]s the number of homeowners who are underwater rises, so do foreclosures.”⁹⁸ In 2011, the Financial Crisis Inquiry Commission put together a report examining the causes of the then-current financial and economic crisis in the United States.⁹⁹ The report indicates that underwater mortgages are the most important factor contributing to mortgage default¹⁰⁰ because “[w]hen the borrower has negative equity, unemployment acts as one of many possible catalysts, increasing the probability of default.”¹⁰¹ While some borrowers default without choice, others actively choose to default—known as “strategic default”—in order to get out of these bad investments.¹⁰²

as the ‘cause’ of blight, and (2) those factors that describe the effects that stem from the conditions of blight.”).

96. See § 66.1333(2m)(bm).

97. See *Id.*

98. Charles Hugh Smith, *Real Estate: The Worrying Numbers Behind Underwater Homeowners*, DAILY FIN. (Aug. 7, 2010, 6:00 AM), <http://www.dailyfinance.com/2010/08/07/real-estate-underwater-homeowners/> (“The data confirms the common-sense expectation that there’s a direct correlation between negative equity and foreclosures: As the number of homeowners who are underwater rises, so do foreclosures.”).

99. FIN. CRISIS INQUIRY COMM’N, FINANCIAL CRISIS INQUIRY REPORT, at xi (2011).

100. *Id.* at 402–03 (“The causes of foreclosures have been analyzed by many academics and government agencies. Two events are typically necessary for a mortgage default. First, monthly payments become unaffordable owing to unemployment or other financial hardship, or because mortgage payments increase. And second (in the opinion of many, now the more important factor), the home’s value becomes less than the debt owed—in other words, the borrower has negative equity.”).

101. *Id.* at 403 (quoting Laurie Goodman, a senior managing director with Amherst Securities).

102. Amy Loftsgordon, *Strategic Default: When It Makes Sense to Walk Away from Your Home*, NOLO, <http://www.nolo.com/legal-encyclopedia/strategic-default-when-it-makes-sense-walk-away-from-your-home.html> (last visited Nov. 10, 2014) (“Many properties have become so far underwater . . . that it could take years before the home regains all of its value, if it ever does. In some cases, borrowers choose to stop making payments, even if they could afford to stay current, simply because the home has become a bad investment.”).

Foreclosed homes and homes in the foreclosure process constitute blight for several reasons. First, they meet the “cause factors” of the “blighted property” definition because a large number of foreclosed homes and homes in the foreclosure process are left vacant.¹⁰³ An analysis by RealtyTrac found that on a national level, 21 percent of properties actively in the foreclosure process were flagged as vacant.¹⁰⁴ Sometimes dubbed “zombie foreclosures,” such properties have been vacated by the distressed homeowner but have not yet been repossessed by the foreclosing lender.¹⁰⁵ The high number of zombie foreclosures is “a byproduct of lengthy foreclosure timelines and changing state foreclosure statutes.”¹⁰⁶ According to Federal Reserve Board Governor Elizabeth Duke, “[t]he potential fallout of high rates of vacancy—blight, crime, lowered home values, and decreased property tax revenue—is the same for every neighborhood and community.”¹⁰⁷

Vacant foreclosed homes are often left in such a state for long periods and thus become dilapidated, deteriorated, and obsolete, and in turn create conditions that endanger life or property by fire or other causes.¹⁰⁸ These vacant homes also become a breeding ground for crime.¹⁰⁹ The dilapidated conditions of these homes, including unkempt lawns and failing roofs, “advertise to thieves that the home is empty,” and these opportunists will “rob the home of copper pipes, copper

103. Barbara Liston, *Foreclosed ‘Zombie’ Homes Exceed 300,000 Properties: Study*, HUFFINGTON POST (May 30, 2013, 5:12 AM), http://www.huffingtonpost.com/2013/03/30/foreclosed-zombie-homes_n_2974263.html (noting that the overall number of homes “in foreclosure or bank-owned rose by 9 percent to 1.5 million properties nationally in the first quarter of 2013 compared to a year ago”); Ginny Walker, *Zombie Foreclosures Still a Lingering Legacy of the Housing Crisis*, REALTYTRAC (June 25, 2014), <http://www.realtytrac.com/content/news-and-opinion/zombie-foreclosures-still-a-lingering-legacy-of-the-housing-crisis-8095>.

