John P. Relman*
Glenn Schlactus (SBN 208414)
Jamie L. Crook (SBN 245757)
RELMAN, DANE & COLFAX PLLC
1225 19th St. NW, Suite 600
Washington D.C. 20036
Telephone: (202) 728-1888
Facsimile: (202) 728-0848
jrelman@relmanlaw.com
gschlactus@relmanalw.com
jcrook@relmanlaw.com
* Subject to admission *pro hac vice*

Marcia Rosen (SBN 67332)
Kent Qian (SBN 264944)
NATIONAL HOUSING LAW PROJECT
703 Market Street, Suite 2000
San Francisco, CA 94103
Telephone: (415) 546-7000
Facsimile: (415) 546-7007
mrosen@nhlp.org
kqian@nhlp.org

Attorneys for Amici Curiae National Housing Law Project, Housing and Economic Rights Advocates, Bay Area Legal Aid, California Reinvestment Coalition, and Law Foundation of Silicon Valley

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

WELLS FARGO BANK, NATIONAL ASSOCIATION, as Trustee, *et al.*, Plaintiffs, v. CITY OF RICHMOND, CALIFORNIA, a municipality, and MORTGAGE RESOLUTION PARTNERS LLC, Defendants.	Case No. CV-13-3663-CRB **MEMORANDUM OF *AMICI CURIAE* NATIONAL HOUSING LAW PROJECT, HOUSING AND ECONOMIC RIGHTS ADVOCATES, BAY AREA LEGAL AID, CALIFORNIA REINVESTMENT COALITION, AND LAW FOUNDATION OF SILICON VALLEY IN SUPPORT OF DEFENDANTS' OPPOSITION TO PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION** Date: September 12, 2013 Time: 10:00 a.m. Judge: Honorable Charles R. Breyer Courtroom 6, 17th Floor

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Amici curiae National Housing Law Project ("NHLP"), Housing and Economic Rights Advocates ("HERA"), Bay Area Legal Aid ("BayLegal"), the California Reinvestment Coalition ("CRC"), and the Law Foundation of Silicon Valley ("Law Foundation") (collectively, "NHLP *et al.*" or "*Amici*") are non-profit organizations based in California that provide legal services and direct representation, and engage in policy advocacy efforts on behalf of low-income communities. Ensuring compliance with state and federal fair housing laws and promoting and protecting homeownership for low-income Californians is fundamental to *Amici*'s organizational missions.

Amici have a vital interest in preserving local governments' ability to address the extraordinary harm inflicted by the underwater mortgage and foreclosure crisis on communities like the City of Richmond ("Richmond") and many others across the country. *Amici*'s perspective has been formed through their direct work with and on behalf of local and regional communities struggling to recover from this crisis. *Amici*'s interests are set forth in greater detail in their Motion for Leave to Participate as *Amici Curiae*, and to File Memorandum in Support of Defendants' Opposition to Plaintiffs' Motion for Preliminary Injunction, filed simultaneously herewith.

SUMMARY OF ARGUMENT

Amici offer this memorandum to explain why, from a fair lending and national housing policy perspective, the "public interest" prong of the preliminary injunction standard compels denial of the injunction sought by Plaintiffs.

The inextricably intertwined epidemics of underwater mortgages and foreclosures are devastating cities across the country. The crisis, while national in scope, is disproportionately concentrated in high-minority communities like Richmond. The securitization industry has already announced its intent to redline these communities if they seek to address the crisis through their Constitutional power of eminent domain. But the industry's redlining plan – which is the source of all the harm to the public interest that Plaintiffs predict will occur unless Richmond is preliminarily enjoined from using its eminent domain authority – violates the Fair

Housing Act and other federal and state anti-discrimination statutes.

Plaintiffs contend that the sky will fall on Richmond and towns throughout the United States without an injunction: *e.g.*, "catastrophic effects on both the Richmond and national housing markets," Doc. No. 8, Pls.' Not. of Mot. & Mot. for Prelim. Inj.; Mem. P. & A. in Supp. Thereof (Aug. 8, 2013) ("Pls.' Mot.") at 21; "significantly decrease the value of all homes and the demand for housing in those areas." Doc. No. 47, Decl. of D. Duncan (Aug. 29, 2013) ("Duncan Decl.") ¶ 22. But what Plaintiffs are really describing is the expected consequence of the securitization industry's own retaliatory, discriminatory, and illegal scheme to redline Richmond and other towns in violation of the Fair Housing Act (42 U.S.C. § 3601 *et seq.*) ("FHA"), the Equal Credit Opportunity Act (15 U.S.C. § 1691 *et seq.*) ("ECOA"), and similar state laws if Richmond or any other jurisdiction defies the industry and implements the eminent domain proposal.

These anti-discrimination statutes make it illegal to discriminate on the basis of race with respect to all aspects of housing, including mortgage lending. The industry's plan violates this prohibition because it denies basic and critical lending rights to all residents of Richmond, who are disproportionately African-American and Hispanic. This means that the plan would have a clear disparate impact on minorities. There is no legitimate business justification for it.

Because the dire consequences that Plaintiffs predict would result from the industry's intentional and illegal acts, the Court should not presume that they will come to fruition. Richmond, local borrowers, and/or fair housing and fair lending organizations will undoubtedly bring a separate suit if and when the industry seeks to act on its discriminatory redlining plan. At that time, there is every reason to expect that the industry will be enjoined from doing so. *See, e.g.*, *Cmty. House, Inc. v. City of Boise*, 490 F.3d 1041, 1052 (9th Cir. 2006) (plaintiffs entitled to preliminary injunction under the Fair Housing Act to stop enforcement of discriminatory policy).

