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Help Me, I'm Drowning! Using the Fair Housing Act to Protect Cities that Use Eminent Domain to Seize Underwater Mortgages

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**HELP ME, I'M DROWNING! USING THE FAIR
HOUSING ACT TO PROTECT CITIES THAT
USE EMINENT DOMAIN TO SEIZE
UNDERWATER MORTGAGES**

By Emily D. Anderson[†]

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I. INTRODUCTION

A significant part of the American dream is home ownership.¹ However, this dream became a nightmare for many homeowners when the housing bubble burst in 2008.² Prior to the collapse, there were record numbers of Americans who owned their own homes.³ When property values began dropping in 2006 and 2007, many Americans found that they owed more than their homes were currently worth.⁴ This led to a drastic decline in homeownership and a record number of foreclosures.⁵ In response to this housing crisis, state and federal governments have attempted to enact legislation or create programs to assist homeowners, with varying degrees of success.⁶

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1. Peter W. Salsich, Jr., *Homeownership—Dream or Disaster?*, 21 J. AFFORDABLE HOUS. & CMTY. DEV. L. 17, 23 (2012).

2. *Id.*

3. *Id.* at 20.

4. *Id.* at 20, 28.

5. *Id.* at 20–21.

6. See Kathryn E. Johnson & Carolyn E. Waldrep, *The North Carolina Banking Institute Symposium on the Foreclosure Crisis: Overview*, 14 N.C. BANKING INST. 191, 203–213, 214–16 (2010) (discussing the following federal programs, “HOPE for

Although the crisis has been gradually improving, “analysts estimate that between 7.4 million and 9.4 million additional home loans are now in danger of default over the next six years. . . . [A]ssum[ing] no further price declines or interest rate rises.”⁷ As states get more desperate to solve this crisis, they consider more drastic remedies. One such remedy is using the power of eminent domain to force lenders to sell their mortgage notes to the city.⁸ Once the city owns the mortgage, the homeowner could either make monthly mortgage payments to the city, or get out from underwater by refinancing their loan at current property values.⁹ Either way, the danger of foreclosure is eliminated.

The legality of this novel use of eminent domain remains uncertain and hotly contested.¹⁰ Lenders, afraid of losing millions of dollars, have filed suit in cities like Richmond, California—where the plan has progressed the furthest—however, the courts have yet to rule on the plan’s legality.¹¹ Many cities have considered eminent domain as a solution, but backed down after lenders threatened to make credit more expensive or withdraw credit entirely from these regions.¹²

Ultimately, though, if lenders were to follow through on these threats, the result would be unlawfully discriminatory. Since the late

Homeowners,” “Making Home Affordable,” “Helping Families Save Their Homes Act of 2009,” and “Neighborhood Stabilization Program”); see also Salsich, *supra* note 1, at 40–51; Aleatra P. Williams, *Foreclosing Foreclosure: Escaping the Yawning Abyss of the Deep Mortgage and Housing Crisis*, 7 NW. J. L. & SOC. POL’Y 455, 461 (2012).

7. Robert Hockett, *Six Years on and Still Counting: Sifting Through the Mortgage Mess*, 9 HASTINGS BUS. L.J. 373, 374 (2013).

8. Ngai Pindell, *Nevada’s Residential Real Estate Crisis: Local Governments and the Use of Eminent Domain to Condemn Mortgage Notes*, 13 NEV. L.J. 888, 889–90 (2013).

9. *Id.*

10. See Josh Harkinson, *Inside the Radical Plan to Fight Foreclosures With Eminent Domain*, MOTHER JONES (Jan. 7, 2013), <http://www.motherjones.com/politics/2013/01/eminient-domain-mortgage-gluckstern>.

11. Terrence Dopp, *Newark Advances Eminent Domain Plan to Slow Foreclosures*, BLOOMBERG (Dec. 5, 2013, 12:59 PM), <http://www.bloomberg.com/news/2013-12-05/newark-advances-eminient-domain-plan-to-slow-foreclosures.html> (“In September, a judge dismissed a lawsuit by Bank of New York Mellon and Wilmington Trust Co. that sought to stop Richmond’s program, saying the case came too early to evaluate the legal merits.”).