104. Walker, *supra* note 103.

105. *Id.*

106. *Id.*

107. Octavio Nuiry, *America’s 14.2 Million Vacant Homes: A National Crisis*, REALTYTRAC (Nov. 22, 2013), <http://www.realtytrac.com/content/news-and-opinion/americas-142-million-vacant-homes-a-national-crisis-7723> (quoting Elizabeth A. Duke, Federal Reserve Board Governor).

108. Jane Jerrard, *As Foreclosures Rise, Departments Should Review Vacant-Structure Policies*, FIRE FIGHTER NATION (Feb. 28, 2009), <http://www.firefighternation.com/article/firefighting-operations/foreclosures-rise-departments-should-review-vacant-structure-policies> (According to Russ Sanders, Executive Secretary of the Metropolitan Fire Chiefs Section of the National Fire Protection Agency, high numbers of vacant structures (due to foreclosure or otherwise), are “a very important issue in the fire service; more vacant buildings mean more fire problems and more firefighter safety problems.”).

109. Brigitte Yuille, *Don’t Let Foreclosed Homes Ruin Your Neighborhood*, INVESTOPEDIA, <http://www.investopedia.com/articles/mortgages-real-estate/10/foreclosed-homes-ruin-value.asp> (last visited Nov. 10, 2014).

wiring, appliances and fixtures,” and the home will also “become a magnet for vandalism, drug dealers, prostitution and violent crimes.”¹¹⁰ To combat these problems, some jurisdictions, such as the city of Milwaukee, require registration of vacant foreclosed properties to ensure that lienholders will take actions to secure and maintain the premises.¹¹¹ Passed in 2009, Milwaukee’s ordinance “is intended to reduce and prevent neighborhood blight, to ameliorate conditions that threaten the health, safety and welfare of the public, to promote neighborhood stability and residential owner occupancy by preserving the condition and appearance of residential properties, and to maintain residential property values and assessments.”¹¹² However, within nearly one year of enacting the ordinance, only 15 percent of vacant buildings in Milwaukee were properly registered.¹¹³

Beyond the apparent “cause factors” associated with vacant foreclosed buildings, these structures also meet the “effect factors” of the “blighted property” definition because they impair the sound growth of the city, retard the provisions of housing accommodations, and pose economic and social liabilities. First, foreclosed homes negatively affect local property values.¹¹⁴ Studies indicate that nearby vacant foreclosed property “can reduce area property values by as much as ten percent.”¹¹⁵ As a result, some homeowners have even attempted to buy neighboring foreclosed homes in order to preserve their neighborhoods.¹¹⁶ Second,

110. *Id.*

111. Brian Quirk, *Wisconsin: Milwaukee Vacant Property Registration Ordinance*, USFN, http://usfn.org/AM/Template.cfm?Section=USFN_E_Update&Template=/CM/HTMLDisplay.cfm&ContentID=13271 (last updated June/July 2009). Under the ordinance, lienholders must pay a \$35 fee for registration. *Id.* Through an abatement order, the Commissioner of Neighborhood Services can order lienholders to clear sidewalks, mow, clean up graffiti, and more. *Id.* Failure to register or comply with the abatement order can subject lienholders to a fine between \$100 and \$2,000 plus costs. *Id.* Failure to pay this fine can result in imprisonment for 10 to 60 days. *Id.*

112. MILWAUKEE, WIS., BUILDING AND ZONING CODE § 200-22.5(1.5) (2014).

113. Willie L. Hines Jr., *The Burden of Vacant Buildings*, MILWAUKEE J. SENTINEL (Dec. 20, 2010), <http://www.jsonline.com/news/opinion/112212659.html>.

114. Zhenguang Lin, Eric Rosenblatt & Vincent W. Yao, *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL EST. FIN. & ECON. 387, 389 (2009) (“[C]onservative estimates indicate that each conventional foreclosure within one eighth of a mile of a single-family home results in a decline of 0.9% in value.”).

115. John P. Harding, Eric Rosenblatt & Vincent W. Yao, *The Contagion Effect of Foreclosed Properties 2* (July 28, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1160354.