The Securities Industries and Financial Markets Association ("SIFMA") has already explicitly announced the industry's discriminatory plan. SIFMA has submitted an *amicus* brief here, but (like Plaintiffs and their other supporters) fails to acknowledge this scheme. SIFMA's redlining plan sounds technical, but it is actually very simple and will have immediate and far-

reaching consequences for all Richmond borrowers. On July 19, 2012, SIFMA announced that "loans to borrowers residing in areas" that use eminent domain to take title to mortgage loans "will not be deliverable into TBA [To-Be-Announced] eligible securities . . . ." *See* Exhibit 1, Decl. of G. Schlactus ("Schlactus Decl.") at Ex. A, SIFMA Eminent Domain Statement, at 1. As described in more detail below, the TBA market is the funding pipeline connecting the secondary market for "agency" mortgage-backed securities ("MBS") to the vast majority of individual mortgage loans being made today. If Richmond borrowers are denied access to the TBA market, at a minimum the cost of borrowing in Richmond will go up substantially. Only then might some of Plaintiffs' predictions come true. SIFMA's Head of Securitization has explicitly connected SIFMA's policy to such predictions: "we would expect that *with the intended closure of TBA to such loans* they would be shunned in the markets." Ex. C to Schlactus Decl. (emphasis added).

Because Richmond is 40% Hispanic and 25% African-American, the impact of SIFMA's retaliatory policy will fall disproportionately on minority borrowers. Indeed, across the country the persistence of the underwater mortgage and foreclosure crisis since the housing bubble burst has been concentrated in communities where the population is disproportionately minority. SIFMA's policy will, therefore, have a clear disparate impact on African Americans and Hispanics in violation of the FHA and ECOA. *See The Comm. Concerning Cmty. Improvement v. City of Modesto*, 583 F.3d 690, 714-15 (9th Cir. 2009); *Ramirez v. GreenPoint Mortg. Funding, Inc.*, 633 F. Supp. 2d 922, 926-27 (N.D. Cal. 2008) (recognizing disparate impact claims under the FHA and ECOA).

There is no legitimate business justification for SIFMA's policy. The eminent domain proposal does not affect any loans that are part of agency MBS, a fundamental distinction in the proposal that Plaintiffs ignore. This means that the risks associated with a Richmond loan headed for the TBA market would be unaltered by implementation of the eminent domain proposal. SIFMA and the industry it represents nonetheless threaten to disrupt all "agency" Richmond lending if the use of eminent domain goes forward. This facially overbroad response is purely a retaliatory effort to dissuade Richmond and other local governments from bucking the industry by redlining them.

Plaintiffs wrongly assume in their motion that the securitization industry will be permitted to apply this unlawful and unjustifiable industry policy. This assumption is the conspicuously unstated basis of their dire prediction of great harm to the public interest if the eminent domain proposal is not enjoined. Because SIFMA's policy is brazen redlining, akin to what the lending industry systematically did to minority communities in the past, a court will be asked to block the policy if it is not retracted.

What is actually essential for the public interest is permitting Richmond and other communities to use their eminent domain authority to address the underwater mortgage and foreclosure crisis if their elected officials choose to do so. The crisis could not be greater: nearly a quarter of U.S. homeowners are underwater, and the pace of foreclosures is more than twice what it was before the housing market collapsed. Underwater mortgages and serious delinquencies (which cause loan servicers to foreclose) go hand in hand because underwater borrowers effectively become renters without a long-term financial stake in their property. The resulting foreclosures are extraordinarily destructive. They reduce cities' property tax revenue while heightening the need for municipal services to address increased crime and blight. High-minority communities like Richmond have been especially hard hit because of the well-documented concentration of predatory lending in these communities during the housing boom. Federal action to address the crisis has been marginal, at best, leaving a critical need for local governments to act. The public interest requires allowing them to do so through the traditional local power of eminent domain.

For these reasons, and as discussed more fully below, *Amici* respectfully urge that if the Court does not dismiss the complaint or deny the motion on the ground of ripeness or lack of subject matter jurisdiction, it should find that the public interest strongly favors denying the preliminary injunction sought by Plaintiffs.[1]

[1] Though the ripeness issue is not the subject of this brief, SIFMA and the California Bankers Association, also an *amicus* supporting Plaintiffs, previously admitted that Richmond's Advisory Services Agreement with Mortgage Resolution Partners "does not obligate the City to use eminent domain." Doc. No. 53-2, Ex. C to Memo. of SIFMA and the Chamber of Commerce of the United States of America (Sept. 3, 2013) at 20-21. These same *amici* now assert that this case is ripe, even though Richmond still has not decided to use eminent domain.

ARGUMENT

Plaintiffs are required to show that the preliminary injunction they seek is in the public interest. *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 20 (2008). Without regard to how the Court analyzes the other parts of the preliminary injunction standard, Plaintiffs' motion should be denied because they cannot make this showing. Two considerations in particular demonstrate that denying Richmond the opportunity to implement the eminent domain proposal would substantially *harm*, not further, the public interest.

First, Plaintiffs' hyperbolic predictions about the harms that will befall Richmond, its residents, and the country if the injunction is denied are wrong. Those harms would only come from the securitization industry's illegal retaliation and discrimination against Richmond, which would be challenged in a separate action and not be allowed to stand.

Second, eminent domain is a critical tool that local governments must be able to use to fight the inextricably intertwined crises of underwater mortgages, foreclosures, shrinking municipal budgets, and blight that continue to afflict Richmond and many other cities years after the financial crisis began.

