NYT: Eminent Domain: a Long Shot Against Blight.

The mayor's plan would buy and refinance underwater mortgages in an attempt to save the city from more boarded-up houses. Jim Wilson/The New York Times

You can't fight city hall, the saying goes. But Gayle McLaughlin, the mayor of Richmond, Calif., a city of 100,000 souls, would tell you that fighting Wall Street is harder. Even for city hall.

Ms. McLaughlin has a plan to help the many Richmond residents who owe more money on their houses than their houses are worth, but it's one that banks like Wells Fargo, large asset managers like Pimco and BlackRock, real estate interests and even Fannie Mae and Freddie Mac, the mortgage finance giants, have tried to quash. Her idea involves a novel use of the power of eminent domain to bail out homeowners by buying up and then forgiving mortgage debt.

But the financial institutions have warned that mortgage lending would halt in any city that tried eminent domain — and they have lobbied Congress to ensure that the threat is not an empty one. Opponents have filed federal lawsuits, while real estate interests have made robocalls to residents and sent mass mailers warning that the plan would allow "slick, politically connected" investors to "take houses on the cheap." (The idea is actually to buy mortgages, not houses.)

Gayle McLaughlin, mayor of Richmond, Calif., defends her plan to use eminent domain to help bail out homeowners. "The risk that is really confronting us," she said, "is waiting on the sidelines for the next wave of foreclosures." Jim Wilson/The New York Times

Under similar pressures, at least four other cities that considered the eminent domain strategy have backed away, deeming the risks too great. But advocates in Richmond say their city is different. They hope a unique alignment of anti-corporate political leadership, a concerted grass-roots campaign and union support will lead to a different outcome in this working-class, largely black and Hispanic community in the Bay Area. For a dozen or so other cities that have similar demographics and are also plagued by foreclosures, Richmond has become a national test case.

Those cities, scattered in states from New Jersey to Washington, have watched as the controversial proposal has threatened Richmond's access to capital: When the city tried to market a highly rated set of bonds in mid-August last year, there were no takers.

In September, the Richmond City Council was preparing to take one of a series of votes on the eminent domain proposal. Before the meeting, opponents amassed at a hot-dog stand near city hall. A local real estate association, backed by money from the National Association of Realtors, offered free dinners to those who showed up to don red "A Bad Deal for Richmond" T-shirts; the group included a huddle of fraternity brothers brought in from Berkeley. If eminent domain were used, a young man who declined to identify himself was telling them, a for-profit company would make big money, and teacher and firefighter pensions would be hurt.

The eminent-domain strategy is not a fabulous idea. Like virtually every other proposal to help homeowners hurt by the housing crash, it tries for simplicity but falters in the face of the enormity of the post-financial-crisis mess, and, as markets improve, it may come too late to make much difference. The plan's legality and wisdom have been debated in editorials and blog posts, with questions ranging from the true value of the mortgages to whether the chosen homeowners deserve the help.

But to advocates, eminent domain offers perhaps the only chance to remedy the failure of the federal government and mortgage servicers to offer widespread, meaningful relief to the hardest-hit communities.

Housing markets around the country may be improving, but about 28 percent of all mortgages in Richmond are deeply underwater (meaning that the homeowners owe significantly more than their homes are worth), compared with 19 percent nationally, according to RealtyTrac.

The local foreclosure rate is declining, but it's still much higher than the national one. In light of this, the mayor shows no sign of backing down. "The risk that is really confronting us," she said, "is waiting on the sidelines for the next wave of foreclosures."

When the council first voted on eminent domain, in April, members were unanimously in favor. But then the opposition campaign began. Ms. McLaughlin predicted that her motion that September night would pass with five of seven council votes, but it squeaked by with just four. Jeffrey Wright, a real estate broker who is leading the local opposition, was satisfied.

"This underwater mortgage bailout program," he said later, "is on life support."

The day after the vote, Ms. McLaughlin was in her office, working on an entirely different project: getting ready for a trip to Ecuador, at the invitation of that country's president, to tour the damage that courts there have ruled was caused by oil drilling by Texaco, now owned by Chevron.