116. Teke Wiggin, *Buy the Vacant Foreclosure Next Door? Even with the Money, It’s Not Always So Easy*, AOL REAL EST. (Oct. 11, 2012, 6:00 PM), <http://realestate.aol.com/blog/2012/10/11/buy-the-vacant-foreclosure-next-door-even-with-the-money-its/#!slide=865012> (Florida resident sought to buy vacant foreclosed property located across the street from her home for fear that the “property would continue to deteriorate and soon blight her neighborhood.”).

foreclosure not only results in financial loss to the homeowner, but also reduces the homeowner's access to stable, decent housing.¹¹⁷ This is because foreclosure significantly damages credit ratings, which hurts "owners' prospects in credit, labor and insurance, and rental housing markets."¹¹⁸ Third, local governments lose tax revenue because of the foreclosure.¹¹⁹ This is a result of both the decrease in property values and the added expenditures to increase public safety, maintain the blighted property, and more.¹²⁰ Lastly, housing is a critical driver of the overall U.S. economy, as housing is "a source of economic vitality and growth."¹²¹

Ultimately, even though properties with underwater mortgages are not necessarily "blighted properties" in their current state, the Act calls for the *prevention* of blight.¹²² By following Richmond's plan, Wisconsin cities can prevent blight by significantly reducing the likelihood of foreclosure. Furthermore, even though underwater mortgages and foreclosed homes are not specifically enumerated within the Act's definition of "blighted property," section 66.1333(17) indicates that the Act "shall be construed liberally to effectuate its purposes."¹²³ Therefore, despite the fact that eminent domain statutes are generally strictly construed,¹²⁴ the Act's "specific direction to construe the statute liberally . . . controls, and the statute is to be liberally applied."¹²⁵

3. THE NECESSARY PROCEDURES OF THE PLAN ARE PROVIDED FOR IN THE ACT

The Act calls for the prevention of blighted properties, and properties with underwater mortgages meet the Act's definition of

117. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUSING POL'Y DEBATE 57, 58 (2006).

118. *Id.*

119. ALLIANCE OF CAL. FOR CMTY. EMPOWERMENT ET AL., HOME WRECKERS: HOW WALL STREET FORECLOSURES ARE DEVASTATING COMMUNITIES 1 (2011), available at <http://www.calorganize.org/sites/default/files/Home-Wreckers-Report-March-16-2011.pdf> ("As housing values decline, property tax revenue losses are estimated to be \$3.8 billion – \$2,058 property tax loss for every foreclosure.").

120. *Id.* These costs are estimated to be \$17.4 billion, or \$19,229 per foreclosure. *Id.*

121. BIPARTISAN POLICY CTR., *supra* note 1, at 15.

122. WIS. STAT. § 66.1333(2) (2011–12).

123. *Id.* § 66.1333(17).

124. *Grunwald v. Cmty. Dev. Auth. of West Allis*, 202 Wis. 2d 471, 485, 551 N.W.2d 36 (1996) ("Grunwald correctly argues that generally eminent domain statutes are strictly construed.").

125. *Id.*

“blighted property” because of the increased likelihood of foreclosure of properties with underwater mortgages. The Plan calls for a five-step process.¹²⁶ Because the Wisconsin Supreme Court said that, in combating blight through the use of eminent domain, cities “must proceed under a specific statute,”¹²⁷ the Act must also provide for the procedures used in the Plan.

It is important to note that the city must first set up a redevelopment authority in order to proceed under the Act.¹²⁸ The Wisconsin Legislature found that a redevelopment authority “constitutes a more effective and efficient means for preventing and eliminating blighted areas in the city and preventing the recurrence of blighted areas.”¹²⁹ In order to exercise its powers, the redevelopment authority must create a resolution “declaring in substance that there exists within the city a need for blight elimination, slum clearance and urban renewal programs and projects.”¹³⁰ Once two-thirds of the local legislature votes in favor of the resolution, the head of the city government will appoint seven city residents as commissioners of the authority who may exercise the authority’s powers enumerated in section 5 of the Act.¹³¹

In the first step of the Plan, the redevelopment authority would set up new loan securitization trusts with the help of a private firm.¹³² Under section 5(a)2 of the Act, an authority may “enter into any contracts determined by the authority to be necessary.”¹³³ As a result, the redevelopment authority can enter into a contract with a private firm in order to set up the new loan securitization trusts.