I. PLAINTIFFS' CONTENTION THAT AN INJUNCTION IS NECESSARY TO AVERT GREAT PUBLIC HARM WRONGLY ASSUMES THE SECURITIZATION INDUSTRY WILL BE ALLOWED TO ILLEGALLY DISCRIMINATE AGAINST RICHMOND

Plaintiffs, their declarants, and their supporting *amici* contend that great public harms will inevitably follow if Richmond is permitted to proceed with the eminent domain proposal. Their various predictions range from greatly increased borrowing costs and stricter underwriting requirements for Richmond residents, *see, e.g.*, Doc. No. 11, Decl. of P. Burnaman (Aug. 8, 2013) ¶ 62 ("Aug. 8 Burnaman Decl."); Duncan Decl. ¶ 22, to a shutdown of lending in the city and further deterioration of its financial situation, *see, e.g.*, Doc. No. 10, Decl. of D. Stevens (Aug. 8, 2013) ¶ 20; Doc. No. 48, Dec. of P. Burnaman (Aug. 29, 2013) ¶ 35 ("Aug. 29 Burnaman Decl."), to the end of mortgage lending as we know it across the country, *see, e.g.*, Pls.' Mot. at 21 ("catastrophic effects on both the Richmond and national housing markets"); Aug. 8 Burnaman Decl. ¶ 10 ("change radically the U.S. residential mortgage market and cause

billions of dollars of losses"). But these predictions presume the securitization industry – through SIFMA, an *amicus* here – will be permitted to cause these harms intentionally by retaliating against Richmond with an already-announced illegal and discriminatory redlining policy. That prediction is wrong because any attempt by the industry to do so will not survive a legal challenge. *See, e.g.*, *Cmty. House, Inc.*, 490 F.3d at 1052 (plaintiffs entitled to preliminary injunction under the Fair Housing Act to stop enforcement of discriminatory policy).

A. THE SECURITIZATION INDUSTRY HAS ALREADY ANNOUNCED ITS PLAN TO REDLINE RICHMOND IF A PRELIMINARY INJUNCTION IS DENIED

SIFMA is a major Wall Street trade association representing hundreds of securities firms, banks, and asset managers. SIFMA controls and sets the rules for what is called the "To-Be-Announced (TBA) market."[2] This is the secondary market for, and thereby makes possible, the vast majority of mortgage loans that are backed by Fannie Mae, Freddie Mac, and Ginnie Mae (the "Agencies").[3] The TBA market has been called "the fulcrum of the system of housing finance" in the United States. Michael E. Murphy, *Fannie Mae and Freddie Mac: Legal Implications of a Successor Cooperative*, 10 DePaul Bus. & Com. L.J. 171, 175 (2012). Access to this market is critical for any community.

SIFMA publicly announced last summer that loans in Richmond or any other city that implements the eminent domain proposal will be banned from the TBA market:

> SIFMA is issuing this statement today to introduce a policy regarding the interaction of eminent domain with TBA [To-Be-Announced] trading. Loans to borrowers residing in areas that municipalities have initiated condemnation proceedings to involuntarily seize mortgage loans through their powers of eminent domain will not be deliverable into TBA-eligible securities on a going-forward basis.

Ex. A to Schlactus Decl., SIFMA Eminent Domain Statement, at 1. In other words, if a preliminary injunction is denied and Richmond ultimately chooses to implement the eminent

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[2] *See* Vickery & Wright, *TBA Trading and Liquidity in the Agency MBS Market* (May 2013) at 5, 11 (hereinafter "*TBA Trading*"), *available at* http://www.newyorkfed.org/research/ epr/ 2013/ 1212vick.pdf (accessed on Sept. 8, 2013); Ex. B to Schlactus Decl., TBA Market Fact Sheet, at 2; Ex. D to Schlactus Decl., T. Hamilton Testimony to House Comm. on Fin. Servs., at 12.

[3] Ginnie Mae's guarantees cover Federal Housing Administration and Department of Veterans Affairs mortgages, among others. *See* www.ginniemae.gov.

domain proposal, the securitization industry, through SIFMA, plans on punishing Richmond with the biggest weapon at its disposal. It plans to do so even though the TBA market has nothing to do with any of the loans addressed by the eminent domain proposal. This facially overbroad response is pure retaliation and intimidation, designed to dissuade Richmond and other local governments from exercising their right to use eminent domain when necessary to protect their citizens and the public interest.

An in-depth review of the mechanics of the TBA market is not necessary for purposes of the current proceedings, and we describe them here in broad strokes. Sellers on the TBA market assemble pools of purchase and refinance mortgage loans that satisfy SIFMA's "Good Delivery Guidelines" (formally, the "Standard Requirements for Delivery on Settlements of Fannie Mae, Freddie Mac and Ginnie Mae Securities"). *See TBA Trading* at 5; Ex. B to Schlactus Decl., TBA Market Fact Sheet, at 2. These are "conforming loans," meaning that they conform to criteria needed to obtain a guarantee from one of the Agencies, and satisfy additional SIFMA criteria. Pools of these loans serve as "collateral for bonds which are traded in the TBA market." Ex. B to Schlactus Decl., TBA Market Fact Sheet, at 2. These bonds (*i.e.*, securitized mortgage loans) are called "agency mortgage-backed securities," or "agency MBS," because they have the backing of the Agencies; this means they have the backing of the United States government. TBA market protocols allow mortgages in pools to be treated as fungible by sellers and investors, thereby increasing trading efficiencies and creating "cost savings for lenders that are passed on to borrowers in the form of lower rates." *Id.* at 1.[4]