12. Shaila Dewan, *More Cities Consider Using Eminent Domain to Halt Foreclosures*, N.Y. TIMES, NOV. 15, 2013, available at http://www.nytimes.com/2013/11/16/business/more-cities-consider-eminient-domain-to-halt-foreclosures.html?_r=0 (“Several local governments that have considered the plan eventually backed away, including San Bernardino County and North Las Vegas.”); ALFRED M. POLLARD, FEDERAL HOUSING FINANCE AGENCY, SUMMARY OF COMMENTS AND ADDITIONAL ANALYSIS REGARDING INPUT ON USE OF EMINENT DOMAIN TO RESTRUCTURE MORTGAGES (Aug. 7, 2013), available at <http://www.fhfa.gov/webfiles/25418/GCMemorandumEminentDomain.pdf>.

1960s, Congress has been regulating consumer transactions,¹³ including promulgating the Fair Housing Act of 1968 (“FHA”) and the Equal Credit Opportunity Act of 1974 (“ECOA”) to provide protection in consumer lending.¹⁴ The FHA and ECOA were enacted to protect would-be homeowners from discriminatory lending practices that plagued minority communities.¹⁵ Since the 1970s, these statutes have been primarily used to fight against lenders who discriminatorily withhold credit—in a process known as redlining—however, more recently, the FHA and ECOA have been invoked to combat lenders targeting minorities for outrageous loans, destined to default—a process known as reverse redlining.¹⁶ Over the last forty years, these statutes and their enforcement, have proven flexible enough to fight new forms of discriminatory lending as they arise.¹⁷

This Note will demonstrate that the FHA and ECOA prohibit implementation of lenders’ threats to limit or refuse credit availability because the result would have a disproportionate effect on minorities. This Note will examine the legality of the lenders’ threats to withhold credit and, in doing so, presumes that courts will find this novel use of eminent domain constitutional. First, Part II will discuss the current situation. Section IIA will explain eminent domain and explore precisely how cities hope to use it in the mortgage note context. Section IIB will describe the growth of this plan and the cities that have considered using it. Section IIC will elaborate on the threats that the lenders are making toward the cities that consider using eminent domain. Second, Part III will discuss the various laws that regulate consumer transactions and how they have restricted lenders in the past. Section IIIA will give a brief history of redlining and its consequences. Section IIIB will discuss the circumstances surrounding the enactment of the FHA and ECOA and exactly what actions these statutes prohibit. Section IIIC will discuss the three causes of action that arise under the FHA and the ECOA. Section IIID will further explore disparate impact and how courts have interpreted 24 C.F.R. Section

13. FRED H. MILLER & JOHN D. LACKEY, *THE ABCs OF THE UCC: RELATED AND SUPPLEMENTARY CONSUMER LAW* 15–16 (2d ed. 2004).

14. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266-01, 18268 (Apr. 15, 1994); Fair Housing Act, 42 U.S.C. §§ 3601–3631 (2012); Equal Credit Opportunity Act, 15 U.S.C. §§ 1691–1691f (2012).

15. Peter P. Swire, *The Persistent Problem of Lending Discrimination: A Law and Economics Analysis*, 73 TEX. L. REV. 787, 797 (1995).

16. Charles L. Nier, III & Maureen R. St. Cyr, *A Racial Financial Crisis: Rethinking the Theory of Reverse Redlining to Combat Predatory Lending Under the Fair Housing Act*, 83 TEMP. L. REV. 941, 945 (2011).

17. Policy Statement on Discrimination in Lending, 59 Fed. Reg. at 18267 (“Discrimination in lending on the basis of race or other prohibited factors is destructive, morally repugnant, and against the law. It prevents those who are discriminated against from enjoying the benefits of access to credit. The Agencies will not tolerate lending discrimination in any form.”).

100.500, which was enacted on March 18, 2013.¹⁸ Lastly, Part IV will apply disparate impact to the lenders' threats and work through the disparate impact analysis in detail to analyze the likelihood that the FHA and the ECOA will be successful in restricting the lenders' threats.