In the second step of the Plan, the redevelopment authority would raise money from private investors.¹³⁴ Under section 5(a)4.a of the Act, an authority may “apply for and accept advances, loans, grants, contributions, and any other form of financial assistance from the city in which it functions, from the federal government, the state, county, or other public body, or from any sources, public or private for the purposes of this section.”¹³⁵ Therefore, it is permissible for the redevelopment

126. *See supra* Part I.A.

127. *Sigma Tau Gamma Fraternity House Corp. v. City of Menomonie*, 93 Wis. 2d 392, 402, 288 N.W.2d 85 (1980).

128. § 66.1333(3)(a)1.

129. *Id.*

130. *Id.* § 66.1333(3)(a)2.

131. *Id.* § 66.1333(3)(a)2.–3. The Act specifically permits the redevelopment authority to acquire property by eminent domain under Chapter 32. *Id.* § 66.1333(3)(f).

132. *See supra* Part I.A.

133. § 66.1333(5)(a)2.

134. *See supra* Part I.A.

135. § 66.1333(5)(a)4.a.

authority to raise money from private investors to assist in blight prevention.

After raising money from private investors, the redevelopment authority would use this money to fund the third step: using its eminent domain power to condemn the mortgage notes and take control of them from the old securitization trusts¹³⁶ and use the money raised in step two to pay the old trusts just compensation.¹³⁷ Under section 3(f) of the Act, “[t]he authority may proceed with the acquisition of [the] property by eminent domain.”¹³⁸ The Act further provides for the use of eminent domain to acquire mortgages in section 5(a)3: the redevelopment authority may “acquire by purchase, lease, *eminent domain*, or otherwise, any real or personal property or *any interest in the property*.”¹³⁹ Therefore, the redevelopment authority can permissibly use eminent domain to condemn underwater mortgages.

In the Plan’s fourth step, the redevelopment authority would write down the principal to create equity for the homeowner.¹⁴⁰ This is the one step that is not necessarily provided for in the Act;¹⁴¹ however, section 5(a)8 says that the authority may “[e]xercise other powers that may be required or necessary to effectuate the purposes of this section.”¹⁴² Writing down the principal is an integral part of the Plan because it creates equity for the homeowner, thus stemming foreclosures and in turn preventing blight.

In the fifth and final step of the Plan, the redevelopment authority would transfer the refinanced loan to the new securitization trust. Under section 9(a)1.a of the Act, “[u]pon the acquisition of any real property in the project area, the authority may lease, sell or otherwise transfer to a redevelopment company, association, corporation or public body, or to an individual, limited liability company or partnership, all or any part of the real property.”¹⁴³ However, before the redevelopment authority can transfer the refinanced loan, “a report as to the terms, conditions and other material provisions of the transaction shall be submitted to the local

136. “Old securitization trust” refers to the original owner of the mortgage. *See* Hockett, *supra* note 46, at 30.

137. *See supra* Part I.A.

138. § 66.1333(3)(f). For further detail on eminent domain procedure, see *infra* Part II.B.

139. § 66.1333(5)(a)3. (emphasis added).

140. *See supra* Part I.A.

141. *See generally* § 66.1333(5)(a).

142. *Id.* § 66.1333(5)(a)8.

143. *Id.* § 66.1333(9)(a)1.a.

legislative body,” which must “approve the report prior to the authority proceeding with the disposition of the real property.”¹⁴⁴

B. The Procedure for Condemning Underwater Mortgages Is Permissible Under Wisconsin’s Eminent Domain Statute

Section 5(b)1 of the Act requires “[c]ondemnation proceedings for the acquisition of real property necessary or incidental to a redevelopment project” to be “conducted in accordance with ch. 32, or any other law relating specifically to eminent domain procedures or redevelopment authorities.”¹⁴⁵ Chapter 32 is Wisconsin’s eminent domain statute. This statute enumerates who may condemn and for what purposes they may use their condemnation power and the procedures utilized in condemnation.¹⁴⁶