It is difficult to overstate the importance of the TBA market to mortgage securitization and the availability of good loan terms for individual borrowers. Though the TBA market is not the exclusive vehicle for the creation and sale of agency MBS, "[m]ore than 90 percent of agency MBS trading volume occurs in" the TBA market. *TBA Trading* at 2. SIFMA describes the TBA

[4] *See also* Financial Industry Regulatory Authority, Proposed Rule Change, File No. SR-2012-020 (Mar. 2, 2012) at 7-8, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p125750.pdf (accessed on Sept. 8, 2013) ("Together, the securitization process and the TBA market transform what is a fundamentally heterogeneous universe of individual mortgages and mortgage pools (with myriad credit and prepayment characteristics) into groups of fungible – and therefore liquid – fixed-income instruments.").

market as "a conduit to draw massive amounts of global investment capital to the U.S. mortgage markets" and states that it permits "borrowers to obtain affordable rate locks as they shop for a home, and provide[s] a critical risk management tool for mortgage lenders and servicers." Ex. A to Schlactus Decl., SIFMA Eminent Domain Statement, at 1; *see also id.* ("The TBA markets are the benchmark for all mortgage markets in the country.").[5]

These are the unstated underpinnings of Plaintiffs' contention that mortgage lending will become dramatically more expensive or dry up in Richmond if Richmond goes forward with the eminent domain proposal. If all Richmond loans are banned from the TBA market, lenders will be strongly deterred from lending to Richmond borrowers. As the trading value of Richmond loans plummets, the cost of credit for Richmond borrowers will soar and many will be priced out of the mortgage market. At a minimum it will become much harder to get a loan, and it will be all but impossible to get one with an interest rate and other terms as advantageous as in surrounding communities where a loan can be securitized through the TBA market.

In predicting doom if Richmond is allowed to pursue the eminent domain proposal, Plaintiffs and their supporting *amici* fail to tell the Court that SIFMA plans on deliberately making the prediction come true. SIFMA has been more forthcoming elsewhere. In an e-mail to federal government officials, SIFMA's Head of Securitization and Managing Director stated that "we would expect that with the intended closure of TBA to such loans they would be shunned in the markets." Ex. C to Schlactus Decl.

SIFMA intends to close the TBA market to Richmond loans even though there is no nexus whatsoever between the TBA market and loans that are covered by the eminent domain

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[5] So-called "private label MBS" are very different from agency MBS. The mortgage pools that serve as the collateral for private label MBS do not have the backing of the Agencies or any other implicit or explicit federal government guarantee. Roughly speaking, during the housing boom agency MBS was the securitization route for traditional lending while private label MBS was the securitization route for riskier subprime lending. With the collapse of housing prices and subprime lending, private label securitization shut down. *See TBA Trading* at 1 ("Agency MBS in the amount of $2.89 trillion were issued in 2008 and 2009, but no non-agency securitizations of new loans occurred during this period."). Plaintiffs' own declarant explains that the amount of outstanding private label MBS (which includes securities issued before the crash) is only 12% of the amount of outstanding agency MBS. *See* Aug. 8 Burnaman Decl. ¶ 17. As a practical matter, the TBA market and agency MBS are the only real game in town in today's world, especially for loans to borrowers without substantial resources and stellar credit.

proposal. The eminent domain proposal extends exclusively to loans backing private label MBS and does not touch agency MBS. *See, e.g.*, Doc. No. 9-8, Ex. H to Ertman Decl. at 2 (agenda report prepared by Richmond's city manager identifying the proposal to "identify[] and arrange[] acquisition financing for private label securities mortgages for the purpose of achieving mortgage principal reduction"); Doc. No. 9-10, Ex. J to Ertman Decl. at 3. Simply put, the TBA market has nothing to do with any loans that might be acquired by Richmond under the proposal.

The securitization industry's planned banishment of loans from the TBA market is redlining, pure and simple. Indeed, SIFMA member Amherst Securities Group explained that Agencies would need "to build screens in their systems to filter out certain zip codes." Ex. E to Schlactus Decl. at 13.

B. THE HARM THAT WOULD FLOW FROM THE INDUSTRY'S PLAN SHOULD NOT BE CONSIDERED BECAUSE THE PLAN CONSTITUTES UNLAWFUL DISCRIMINATION

The FHA and ECOA prohibit discrimination in mortgage lending based on race, national origin, and other enumerated classifications. *See* 42 U.S.C. §§ 3604, 3605; 15 U.S.C. § 1691(a). It is well established that the FHA and ECOA prohibit both intentional discrimination as well as practices that disproportionately harm members of a protected class. The latter type of claim ("disparate impact") is actionable regardless of whether there is any intent to discriminate. *See The Comm. Concerning Cmty. Improvement*, 583 F.3d at 711; *Ramirez*, 633 F. Supp. 2d at 926-27. The U.S. Department of Housing and Urban Development ("HUD") recently reemphasized the importance of disparate impact claims by adopting a national regulatory framework for impact claims under the FHA. *See* 24 C.F.R. § 100.500 (Mar. 18, 2013). California state law likewise prohibits discrimination in mortgage lending and supports both intentional discrimination and disparate impact claims. *See* Cal. Gov't Code §§ 12955, 12955.8; *Sisemore v. Master Fin., Inc.*, 151 Cal. App. 4th 1386, 1418-23 (2007).

SIFMA's planned exclusion of all Richmond loans from the TBA market (the "Redlining Policy") would have a clear disparate impact on African Americans and Hispanics in violation of the FHA, ECOA, and state law.