II. THE CURRENT CRISIS

A. *Eminent Domain as a Solution*

Eminent domain is provided for in the Takings Clause of the Fifth Amendment.¹⁹ The Clause states that "private property [shall not] be taken for public use, without just compensation."²⁰ Historically, the government used eminent domain to seize land for the "development of roads, drainage of land, construction of government buildings, and compensation to property owners for flooding of their lands caused by local mills."²¹ However, over the years, the definition of "public use" has evolved from a narrow view—requiring that the public actually be able to use the seized property—to a more abstract and broad view, which includes takings that "provide a public benefit or serve a public purpose."²²

There have been three landmark U.S. Supreme Court cases regarding the interpretation of public use.²³ In *Berman v. Parker*, the Supreme Court ruled that "promoting public welfare" was valid as a public use and deferred much of the eminent domain review to the state legislature.²⁴ The Court emphasized that public use does not require that the public actually use the property—private parties could own the redeveloped property without issue.²⁵ In *Hawaii Housing Authority v. Midkiff*, the Supreme Court held that the "purpose of the taking, not its mechanics," is what must be justified as a public use. In other words, the public does not need to be able to use the land as long as taking the land accomplishes a public purpose.²⁶ Moreover, the Court held that rational basis review was to be used when determining whether there is a "conceivable public purpose."²⁷ Finally, in

18. 24 C.F.R. § 100.500 (2013).

19. BLACK'S LAW DICTIONARY (9th ed. 2009), Takings Clause.

20. U.S. CONST. amend. V, § 5.

21. David B. Fawcett III, Comment, *Eminent Domain, the Police Power, and the Fifth Amendment: Defining the Domain of the Takings Analysis*, 47 U. PITT. L. REV. 491, 494 (1986).

22. Nancy Kubasek & Garrett Coyle, *A Step Backward Is Not Necessarily A Step in the Wrong Direction*, 30 VT. L. REV. 43, 46–48, 46 n.22 (2005).

23. *Id.* at 50.

24. *Berman v. Parker*, 348 U.S. 26, 32 (1954); Kubasek & Coyle, *supra* note 22, at 51.

25. *Berman*, 348 U.S. at 33–34; Kubasek & Coyle, *supra* note 22, at 50.

26. *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 244 (1984); Kubasek & Coyle, *supra* note 22, at 53.

27. *Hawaii Hous. Auth.*, 467 U.S. at 242–43; Kubasek & Coyle, *supra* note 22, at 53.

Kelo v. City of New London, the Supreme Court held that the legitimate public use required by the Takings Clause includes projects designed to create new jobs, generate taxes, or otherwise seek to “promot[e] economic development.”²⁸

The Court’s broad definition of public use under the Fifth Amendment has paved the way for cities like Richmond, California, to turn to eminent domain as a means of reducing the ills associated with vacant, uncared-for homes, while simultaneously generating much-needed tax revenue.²⁹ Richmond argues that “[s]ixteen percent of mortgages in the city have gone into foreclosure, which . . . has worsened crime, vacancy, and blight.”³⁰ Under the Supreme Court’s broad and deferential definition of “public use,” here, it seems as though Richmond’s stated purpose is sufficient to properly invoke the state’s power of eminent domain.

The idea to use eminent domain to seize underwater mortgage notes originated in San Francisco at an investment firm called Mortgage Resolution Partners LLC (“MRP”). MRP plans to collaborate with cities and counties greatly affected by the housing crisis to reduce the principals and monthly payments so people can keep their homes.³¹ To accomplish this, the cities will force the lenders to sell their mortgage notes and will give the lenders fair market value in return.³² This is where MRP becomes essential: these struggling cities do not have the money to buy all of these mortgages, MRP will pro-

28. *Kelo v. City of New London*, 545 U.S. 469, 472, 489 (2005); Kubasek & Coyle, *supra* note 22, at 57. In the aftermath of *Kelo*, many states changed their eminent domain laws to be much stricter on the definition of “public use.” However, this does not necessarily mean that the current mortgage plan will fail, as there are many differences between seizing homes and seizing mortgage notes; see Pindell, *supra* note 8, at 893–900.

29. Harkinson, *supra* note 10 (stating “how preventing a single foreclosure could save the city nearly \$20,000 in lost taxes and other expenses.”); Shaila Dewan, *Eminent Domain: A Long Shot Against Blight*, N.Y. TIMES, Jan. 11, 2014, available at <http://www.nytimes.com/2014/01/12/business/in-richmond-california-a-long-shot-against-blight.html>.