Section 32.01(1) of the statute, which defines “person,” includes a redevelopment authority created under the Act.¹⁴⁷ Furthermore, section 32.02(11) specifically lists redevelopment authorities as an entity that “may acquire by condemnation any real estate and personal property appurtenant thereto *or interest therein* which they have power to acquire . . . for the purposes specified.”¹⁴⁸

Section 32.03(6)(a) defines blighted property, in relevant part, as:

Any property that by reason of abandonment, dilapidation, deterioration, age or obsolescence . . . unsanitary or unsafe conditions, deterioration of site or other improvements, or the existence of conditions that endanger life or property by fire or other causes, or any combination of such factors, is detrimental to the public health, safety, or welfare.¹⁴⁹

However, under this statute, property that consists of only one dwelling unit is not blighted property unless, in addition, at least one of the following applies: (1) the property is not occupied by the owner, or (2) the crime rate in, on, or adjacent to the property is at least three times the crime rate in the remainder of the municipality in which the property is located.¹⁵⁰ If the property with an underwater mortgage does not meet

144. *Id.* § 66.1333(9)(d)1.d. The Act’s definition of “real property” includes lands together with every interest in the land including mortgages. *Id.* § 66.1333(2m)(j).

145. *Id.* § 66.1333(5)(b)1.

146. WIS. STAT. §§ 32.02–.04 (2011–12).

147. *Id.* § 32.01(1).

148. *Id.* § 32.02(11) (emphasis added).

149. *Id.* § 32.03(6)(a).

150. *Id.*

these requirements, redevelopment authorities will simply need to condemn multiple properties.¹⁵¹

III. WHY WISCONSIN CITIES SHOULD CONDEMN UNDERWATER MORTGAGES

At the end of the second quarter in 2014, 10.9% of residential properties with a mortgage in Wisconsin had negative equity, as compared to 10.7% nationwide.¹⁵² Even though Wisconsin's negative equity rate as a whole is only slightly above the national average, some Wisconsin cities are far above average. For example, approximately 32% of homes in the city of Racine and 37.5% of homes in the city of Milwaukee are underwater.¹⁵³ Over 46% of homes in four Milwaukee zip codes are underwater, meaning these zip codes have more underwater mortgages than 99% of zip codes nationwide.¹⁵⁴ There is an obvious problem in these cities, yet neither city has used a method as novel or extreme as the Plan to address underwater mortgages; however, because these cities have already created redevelopment authorities, they can easily proceed under the Plan.¹⁵⁵

Because of the high number of underwater mortgages in Milwaukee and Racine, these cities in particular should implement the Plan in order to prevent the blight associated with foreclosure.¹⁵⁶ The high number of underwater mortgages combined with two of the highest unemployment rates in the state¹⁵⁷ increase the likelihood of strategic default¹⁵⁸ and

151. It is important to note the difference in the construction of the Act and the condemnation statute. The Act calls for liberal construction, while condemnation statutes are strictly construed. Braun, *supra* note 74. It remains unclear if and how the condemnation's construction will affect the Act. *See supra* Part I.C.

152. CORELOGIC EQUITY REPORT, *supra* note 10, at 3, 13.

153. *Where Are Home Loans Underwater?*, *supra* note 33 (This calculation was done by taking an average of the 20 Milwaukee zip codes and three Racine zip codes for which Zillow had data). Milwaukee and Racine are not the only cities experiencing high underwater mortgage rates. Other city zip codes with high rates include: 53703 (Madison) at 30% and 53143 (Kenosha) at 37%. *Id.*

154. *Id.* These zip codes are: 53204 (46%), 53216 (47%), 53209 (49%), and 53218 (50%). *Id.*

155. *See Redevelopment Authority of the City of Milwaukee*, CITY OF MILWAUKEE, <http://city.milwaukee.gov/racm#.Ut9VmGTnZhE> (last visited Nov. 10, 2014); *Welcome to the Department of City Development*, CITY OF RACINE, WISCONSIN, <http://www.cityofracine.org/Development.aspx> (last visited Nov. 10, 2014).

156. *See supra* Part II.A.2.