It is Chevron, not mortgage debt relief, that has defined much of Ms. McLaughlin's tenure. The company, which has a large refinery in Richmond, is the city's largest taxpayer and employer, and Ms. McLaughlin has led the fight — first as an activist, and then as mayor — to force Chevron to pay higher taxes and to pay more damages after a refinery explosion last year sent thousands of area residents to emergency rooms.

A longtime advocate of left-wing causes, Ms. McLaughlin, a Green Party member, is part of a Richmond political alliance that has vowed not to accept corporate campaign donations. In 2010, she was re-elected over a Chevron-backed challenger. She helped ease policies that criminalized homelessness and harried illegal immigrants, and brought a solar panel factory and a branch of the Lawrence Berkeley National Laboratory to town.

But Richmond was staggered by the recession. Homes in the city lost 66 percent of their value, on average, and are still worth less than half what they were at their peak, in January 2006. Some 16 percent of homeowners lost their homes in foreclosure, leaving so many scars on neighborhoods that the city began fining banks $1,000 a day if they failed to maintain their property; the city has collected $1.5 million so far.

Richmond held sessions where homeowners could meet with bank representatives and legal aid groups, but too often, the mayor says, the efforts came to naught. Last summer, underwater homeowners owed, on average, 45 percent more than the value of their homes, according to the city manager.

So the mayor was all ears when she heard about the eminent domain plan, from both Mortgage Resolution Partners, a company that hopes to make money by administering and financing the plan for many cities, and from her longtime ally, the Alliance of Californians for Community Empowerment, an offshoot of Acorn.

The A.C.C.E. thought an earlier attempt to use eminent domain, in San Bernardino County, had failed because of a lack of grass-roots support. So in Richmond it held a door-knocking campaign. Its success was seen when more than 100 people, most in favor, signed up to speak at the September meeting. It lasted seven hours.

Using eminent domain to heal the wounds of the mortgage crisis has been called crazy, unconstitutional and even “one of the worst ideas ever.” But it is not so far removed from mainstream thinking. In 2008, Senator John McCain of Arizona, then the Republican presidential candidate, suggested using $300 billion in federal bailout money to buy troubled mortgages and write them down.

The problem was that the mortgages had been bundled into pools and resold to thousands of investors all over the world. The rules governing many of the pools forbade the investors’ representative, known as the trustee, from selling off mortgages or modifying them unless they were already in default, even though it might be in the investors’ interest to do so.

Scholars suggested that eminent domain could give trustees the legal cover they needed to get rid of the bad loans. So far, though, the investors have not seen it that way. In Richmond, investors (including BlackRock and Pimco) asked their trustees, Wells Fargo and Deutsche Bank, to sue the city to stop the program.

Eminent domain allows governments to condemn property for a public purpose, like building a road or eliminating urban decay, and applies to intangible property like mortgages as well as to real estate. Richmond argues that its public purpose is to prevent foreclosures and the blight of vacant properties.

The idea is to buy those mortgages out of the bundles and restructure them, restoring equity to the homeowners and keep them from defaulting.

Opponents of the plan argue in legal briefs that the risk of default now, so long after the crash, is vastly overstated. More than half of the 624 homeowners initially identified for the program are current on their payments. Not only that, 91 of the loans have already received a modification that included debt forgiveness — though many early modifications were unsustainable. Then there is the question of whether homeowners who got cash by refinancing their homes during the bubble — taking out new, riskier mortgages, as many of these did — deserve help now. (Ms. McLaughlin says the homeowners fell prey to unscrupulous lenders.) Lastly, opponents calculate that with rising home values, almost a third of the homeowners aren’t even underwater, a figure that Mortgage Resolution Partners disputes.

Opponents argue that the plan may help certain homeowners but hurt other working-class people whose pension funds invested in the loans. But pensioners and those stuck in underwater mortgages are often the same people, said Stephen Abrecht, an official of the Service Employees International Union, which supports the use of eminent domain. “We have members who are locked into these kinds of situations and can’t get out of it,” he said. “We think it’s a drag on the economy and we’re interested in seeing the economy take off again.”