30. Lydia DePillis, *Wall Street Has So Far Crushed a Drastic Foreclosure Fix. One California Town Could Change That*, WASH. POST (Sept. 10, 2013), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/09/10/wall-street-has-so-far-crushed-a-dramatic-foreclosure-fix-one-california-town-could-change-that/>.

31. *Home*, MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com/> (last visited Jan. 26, 2014); Richard E. Gottlieb & Vivian I. Kim, *Eminent Domain: Will Local Governments Attempt to Use This Extraordinary Power to Purchase Troubled Residential Mortgages?*, 31 NO. 11 BANKING & FIN. SERVICES POL’Y REP. 1, 4 (2012).

32. Carl Gibson, *Richmond, California Mayor Occupies Wall Street*, HUFFINGTON POST, Oct. 17, 2013, http://www.huffingtonpost.com/carl-gibson/richmond-california-mayor_b_4118203.html; Emily Badger, *Why Wall Street Is Very, Very Angry at Richmond, California, Right Now*, THE ATLANTIC CITIES: PLACE MATTERS (Sept. 11, 2013), <http://www.theatlanticcities.com/housing/2013/09/why-wall-street-very-very-angry-richmond-california-today/6858/>.

vide the capital in exchange for a flat fee of \$4,500.00 per loan.³³ MRP's plan allows the lenders to conduct their own appraisals to ensure that the lender receives adequate compensation.³⁴ Once an appraisal is done, lenders could accept the payment from MRP and still challenge whether the amount was high enough in court.³⁵ Once the city owns the mortgage note, the homeowner could continue making payments to the city to pay the mortgage, or refinance the mortgage with another lender at the current fair market value.³⁶ Steven M. Gluckstern, the company's chair,³⁷ "calculates that a family . . . that bought a \$200,000 house that's now worth \$100,000 . . . would see its monthly payments decrease from between \$800 to \$300."³⁸

It is not surprising that the lenders are upset. MRP's plan provides the lenders with a mortgage's current fair market value, but completely ignores the amount of the original loan, so the lenders may lose money overall.³⁹ In a complaint filed against Richmond, Wells Fargo asserted that it could lose \$200 million on the 624 mortgages Richmond planned to seize.⁴⁰

Gluckstern, however, believes that lenders like Wells Fargo are exaggerating estimated losses because they are outraged at having their dominance of the financial system challenged. If it is true, as studies suggest, that "80 percent of underwater mortgages owned by private-label securities will end up defaulting,"⁴¹ lenders would not be likely to get much more than fair market value from a foreclosure sale—leaving a deficiency identical to the one under MRP's plan.⁴² MRP's plan may well prove to be more economically beneficial to these banks because under MRP's plan, banks would not have to pay upkeep on vacant homes before the homes can be sold. Indeed, Richmond has even begun "fining banks \$1,000 a day if they fail to

33. Gottlieb & Kim, *supra* note 31, at 4; Harkinson, *supra* note 10; DePillis, *supra* note 30.

34. Gibson, *supra* note 32.

35. Jon Prior, *Still no partner for radical mortgage resolution*, POLITICO (Jan. 16, 2013, 4:39 AM), <http://dyn.politico.com/printstory.cfm?uuid=C1252E22-11FC-403D-8F06-D21F86EE27AA>.

36. Pindell, *supra* note 8, at 889–90.

37. Gottlieb & Kim, *supra* note 31, at 1; *Management, MORTGAGE RESOLUTION PARTNERS*, <http://mortgageresolution.com/management> (last visited Jan. 26, 2014).

38. Harkinson, *supra* note 10.

39. See *FAQS, MORTGAGE RESOLUTION PARTNERS*, <http://mortgageresolution.com/faqs> (last visited Jan. 26, 2014).

40. Jody Shenn et al., *Pimco, BlackRock Seek to Bar California Mortgage Seizures*, BLOOMBERG PERSONAL FINANCE (Aug. 8, 2013), <http://www.bloomberg.com/news/2013-08-07/bondholders-sue-california-city-to-block-mortgage-seizures-1.html>.