157. SECRETARY'S OFF., DEP'T OF WORKFORCE DEV., WISCONSIN LOCAL EMPLOYMENT & UNEMPLOYMENT ESTIMATES RELEASED (2014), available at http://www.thewheelerreport.com/wheeler_docs/files/0924dwd.pdf. In August 2014, Racine had an unemployment rate of 9.6%, while Milwaukee had an unemployment rate of 8.3%. *Id.* Racine had the overall highest unemployment rate in the state, while Milwaukee was the

foreclosure in these cities, thereby greatly increasing expenditures to eliminate blight¹⁵⁹ when it could be prevented through implementation of the Plan. In 2013, Governor Scott Walker unveiled a \$2 million blight elimination plan in Milwaukee.¹⁶⁰ Additionally, Wisconsin borrowers may be more likely to strategically default because “[m]ost large national lenders foreclosing in Wisconsin waive any and all rights to a deficiency judgment”; therefore, Wisconsin borrowers do not have to worry about this liability.¹⁶¹

This Part explains the importance of Richmond’s plan and why local governments of Wisconsin should adopt the Plan. Primarily, blight prevention benefits individuals, the public, the local government, and lenders alike. Combined, Parts II and III emphasize that Wisconsin cities can and should follow Richmond’s lead and use their eminent domain powers to condemn underwater mortgages in order to prevent the dissemination of blight.

A. Potential Backlash of the Plan Is Outweighed by Its Benefits

Before discussing the many benefits of the Plan, it is important to note that the Plan presents potential backlash. There are numerous arguments questioning the constitutionality of the Plan. First, opponents argue that the Plan results in an impermissible taking of private property under the Fifth Amendment.¹⁶² Second, opponents argue that the Plan violates the Contracts Clause.¹⁶³ Lastly, opponents argue that the Plan

third highest after Beloit. *Id.* Wisconsin’s overall unemployment rate was 5.6% compared to 6.1% nationwide. *Id.* at 1.

158. See *supra* notes 102–06 and accompanying text.

159. See Pabst, *supra* note 87 and accompanying text; see also Press Release, Office of the Governor, Governor Scott Walker Unveils \$2 Million Blight Elimination Program for Milwaukee (Sept. 17, 2013), available at <http://www.wisgov.state.wi.us/newsroom/press-release/governor-scott-walker-unveils-2-million-blight-elimination-program-milwaukee> (“Vacant, dilapidated properties can serve as a haven for criminal activity, have an adverse impact on property values, and hinder economic growth’ [The program] will help Milwaukee “improve public safety in its neighborhoods through the elimination of blighted properties.”).

160. See Press Release, Office of the Governor, *supra* note 159.

161. Mark Richard Cummisford, *Advising Clients Facing Foreclosure*, WIS. LAW., Dec. 2007, at 12, 14; see also Loftsgordon, *supra* note 102 (cautioning that borrowers considering strategic default should be aware that they may be liable for a deficiency judgment). A deficiency judgment may occur when “the total debt owed by the borrower to the lender . . . exceeds the foreclosure sale price.” *Id.* “The difference between the sale price and the total debt is called a ‘deficiency.’” *Id.*

162. Memorandum from Walter Dellinger et al., O’Melveny & Myers LLP, to Sec. Indus. & Fin. Mkts. Ass’n 1, 3 (July 16, 2012), available at <http://www.sifma.org/issues/item.aspx?id=8589939523>.

163. *Id.* at 2.

impermissibly burdens interstate commerce in violation of the Commerce Clause.¹⁶⁴ In addition to these supposed constitutional violations, “financial institutions have warned that mortgage lending would halt in any city that tried eminent domain.”¹⁶⁵ Despite the threats of lawsuits and an end to mortgage lending,¹⁶⁶ the Plan’s many benefits greatly outweigh any potential consequences.

