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WSJ: In California, a Novel Use of Eminent Domain Hits Headwinds.

RICHMOND, Calif.— Morris LeGrande and Scott Barker would both benefit from a radical plan being eyed here to use the power of eminent domain to slash their home mortgages.

Yet the two homeowners occupy opposite ends of a debate over who should take responsibility for inflated housing debts—lenders or borrowers.

Without debt forgiveness, Mr. LeGrande says, he and his wife "have a decision to make as to how long we stay" in their house. Mr. Barker condemns the city's plan to chop his mortgage as "snake-oil stuff" that is "wrong on a number of levels." Both have loans that were among the 624 mortgages the city proposed forcibly purchasing last year.

Six years after the financial crisis spurred Washington to bail out entire sectors of the economy, few cities capture the unevenness of the nation's recovery quite like this industrial hub of 100,000 residents on San Francisco's East Bay.

Home prices in nearby San Francisco and Silicon Valley are setting new highs, but prices here still hover around 37% below where they were at their peak in 2006. More than a quarter of Richmond borrowers owe more than their homes are worth, according to a report prepared by researchers at the University of California, Berkeley, compared with 10% nationally.

How so many Richmond homeowners got so deeply in debt helps explain why the plan is so controversial. Borrowers often compensated for slowly rising incomes during the boom years by tapping rising home equity to pay for bills and repairs. Then when the market crashed, they were left with mortgage debt exceeding their homes' values.

Richmond Mayor Gayle McLaughlin wants to use the city's property-seizing powers of eminent domain—normally reserved for shared public purposes like building roads—to help homeowners like Mr. LeGrande dig out from huge housing debts. Other cities, including Newark and Irvington in New Jersey, have proposed similar plans but none has advanced as far as Richmond's.

Under Richmond's plan, the city would seize the mortgage—but not the home—with backing from a private firm. They would then reduce the loan principal and refinance into a new government-guaranteed loan. That would leave the borrower with a fixed payment and less debt.

But the plan has met a wall of protest from banks and mortgage-bond investors, who have sued to block the seizures. They fear the plan works only if cities are able to buy loans at deep discounts, and mortgage investors say the proposal would make them less willing to extend credit in Richmond.

Mr. Barker's experience gives some sense of the costs involved. The city proposed buying 10 loans last year in his neighborhood, developed in 2004 on a ridge overlooking the San Francisco Bay. While homes have sold in the $600,000 range over the past year, the city last year offered to pay as little as $231,000 for some loans.

The next few weeks could determine the plan's fate. The seven-member City Council is one vote shy of the state-required supermajority needed to begin eminent-domain proceedings. Backers have been working furiously to find another city willing to join them, holding talks recently with city leaders in San Francisco; creating a joint-powers authority with another city would require a simple majority.

Time is running out because November's elections could alter city leadership. Ms. McLaughlin, who is running for a council seat, isn't eligible to run again for mayor.

Mr. LeGrande, who bought in Richmond in 2004 after he tired of moving between rentals in Oakland, figures that he owes $250,000 more than his four-bedroom home is worth.

The 58-year-old jazz musician and his wife, Luajuana, put no money down for the $310,000 purchase of their four-bedroom home by taking out two loans. They refinanced the two loans into a larger one in 2005, using some of the proceeds to pay down a car loan, fix a bathroom and repair a fence, he says.

The LeGrandes refinanced again to avoid higher payments, but by 2008, they fell behind on the loan, which had swelled to $423,000. Their mortgage company modified the loan twice. But without more help, Mr. LeGrande said, "it becomes a bad decision to keep this house."

An extreme example: Doris Ducre, a 61-year-old laboratory technician, bought her parents' four-bedroom home here in 1999 and steadily increased her mortgage debt from $144,000 to $412,000 over eight years.

She says she and her husband used the proceeds of refinancing—after brokers took their cut—to fix her home. But the property today is worth far less today than the $385,000 they still owe.

"Right now, we're like renters. I don't own anything," she said. "The banks got bailed out, and the average person was left behind."

Meanwhile, even though Mr. Barker and his wife, Vivian, say it is in their interest to accept the city's help, they don't want it. They bought their home for $997,000 with 20% down in 2005, just as the market peaked. They recall neighbors who walked away from homes as the foreclosure crisis deepened.

"Who's going to want to invest in loans if someone like us, paying their loan, can get it written down?" said Mr. Barker, a software salesman who lost his job during the recession and was unemployed for 18 months. "There's a ton of people who got screwed, but I don't feel like this is the answer."

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