41. Harkinson, *supra* note 10.

42. BLACK'S LAW DICTIONARY (9th ed. 2009), deficiency ("The amount still owed when the property secured by a mortgage is sold at a foreclosure sale for less than the outstanding debt.").

maintain the properties they own and they have collected \$1.5 million so far.”⁴³

B. *The Housing Crisis in Nevada and in Other States*

Many cities across the nation that were hit especially hard by the housing crisis have considered implementing eminent domain to help their struggling citizens. In June 2012, San Bernardino County was one of the first to consider using eminent domain after a record number of foreclosures and no relief in sight.⁴⁴ After this first look, many other cities and counties have considered or are actively trying to implement eminent domain. Together with San Bernardino County, Richmond County and the California cities of Fontana and Ontario have formed a committee to explore the idea.⁴⁵ Thirty other local governments followed suit,⁴⁶ including the cities of: North Las Vegas, in Nevada;⁴⁷ Sacramento,⁴⁸ Berkeley,⁴⁹ Pomona,⁵⁰ El Monte,⁵¹ Oakland,⁵² and Salinas⁵³ in California; Seattle, in Washington;⁵⁴ Yonkers⁵⁵

43. Dewan, *supra* note 29.

44. Mark Muckenfuss, *SAN BERNARDINO: County Steps Forward on Housing Idea*, THE PRESS-ENTERPRISE (June 30, 2012, 4:52 PM), <http://www.pe.com/local-news/san-bernardino-county/san-bernardino-county-headlines-index/20120630-san-bernardino-county-steps-forward-on-housing-idea.ece> (“The rate in San Bernardino and Riverside counties is one foreclosure per 179 homes, which is 3½ times the national average.”).

45. Muckenfuss, *supra* note 44.

46. Prior, *supra* note 35.

47. James Dehaven, *North Las Vegas approves plan to use eminent domain to aid underwater homeowners*, LAS VEGAS REVIEW-JOURNAL (June 20, 2013, 10:49 PM), <http://www.reviewjournal.com/news/las-vegas/north-las-vegas-approves-plan-use-eminent-domain-aid-underwater-homeowners>.

48. Hudson Sangree, *Eminent Domain Would Aid Underwater Owners*, THE SACRAMENTO BEE, Aug. 11, 2012, at A1.

49. Oksana Yurovsky, *Berkeley City Council explores solutions to home foreclosures*, THE DAILY CALIFORNIAN (Aug. 5, 2012), <http://www.dailycal.org/2012/08/05/berkeley-city-council-explores-solutions-to-home-foreclosures/>.

50. Monica Rodriguez, *Pomona to hear eminent domain proposal*, DAILY BULLETIN NEWS (May 11, 2013, 9:00 PM), <http://www.dailybulletin.com/general-news/20130512/pomona-to-hear-eminent-domain-proposal>.

51. Shaila Dewan, *A City Invokes Seizure Laws to Save Homes*, N.Y. TIMES, July 29, 2013, available at http://www.nytimes.com/2013/07/30/business/in-a-shift-eminent-domain-saves-homes.html?pagewanted=all&_r=0.

52. Labor Solidarity Comm., *Special Oakland City Council Meeting to Consider Resolution in Support of Richmond's Proposed Mortgage Relief Program using Eminent Domain*, OCCUPY OAKLAND (Oct. 27, 2013), https://occupyoakland.org/ai1ec_event/special-oakland-city-council-meeting-consider-resolution-support-richmonds-proposed-mortgage-relief-program-using-eminent-domain/?instance_id=.

53. *ASF Submits Letter to Salinas, CA Opposing Proposed Eminent Domain Agreement with MRP*, AMERICAN SECURITIZATION FORUM (Dec. 16, 2012), <http://www.americansecuritization.com/content.aspx?id=8651#.UtiCxrRzLKc>.

54. Alison Morrow, *Underwater homeowners get a chance for relief in Seattle*, KING5.COM (Dec. 11, 2013, 6:33 PM), <https://web.archive.org/web/20140217091338/http://www.king5.com/news/cities/seattle/Underwater-homeowners-get-a-chance-for-relief-in-Seattle-235497161.html>.

in New York; Newark⁵⁶ and Irvington⁵⁷ in New Jersey; Chicago;⁵⁸ and Brockton⁵⁹ in Massachusetts.