B. Benefits of Blight Prevention

Avoiding foreclosure has many obvious benefits for individual homeowners. First, foreclosure is an expensive process for borrowers. Costs associated with foreclosure include moving expenses and reduced ability to access credit in the future.¹⁶⁷ As a result of their injured credit, borrowers will have a difficult time accessing housing in the future due to weakened ability to borrow and weakened ability to rent.¹⁶⁸ Furthermore, owning a home offers other financial benefits because it “permits the owner to leverage capital, which can help to buy investment properties, start a new business, send a child to college, or save for retirement.”¹⁶⁹ In addition to financial benefits, homeownership also provides important psychological benefits due to the considerable virtue our culture attributes to homeowners.¹⁷⁰

Beyond the individual, avoiding foreclosure is also beneficial for the general public. First, avoiding foreclosure keeps property values high because it stabilizes the housing prices by keeping many homes off the market.¹⁷¹ Furthermore, “each foreclosure in the neighborhood decreases the value of everyone else’s home, which is a drag on the local housing market.”¹⁷² Second, due to the likelihood that these homes will remain vacant, avoiding foreclosure can keep crime and other dangerous conditions at bay.¹⁷³ Neglect and vandalism result in increased fire risk and increased neighborhood crime.¹⁷⁴ Lastly, avoiding foreclosure helps

164. *Id.*

165. Dewan, *supra* note 11.

166. *See supra* note 51 and accompanying text; *see also* Hockett, *supra* note 54, at 6–8.

167. MARK LIEBERMAN, EFFECT OF EXTENDED FORECLOSURE TIMELINES ON LOCAL ECONOMIES, COMMUNITIES, AND HOME VALUES 6 (2013).

168. Immergluck & Smith, *supra* note 117, at 58.

169. Godsil & Simunovich, *supra* note 2, at 954.

170. *Id.*

171. GRIFFITH & EIZENGA, *supra* note 38, at 2–3.

172. *Id.* at 2.

173. Jerrard, *supra* note 108; Yuille, *supra* note 109.

174. Jerrard, *supra* note 108; Yuille, *supra* note 109.

keep consistent tax revenue, which means police, firefighters, and local schools remain funded.¹⁷⁵

In addition to individuals and the general public, the government benefits from the Plan for several reasons. First, by condemning underwater mortgages before foreclosure occurs, local governments can avoid significant direct costs associated with foreclosure, including “increased policing and fire suppression, demolition contracts, building inspections, legal fees, and expenses associated with managing the foreclosure process.”¹⁷⁶ One study estimates that a “single mortgage failure, especially one that leaves the home vacant and unsecured, can impose tens of thousands of dollars of costs on cash-strapped public agencies.”¹⁷⁷ In addition to avoiding direct outward costs, implementing this plan assures that tax revenues remain steady because borrowers in financial distress often stop paying property taxes.¹⁷⁸ Furthermore, if foreclosure leads to demolition, the local government “faces additional property tax losses because it must remove the assessed value of the structure from its tax roles.”¹⁷⁹

Finally, lenders themselves might benefit from the Plan due to the expense of foreclosure. Lender’s costs associated with foreclosure include “the shortfall between the ultimate sales price and the mortgage balance” and carrying costs, which include legal, property management, sales expenses, and forgone interest costs.¹⁸⁰ Through this plan, lenders will likely get more money because they will get close to the fair market value of the property, but avoid the expenses associated with foreclosure.¹⁸¹

CONCLUSION

In order to protect its communities, Richmond, California, has taken steps to implement a plan under which it would use its eminent domain power to stop foreclosure before it occurs. By using a multi-step process to condemn underwater mortgages, Richmond hopes to prevent the blight associated with foreclosure. Close to 8,000 foreclosures were completed in Wisconsin by mid-2014.¹⁸² Foreclosures cause blight in these

175. See WILLIAM C. APGAR & MARK DUDA, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY’S MORTGAGE FORECLOSURE BOOM 7 (2005), available at http://www.995hope.net/content/pdf/Apgar_Duda_Study_Short_Version.pdf.

176. *Id.* at 6.

177. *Id.* at 4.

178. *Id.* at 7.

179. *Id.*

180. LIEBERMAN, *supra* note 167, at 6.

181. See *Id.*; see also Foushee, *supra* note 42 and accompanying text.

182. See CORELOGIC EQUITY REPORT, *supra* note 10, at 9.

Wisconsin communities because they lower housing values, decrease property tax revenue, and often become breeding grounds for crime.

Fortunately, Wisconsin's Blight Elimination and Slum Clearance Act authorizes local governments to use eminent domain to prevent blight. The five key steps of Richmond's plan are permitted under the Act. Ultimately, by using the Blight Elimination and Slum Clearance Act, Wisconsin's local governments can and should condemn underwater mortgages in order to stop the dissemination of blight.