Under HUD's regulatory framework, a plaintiff must first demonstrate a *prima facie* case

that the "challenged practice caused or predictably will cause a discriminatory effect," meaning, *inter alia*, that it "actually or predictably results in a disparate impact on a group of persons." 24 C.F.R. § 100.500(a), (c)(1). The burden of proof then shifts to the defendant to establish, if it can, that the "challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent or defendant." *Id.* § 100.500(c)(2). If the defendant meets this burden of proof, the plaintiff will nonetheless prevail by proving that the "the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect."[6] *Id.* § 100.500(c)(3).

The Redlining Policy will predictably result in a clear and harmful disparate impact on minorities; does not serve any legitimate nondiscriminatory interest of SIFMA or its members; and even if it did, that interest could be served by a much less restrictive practice that SIFMA already utilizes for other types of loans on the TBA market. The Redlining Policy will undoubtedly be held unlawful if SIFMA seeks to apply it against Richmond.

1. The Redlining Policy Would Disproportionately Harm African Americans and Hispanics

The concentration of African Americans and Hispanics in Richmond is vastly greater than in the surrounding area and the country as a whole, and there can be no dispute that being banned from the TBA market would be exceedingly harmful to Richmond residents. Establishing a *prima facie* case will be a simple exercise.

The discriminatory effect of a practice may be assessed by comparing the proportion of the adversely affected population who are members of the protected class at issue to the proportion of the general population who are members of the protected class. For example, if 50% of those adversely affected by a policy are in a protected class while members of that class make up only 10% of the general population, a plaintiff will have demonstrated a *prima facie*

[6] Analysis of ECOA and California law disparate impact claims is comparable. *See Ramirez*, 633 F. Supp. 2d at 927-30 (applying same analysis to plaintiffs' disparate impact claims under the FHA and ECOA); *Nat'l Ass'n for Advancement of Colored People v. Ameriquest Mortgage Co.*, 635 F. Supp. 2d 1096, 1103-04 (C.D. Cal. 2009) (same); *Iniestra v. Cliff Warren Invs., Inc.*, 886 F. Supp. 2d 1161, 1169 (C.D. Cal. 2012) ("Because FEHA is based on the Fair Housing Act, liability under the Fair Housing Act also supports liability under FEHA.").

case of the policy's discriminatory effect and satisfied the first part of a disparate impact analysis. *See, e.g.*, *Gallagher v. Magner*, 619 F.3d 823, 834 (8th Cir. 2010) (*prima facie* case established where 61% of the population seeking affordable housing was African-American but African Americans made up only 11.7% of the City's population); *Smith v. Town of Clarkton*, 682 F.2d 1055, 1060-61, 1065 (4th Cir. 1982) (*prima facie* case established regarding town's withdrawal from low-income authority where 56% of all poverty-level families were African-American and 69.2% of all African-American families were eligible for low-income housing, but African Americans made up only 40% of the general population).

The affected population here is all of Richmond because the Redlining Policy will apply to all loans secured by homes in Richmond. Richmond's population is 40% Hispanic and 25% African-American. *See* Doc. No. 33, Decl. of W. Lindsay (Aug. 22, 2013) ¶ 5 ("Lindsay Decl.").

The general population for comparison may be either that of the surrounding region, because it reflects the area lending market, or the nationwide population, because the TBA market is national. *See Greater New Orleans Fair Hous. Action Ctr. v. St. Bernard Parish*, 641 F. Supp. 2d 563, 568 (E.D. La. 2009) (analysis based on regional data appropriate to assess discriminatory effect of municipal ordinance); *Ramirez*, 633 F. Supp. 2d at 928-29 (considering nationwide data comparing prevalence of high-APR loans among minorities as compared to similarly situated whites where plaintiffs challenged defendant's nationally applied lending policy); *Nat'l Fair Hous. Alliance, Inc. v. Prudential Ins. Co. of Am.*, 208 F. Supp. 2d 46, 50, 60 (D.D.C. 2002) (same). The population of the nine counties that make up the Bay Area region is only 23.5% Hispanic and 6.7% African-American.[7] Nationwide, Hispanics make up 16.9% of the population, and African Americans make up 13.1%.[8]

By either comparison, the Redlining Policy will disproportionately harm African Americans and Hispanics because they are substantially overrepresented in the Richmond population compared to their representation within the Bay Area and the nation. The disparate

[7] San Francisco Bay Area, www.bayarea.census.ca.gov/bayarea.htm (accessed on Sept. 9, 2013).

[8] U.S. Census Bureau, State and County Quick Facts (2012), *available at* http://quickfacts.census.gov/qfd/states/00000.html (accessed on Sept. 6, 2013).

impact is clear.

2. The Redlining Policy Is Not Necessary to Achieve—Or Even Rationally Related To—Any Legitimate Nondiscriminatory Interest

No legitimate interest justifies the clear discriminatory effect that SIFMA's Redlining Policy will have if applied to Richmond. This means that it constitutes unlawful discrimination. See 24 C.F.R. § 100.500(c)(2).

SIFMA has sought to justify its Redlining Policy as necessary to avoid "unpredictable prepayment behavior" in TBA loan pools. Ex. A to Schlactus Decl., SIFMA Eminent Domain Statement, at 1. Predictable mortgage prepayment behavior, it contends, is highly valued by TBA investors who do not want to see their long-term investments pulled out from under them unexpectedly. Whether or not that is so is irrelevant. Only agency MBS can be traded in the TBA market, and the eminent domain proposal by definition would not affect any loans that are securitized through agency MBS. To the contrary, the use of eminent domain would affect only loans that are securitized in private label MBS which, as discussed above, have nothing to do with the TBA market. Early prepayment of loans through the exercise of eminent domain would simply have no impact, prepayment or otherwise, on loans that go through the TBA market and come to rest in agency MBS.