Unfortunately, most of these cities have succumbed to the pressure put on them by national lenders and the Government-Sponsored Enterprises (“GSEs”) Fannie Mae and Freddie Mac.⁶⁰ However, Richmond, California has refused to back down and has taken MRP’s proposal further than any other city.⁶¹ Richmond’s mayor, Gayle McLaughlin, is adamant that eminent domain will help struggling homeowners in Richmond lower their monthly payments and stay in their homes:

The foreclosure crisis hit Richmond hard. When one home goes into foreclosure, nine other homes are impacted. That invites blight, crime, and affects the city’s tax base as a result. When there are neighborhoods with lots of vacant homes, that means there aren’t enough homeowners with money to spend in local economies, to send their kids to our schools, to support local business. So this is addressing all of that.

We want to stop homelessness, and we want to keep families in their homes, living and working in our community. We’ve got people hanging on by their fingernails right now. And we’ve bailed out the banks to the tune of \$2 trillion. We just want them to not stand in our way.⁶²

Still, Richmond has not actually implemented eminent domain.⁶³ In July 2013, the city sent out letters to the lenders of 624 homes asking them to sell their mortgage notes at fair market value—unsurprisingly, all lenders declined.⁶⁴ Currently, two banks have brought lawsuits against Richmond challenging the legality of the program and pushing

55. The Daily Voice, *Yonkers City Council Explores Program To Help Homeowners In Foreclosure*, YONKERS: DAILY VOICE (Nov. 20, 2013), <http://yonkers.dailyvoice.com/news/yonkers-city-council-explores-program-help-homeowners-foreclosure>.

56. Dopp, *supra* note 11.

57. Dewan, *supra* note 12.

58. Micah Maidenberger, *Alderman wants to explore fighting foreclosures with eminent domain*, CHICAGO REALESTATE DAILY.COM (July 30, 2012), <http://www.chicagorealestatedaily.com/article/20120730/CRED03/120739989/alderman-wants-to-explore-fighting-foreclosures-with-eminent-domain#>.

59. Eleazar David Melendez, *Brockton, Massachusetts, Considers Eminent Domain To Address Foreclosures*, HUFF POST: BUSINESS (Jan. 15, 2013), http://www.huffingtonpost.com/2013/01/11/brockton-eminent-domain-foreclosure_n_2458369.html.

60. *See infra* Part I Section C.

61. Dewan, *supra* note 29.

62. Gibson, *supra* note 32.

63. Christina Mlynski, *Eminent domain remains minor headwind as housing recovers*, HOUSING WIRE (Nov. 15, 2013, 10:12 AM), <http://www.housingwire.com/articles/27985-eminent-domain-remains-minor-headwind-as-housing-recovers>; Gibson, *supra* note 32.

64. DePillis, *supra* note 30; Shenn, et al., *supra* note 40.

for an injunction against the city; however, both have been dismissed as not ripe.⁶⁵

C. *The Lenders' Reactions*

To prevent local governments from implementing this plan, lenders have begun bullying cities that consider it.⁶⁶ The Federal Housing Finance Agency ("FHFA")⁶⁷ released a statement in August 2013, stating that FHFA may:

[I]nitiate legal challenges to any local or state action that sanctions the use of eminent domain to restructure mortgage loan contracts that affect FHFA's regulated entities; act by order or by regulation to direct the regulated entities to limit, restrict or cease business activities within the jurisdiction of any state or local authority employing eminent domain to restructure mortgage loan contracts.⁶⁸

Likewise, the Securities Industry and Financial Markets Association ("SIFMA") asserted in a statement, following Richmond's decision to continue exploring eminent domain, that "the plan . . . could deter private capital from returning to the housing markets and make home loans harder to access and more expensive for all Richmond residents."⁶⁹ This prediction that lenders will cease activity in these areas is particularly potent because if followed through with, these cities will face a chilling effect where "no one will give credit to cities that show they're willing to seize property like this" and the ones that do will "hike up interest rates" until the loans are basically infeasible.⁷⁰ Illustratively, in August 2013, Richmond attempted to sell a highly rated set of bonds, but was unsuccessful:⁷¹