Mr. Wright, the real estate agent, said that what bothers him most about the plan is that it will help so few; no one with loans backed by Fannie Mae or Freddie Mac, which guarantee a majority of mortgages, is included. “They’re bearing these placards saying, ‘Save our homes’ and they don’t even realize that this program won't benefit them," he says. "There's a lot of false hope and that irritates me, that really irritates me."

Wall Street also objects to the plan on principle, portraying it not as a targeted response to an extraordinary event — the housing crash — but as a dangerous precedent that disrupts contracts and would all but end mortgage lending.

"Why would anybody think that private investors would provide additional capital to the mortgage finance market when somebody thinks it's O.K. to take it from them?" asked Tim Cameron, the head of the asset management group for the Securities Industry and Financial Markets Association, the Wall Street trade association that has been spearheading the campaign against eminent domain.

Sifma and its allies have lobbied Congress to obstruct lending in any area where mortgages are vulnerable to government condemnation and have urged support for a bill from Representative Jeb Hensarling, a Texas Republican who is chairman of the House Financial Services Committee, that would bar any federal guarantee for such loans.

After Richmond voted to pursue eminent domain, Sifma officials flew out to meet with city officials, providing them with a thick binder of analysis and research reports warning of potential negative consequences. Then these officials went a step further, said Bill Lindsay, the city manager, by placing a phone call to the city's bond underwriter and complaining that the disclosure language in a coming offering — to refinance some old economic development bonds — did not adequately disclose the legal risks of the mortgage plan.

Cheryl Crispen, a spokeswoman for Sifma, said the call was routine. "Sifma staff regularly inquire with underwriters to understand market trends, and did so to better understand the impact the threat of taking mortgages was having on the offering and consequently the municipal bond market more broadly," she said. The underwriter, RBC Capital Markets, concurred that Sifma did not try to interfere in the offering, which was halted when there was no interest from investors.

Opponents say the idea could harm pensioners. Jim Wilson/The New York Times

But Mr. Lindsay said all the attention was unusual. "I've handled 40 different bond issuances," he said. "I never even heard of Sifma before this."

In 2002, the Georgia Legislature passed the toughest predatory-lending law in the country. Hailed as a victory for consumers, it was intended to prevent abusive practices like steering customers to high-interest loans. Lenders immediately started trying to dismantle the law, warning that the "good guys" would no longer make loans to people with poor credit.

Some lenders did pull out of the state, and two of the three ratings agencies said they could no longer rate Georgia loans for resale to investors because they could be sued under the law. The state banking commissioner estimated that the mortgage market shrank by 15 percent. The following year, after a nasty fight, lawmakers gutted the statute.

Sifma officials point to this affair as proof that messing with housing finance can have ruinous effects. But it is an example that offers other lessons, too.

The loans that disappeared from the market after the law was passed were the same kinds of subprime loans that set off the foreclosure wave; conventional 30-year mortgages were not affected. The lenders whose departure was met with such alarm included Countrywide Financial, whose practices during the housing boom have cost billions in legal settlements.

In an article in The Atlanta Journal-Constitution, experts concluded that had the law stayed intact, the housing crisis would have been less dire in the state, which became one of the hardest-hit. The article even implied that the whole country might have fared better, because “the Georgia drama also stemmed a tide of similar laws that were being considered in other states.”

Richmond has not yet tried to use eminent domain. The City Council must vote again before that happens. But the beating the city is taking from financial institutions makes the idea less likely to catch on in places like Irvington, N.J., and El Monte, Calif., which have expressed interest.

Richmond’s mayor says she has always known it would be a slog. “I’m not trying to minimize what we’re dealing with; it’s just like, if you’re willing to buck up against an unjust set of circumstances, you’re going to have those attacks coming at you,” Ms. McLaughlin said. “And in some sense that says you’re doing your job.”

By SHAILA DEWAN JAN. 11, 2014