This means that SIFMA's attempt to ascribe heightened prepayment risk to Richmond loans headed for the TBA market is entirely without basis. In truth, the prepayment behavior of such loans would be wholly unaltered by implementation of the eminent domain proposal. As California's Lieutenant Governor stated in a letter to the U.S. Department of Justice:

> [T]here is no legitimate reason for excluding a borrower's federally guaranteed loan from trading the normal way just because a local government acquired another borrower's private loan through eminent domain . . . . Condemning private loans has no impact on federally guaranteed loans.[9]

[9] Ltr. from G. Newsom to E. Holder (Sept. 20, 2012) at 5, *available at* http://www.ltg.ca.gov/09102012_LTG_DOJ_LETTER.pdf (accessed on Sept. 8, 2013). Lieutenant Governor Newsom addressed both antitrust and discrimination violations inherent in the securitization industry's response to the eminent domain proposal. The substantial antitrust concerns, though beyond the scope of this brief, would provide yet another reason for a court to enjoin the Redlining Policy and prevent the dire consequences predicted by Plaintiffs from coming to pass.

The astounding overbreadth of SIFMA's Redlining Policy makes plain that its real purpose is not to protect investor expectations regarding agency MBS. Rather, it is to coerce jurisdictions like Richmond to abandon the eminent domain proposal by raising the price and limiting the availability of mortgage credit across-the-board for all borrowers in the city. It is punishment, not self-protection. This gives rise to a separate and independent cause of action, beyond the disparate impact violation, under 42 U.S.C. § 3617 of the Fair Housing Act for retaliation. *See United States v. City of Hayward*, 36 F.3d 832, 835 (9th Cir. 1994) (recognizing redlining as actionable "interference" under § 3617).

3. Even If the Redlining Policy Served a Legitimate Interest– Which It Does Not—That Interest Could Be Served by a Less Discriminatory Alternative

Even if there were a connection between the Redlining Policy and SIFMA's purported concern about increased prepayment behavior—which there is not—there is a less discriminatory alternative currently utilized by SIFMA with respect to other categories of loans that would adequately address this concern.

SIFMA already allows a limited portion of any TBA pool to be comprised of what it calls "nonstandard" loans. For example, in 2008, the conforming loan limits for the Agencies were increased temporarily from $417,000 to as much as $729,750. *See TBA Trading* at 10. SIFMA promptly announced that the larger "high-balance" loans would not be eligible for trading through the TBA market. *See id.* at 11. In large part it justified this decision on the ground that high-balance loans exhibit greater prepayment activity, the same justification offered now. *See id.*; Ex. D to Schlactus Decl., T. Hamilton Testimony. But when the higher conforming loan limits became permanent, SIFMA adopted a middle ground position that permitted securitization of the nonstandard high-balance loans through the TBA market, subject to "de minimis" limits set forth in its Good Delivery guidelines. *TBA Trading* at 11. As a result, up to 10% of any TBA

pool may be comprised of high-balance loans, notwithstanding any concerns about these loans' different prepayment characteristics.[10]

SIFMA could likewise permit loans from Richmond, or any other jurisdiction that implements the eminent domain proposal, to trade through the TBA market subject to a comparable de minimis limitation. Given the extraordinary size of the TBA market, loans to borrowers from these jurisdictions could easily fit within such a limitation. This would eliminate, or at a minimum dramatically reduce, the disparate impact on these borrowers.

Accordingly, even if the Redlining Policy could survive to the third and final step of a disparate impact analysis (which it cannot), it could not satisfy that step and would be found unlawful.

Because the harms that Plaintiffs predict for Richmond would flow from the Redlining Policy, the Court should not consider them. If SIFMA tries to apply the Redlining Policy to Richmond, many individuals and entities will have a strong incentive to bring suit and the policy will be enjoined, preventing the predicted harms from ever happening.[11]

II. THE PUBLIC INTEREST REQUIRES AFFORDING LOCAL GOVERNMENTS THE ABILITY TO USE THEIR EMINENT DOMAIN POWER TO ADDRESS THE LOCAL HARMS CAUSED BY UNDERWATER MORTGAGES AND FORECLOSURES

Despite Plaintiffs' spurious claim that the public interest would be harmed without an injunction, it is clear that the issuance of an injunction would itself actually cause extensive harm. Underwater mortgages and foreclosures remain at crisis levels in the United States. Six years

[10] In 2008 the Good Delivery guidelines already permitted up to 15% of a pool to be comprised of other nonstandard loans, namely relocation, co-op, and buydown loans. *See* Ex. D to Schlactus Decl., T. Hamilton Testimony, at 26; *see* Fannie Mae, *High Balance Loans in Fannie Mae MBS* (Dec. 2008) at 3, *available at* http://www.fanniemae.com/mbs/pdf/mbsengerhighbalanceloans.pdf (accessed on Sept. 8, 2013).