Just days after Richmond became the first city in the country to use the threat of eminent domain to obtain underwater mortgages, Wall Street spurned its efforts to refinance its highly rated municipal bonds, an unusual snub that cost the city nearly \$4 million in lost savings . . . Bonds are a crucial funding mechanism for local governments, which depend on them to finance public projects like roads, schools and utilities. Being unable to sell or refinance bonds

65. See Mlynski, *supra* note 63.

66. See Harkinson, *supra* note 10; Dewan, *supra* note 12.

67. *About Us*, FED. HOUS. FIN. AGENCY, <http://www.fhfa.gov/AboutUs> (last visited June 15, 2014) ("[The FHFA is an] independent regulatory agency responsible for the oversight of vital components of the secondary mortgage markets—the housing government sponsored enterprises of Fannie Mae, Freddie Mac and the Federal Home Loan Bank System.").

68. *Media Statements*, FED. HOUS. FIN. AGENCY, <http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Statement-on-Eminent-Domain.aspx> (last visited Sept. 12, 2014).

69. *SIFMA Statement Following Richmond Vote on Eminent Domain*, SIFMA (Sept. 11, 2013), <http://www.sifma.org/newsroom/2013/sifma-statement-following-richmond-vote-on-eminent-domain/>.

70. Badger, *supra* note 32; Harkinson, *supra* note 10; Shenn, et al., *supra* note 40.

71. Dewan, *supra* note 29.

to lower interest rates could hurt a city's ability to meet its long-term obligations.⁷²

Realistically, if lenders are able to restrict access to credit in these cities, this action would "stop the [eminent domain] program immediately."⁷³ Therefore, this threat, coupled with the inevitable legal battles,⁷⁴ have understandably caused several local governments to back down.⁷⁵

III. HISTORICAL LIMITATIONS ON LENDERS

Essentially, the lenders want to decline to do business in cities that implement eminent domain. Historically, through a process now known as "redlining," lenders categorically refused to do business in certain geographic areas because of the region's racial or ethnic composition.⁷⁶ Although the lenders' motives in the current situation are slightly different—they are refusing business not because of race but because of the cities' actions—their motives are irrelevant because their policy will have a disparate impact on citizens of a minority race or ethnicity.

A. Redlining

Around the 1930s, lenders began considering factors other than the value of the borrower's collateral before approving a loan, such as the location of the collateral and characteristics of the applicant.⁷⁷ Thus, in order to bring some stability and consistency to residential mortgage loans, Congress enacted the National Housing Act of 1934, which created the Federal Housing Administration.⁷⁸ To achieve national consistency in lending practices, the Federal Housing Administration published a manual that covered, among other topics,

72. Carolyn Said, *Eminent domain plan may have spooked investors*, SFGATE (Aug. 29, 2013, 11:00 PM), <http://www.sfgate.com/realestate/article/Eminent-domain-plan-may-have-spooked-investors-4773720.php>.

73. Alejandro Lazo, *Lt. Gov. Gavin Newsom alleges 'threats' against mortgage plan*, LOS ANGELES TIMES, Sept. 11, 2012, <http://articles.latimes.com/2012/sep/11/business/la-fi-eminent-domain-20120911>.

74. FAQS, *supra* note 39 (however, MRP has stated that they will pay the costs of these legal challenges).

75. James Dehaven, *North Las Vegas rejects use of eminent domain to rescue homeowners*, LAS VEGAS REVIEW-JOURNAL (Sept. 4, 2013, 8:55 PM), <http://www.reviewjournal.com/news/government/north-las-vegas-rejects-use-eminent-domain-rescue-homeowners>; Jean Tepperman, *Fearing Wall Street Reprisals, Oakland Council Abandons Anti-Foreclosure Plans*, EAST BAY EXPRESS (Nov. 20, 2013), <http://www.eastbayexpress.com/SevenDays/archives/2013/11/20/fearing-wall-street-reprisals-oakland-council-abandons-anti-foreclosure-plans>; Dewan, *supra* note 29.