[11] The securitization industry has lobbied federal regulators to join it in redlining any communities that implement the eminent domain proposal. Were those regulators to acquiesce, their actions would violate the FHA and ECOA for the same reasons as SIFMA's Redlining Policy.

after the housing bubble burst, "23.8 percent of U.S. homeowners with a mortgage were in negative equity, or 'underwater,' at the end of the second quarter [of 2013]," and they "were collectively underwater by approximately $913 billion."[12] Likewise, the number of foreclosures completed each month is 2⅓ times what it was before the crisis.[13] The refrain of Plaintiffs and their supporters is that the epidemic is not quite as bad as it was, but that misses the point; as these national figures and the local Richmond figures set forth in the City Manager's declaration make plain, the situation for a massive number of homeowners remains grim. *See* Lindsay Decl. ¶¶ 6-12.

The connection between being underwater and going into delinquency and foreclosure is clear—the Congressional Budget Office estimates that underwater mortgage borrowers are six times as likely to be seriously delinquent than borrowers who are not underwater.[14] The reason for the connection is straightforward. Underwater borrowers, in addition to facing the challenges of a weak economy, typically have no concrete incentive to stay current on their mortgages. Their monthly mortgage payments are no longer investments in an asset that brings long-term financial health and prosperity. *See, e.g.*, Gregory Scott Crespi, *The Trillion Dollar Problem of Underwater Homeowners: Avoiding a New Surge of Foreclosures By Encouraging Principal-Reducing Loan Modifications*, 51 Santa Clara L. Rev. 153, 155-56 (2011) ("[T]he interests of those underwater homeowners who have significant negative equity positions, but still continue to make their mortgage payments, would often be better served by their defaulting on those mortgages and going through a foreclosure proceeding."). Each payment now throws good money after bad and is financially damaging. Underwater borrowers generally cannot even refinance their existing loans to lower their payments by taking advantage of historically low

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[12] Zillow, *The U.S. Housing Crisis: Where Are Home Loans Underwater?*, *available at* http://www.zillow.com/visuals/negative-equity/#4/39.98/-106.92 (accessed on Sept. 8, 2013).

[13] CoreLogic National Foreclosure Report (July 2013) at 2, *available at* http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-july-2013.pdf (accessed on Sept. 8, 2013).

[14] *See* CBO, *Modifying Mortgages Involving Fannie Mae and Freddie Mac: Options for Principal Forgiveness* (May 2013) at 1, *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/44115_Principal Forgiveness.pdf (accessed on Sept. 8, 2013).

interest rates. If something in an underwater family's budget has to give, it is going to be the mortgage. The foreclosure epidemic cannot be cured without a solution to the underwater mortgage problem.

The crisis is especially acute among minority borrowers and communities like Richmond with large minority populations. The reason is that predatory and abusive lending practices were disproportionately targeted at these communities in the years before the housing market crashed, an illegal practice known as "reverse redlining." Reverse redlining was commonly accomplished with subprime loans funded through private label MBS. Many studies have confirmed the prevalence of reverse redlining, even after controlling for creditworthiness and other legitimate underwriting factors.[15] Indeed, last year Plaintiff Wells Fargo Bank, N.A. entered into a settlement with the United States Department of Justice worth $234.3 million after the government found that Wells Fargo charged African-American and Hispanic mortgage borrowers more than similarly situated non-Hispanic white borrowers.[16] It is therefore no surprise that at the end of 2011 the Center for Responsible Lending found that "[i]n high-minority neighborhoods [nationally], 8.7 percent of loans taken out between 2004 and 2008 have resulted

[15] *See, e.g.*, Gregory D. Squires, et al., *Segregation and the Subprime Lending Crisis* (2009), *available at* http://www.kansascityfed.org/publicat/events/community/2009carc/Hyra.pdf (accessed on Sept. 8, 2013); Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (2006) at 16-17, *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/rr011-Unfair_Lending-0506.pdf (accessed on Sept. 8, 2013); HUD & Dept. of the Treasury, *Curbing Predatory Home Mortgage Lending* (2000) at 72, *available at* http://www.huduser.org/Publications/pdf/treasrpt.pdf (accessed on Sept. 8, 2013); HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (2000) at 4-5, *available at* http://www.huduser.org/Publications/pdf/unequal_full.pdf (accessed on Sept. 8, 2013); National Community Reinvestment Coalition, *The Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age – Subprime Lending in Ten Large Metropolitan Areas* (2003) at 31-34, *available at* http://www.ncrc.org/images/stories/pdf/ research/ncrcdiscrimstudy.pdf (accessed on Sept. 8, 2013).

[16] *See* Doc. No. 10, Consent Order, *United States v. Wells Fargo*, Case No. 1:12-cv-1150 (D.D.C. 2012), *available at* http://www.justice.gov/crt/about/hce/documents/wellsfargocd.pdf (accessed on September 6, 2013).

in foreclosure, and another 10.8 percent are at risk of default."[17] A year later, the Center found that "[a]mong Latino and African-American households, an additional 11.5% and 13% of loans, respectively, were seriously delinquent, compared with six percent for non-Hispanic whites."[18] This is a national crisis, but it is most pronounced in high minority jurisdictions.

The effect of the crisis on cities like Richmond has been and continues to be devastating. Many studies demonstrate that (1) foreclosures drag down the value of nearby properties and thereby reduce property tax revenues, and (2) the vacancies that result from foreclosures lead to increased crime and blight and further stress municipal finances. *See, e.g.*, Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 5 n.90 (2011) (citing studies); *id.* at 84 ("The community in which the property is based can suffer too, as the decline in neighboring property values reduces property tax revenue for local government, while simultaneously increasing local government burdens. Foreclosed properties are often magnets for crime and fire, which increase burdens on local fire and police services.").

The Richmond City Manager's declaration shows that this is exactly what has happened in Richmond and confirms that the economic toll of foreclosures at the municipal level can hardly be overstated. Indeed, near the end of last year the National League of Cities projected 2012 as the sixth consecutive year of declining city revenues and predicted a further decline in property tax revenue in 2013.[19] Until the foreclosure tide is stemmed, the future is bleak for many American cities and their residents. To address the crisis, many policy experts have called for significant action by the federal government to reduce the principal on underwater borrowers' loans. *See, e.g.*, Chairman Phil Angelides, *The Financial Crisis Inquiry Commission's Autopsy of Our Failed Financial System*, 80 UMKC L. Rev. 949, 963 (2012) (transcript of address at

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[17] *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures* (Nov. 2011) at 28, *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf (accessed on Sept. 8, 2013)

[18] *The State of Lending in America & Its Impact on U.S Households (Mortgages)* (Dec. 2012) at 40, *available at* http://www.responsiblelending.org/state-of-lending/State-of-Lending-report-1.pdf (accessed on Sept. 8, 2013)

[19] *See City Fiscal Conditions in 2012* (Sept. 2012) at 1, 3, *available at* http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20 Innovation /Finance/city-fiscal-conditions-research-brief-rpt-sep12.pdf (accessed on Sept. 8, 2013).

symposium on Nov. 10, 2011) ("[W]ith respect to the matter of housing, the mortgages of all those homes that have been underwater, they've lost their value. They need to be written down, there needs to be principal reduction, so we avoid the next wave of foreclosures and instability that will happen in this country if we do not do it."). But while there has been much talk, little of note has been accomplished. *See, e.g.*, Arthur E. Wilmarth, Jr., *Turning a Blind Eye: Why Washington Keeps Giving In to Wall Street*, 81 U. Cin. L. Rev. 1283, 1351-59 (2013) (step by step explanation of how "the Obama Administration rejected proposals for programs that could have provided significant principal reduction to large numbers of underwater borrowers"). For example, the Federal Housing Finance Agency refuses to allow principal reductions for loans backed by Fannie Mae and Freddie Mac.[20] The private sector has been no better; 84% of loan counselors reported that the four highest volume loan servicers "always or almost always fail to reduce principal when granting modifications."[21]

The proposed use of eminent domain by local governments to reduce foreclosures and blight by restoring underwater borrowers to positive equity fills the void left by the federal government. It is a local solution to a problem with profoundly negative local consequences. *Amici* and many others have concluded that eminent domain is an essential tool that must remain available to local governments to address the crisis, especially in the absence of meaningful national action. In addition to *amici*, supporters of local governments' right to utilize the eminent domain proposal include a broad array of organizations such as The American Federation of State, County and Municipal Employees; the AFL-CIO; the National Community Law Center; the National Community Reinvestment Coalition; the National Fair Housing Alliance; and the Service Employees International Union, among many more. Ex. F to Schlactus Decl.; Ltr. from Nat'l Cmty. Reinvestment Coalition to Federal Housing Fin. Agency (Sept. 7, 2012), *available at*

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[20] Nisen, *A Career DC Bureaucrat Rejected a Plan that Could Have Helped Almost Half-a-Million Struggling Homeowners* (Aug. 1, 2012), *available at* http://www.businessinsider.com/fhfa -head -rejects-principal-reduction-2012-8 (accessed on Sept. 9, 2013).

[21] Cal. Reinvestment Coalition, *Chasm Between Words and Deeds VIII: Lack of Bank Accountability Plagues Californians* (Apr. 2012) at 6-7, *available at* www.calreinvest.org/system/resources/W1siZiIsIjIwMTIvMDQvMTIvMDJfMjJfMjJfMjEwX0NvdW5zZWxvclN1cnZleUZJTkFMLnBkZiJdXQ/CounselorSurveyFINAL.pdf (accessed on Sept. 8, 2013).

http://www.ncrc.org/images/stories/pdf/ commentary_use%20of%20eminent%20domain_9.7.12.pdf (accessed on Sept. 8, 2013) (hereinafter "NCRC Ltr. to FHFA"). These many supporters are of the shared view that the eminent domain policy option can broadly benefit many cities like Richmond that continue to suffer from the foreclosure crisis by helping to restore neighborhood stability and fiscal health. It is vital to the public interest that the elected leaders of these communities not be enjoined from exercising this legal option.

CONCLUSION

For the reasons stated herein, if the Court considers the preliminary injunction legal standard (which it will have no reason to do if it finds that it lacks subject matter jurisdiction or that Plaintiffs' claims are not ripe, as Defendants properly urge) it should find that Plaintiffs are not entitled to a preliminary injunction because an injunction would be manifestly at odds with the public interest.

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Respectfully submitted,

/s/ Glenn Schlactus
John P. Relman*
Glenn Schlactus (SBN 208414)
Jamie L. Crook (SBN 245757)
RELMAN, DANE & COLFAX PLLC
1225 19th St. NW, Suite 600
Washington D.C. 20036
Telephone: (202) 728-1888
Facsimile: (202) 728-0848
jrelman@relmanlaw.com
gschlactus@relmanlaw.com
jcrook@relmanlaw.com
* Subject to admission *pro hac vice*

Marcia Rosen (SBN 67332)
Kent Qian (SBN 264944)
NATIONAL HOUSING LAW PROJECT
703 Market Street, Suite 2000
San Francisco, CA 94103
Telephone: (415) 546-7000
Facsimile: (415) 546-7007
mrosen@nhlp.org
kqian@nhlp.org

Attorneys for Amici Curiae National Housing Law Project, Housing and Economic Rights Advocates, Bay Area Legal Aid, California Reinvestment Coalition and Law Foundation of Silicon Valley