76. BLACK'S LAW DICTIONARY (9th ed. 2009), redlining.

77. ROBERT SCHAFFER & HELEN F. LADD, DISCRIMINATION IN MORTGAGE LENDING 4 (1981).

78. Stephen M. Dane, *Eliminating the Labyrinth: A Proposal to Simplify Federal Mortgage Lending Discrimination Laws*, 26 U. MICH. J.L. REFORM 527, 534–35 (1993).

creditworthiness of the applicant and adequacy of the collateral.⁷⁹ For a decade or so after its creation, this manual actually required lenders to decline loans to minorities who wished to live in non-minority neighborhoods.⁸⁰ Likewise, the American Institute of Real Estate Appraisers Manual ranked minorities in order of their impact on a neighborhood's value.⁸¹

The Housing Administration officially eliminated race-based lending criteria from its manual in the 1960s, but this did not stop the private lenders from continuing to employ its discriminatory tenets.⁸² During the 1960s and 1970s, Congress passed legislation, such as the FHA and the ECOA, to combat this private lending discrimination.⁸³ However, rather than discontinuing these practices altogether, lenders merely utilized more subtle methods of discrimination that were difficult to detect and prove.⁸⁴ These methods allowed the discrimination to continue almost entirely unchecked until several years after the FHA had been enacted.⁸⁵ This discrimination was often seen in the form of "redlining," which is where banks and lenders refuse to extend credit to certain geographic locations, such as those with high minority or low-income populations.⁸⁶ Redlining usually refers to the broader exclusion of people from a certain geographic location and it is not dependent on the race of the prospective borrower.⁸⁷ Ultimately, although officially prohibited by the FHA and ECOA, redlining continued as a pervasive lending practice in many low-income and inner city areas until the 1990s.⁸⁸

79. *Id.* at 535.

80. *Id.*

81. *Id.* at 534.

82. *Id.* at 536.

83. Dane, *supra* note 78, at 537.

84. *Id.* (One such method is prescreening and another is to manipulate the terms and conditions of the loan to take advantage of minorities who may not know it is unfavorable or who do not have any other option); *Id.* at 537 n.37.

85. Robert G. Schwemm, *Introduction to Mortgage Lending Discrimination Law*, 28 J. MARSHALL L. REV. 317, 319–20 (1995).

86. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266-01, 18268 (Apr. 15, 1994) (to be codified at 24 C.F.R. pt. 100) (Redlining refers to "the illegal practice of refusing to make residential loans or imposing more onerous terms on any loans made because of the predominant race, national origin, etc., of the residents of the neighborhood in which the property is located."); BLACK'S LAW DICTIONARY (9th ed. 2009), redlining.

87. Swire, *supra* note 15, at 800–01 ("Some institutions that would not lend to blacks entering white neighborhoods would indeed provide mortgages once a neighborhood had become clearly black. But many lenders had policies of not making loans in black neighborhoods. Agencies often refused to insure loans secured by properties in black neighborhoods . . ."); Schwemm, *supra* note 85, at 319 (In *Laufman v. Oakley Building & Loan Co.*, the plaintiff was a "white individual who bought a house in a racially diverse area of Cincinnati and felt that the defendant did not provide equal loans in that area. . . [H]e claimed that he was discriminated against not because of his race, but because of the racial make-up of the area where he wanted to buy a house.").

88. Schwemm, *supra* note 85, at 321; Nier & St. Cyr, *supra* note 16, at 947.

As redlining gained media attention, some unscrupulous lenders realized that they could exploit the minorities and the low-income citizens who were being denied credit by other lenders. Accordingly, “reverse redlining”—the practice of targeting communities that had been victims of redlining in the past for subprime or unfair loans—began in the late 1900s.⁸⁹ Redlining facilitated the growth of these subprime loans because many minority communities that had been continuously denied credit were both desperate and unsophisticated enough for lenders to target and exploit.⁹⁰ Typical reverse redlining practices include unreasonable interest rates or fees, fraudulent or misleading marketing, and high rates of refinancing.⁹¹ This type of lending “result[ed] in devastating personal losses, including bankruptcy, poverty, and foreclosure.”⁹² It has disproportionately affected minority borrowers and neighborhoods, and has consequently “strip[ped] assets and wealth from communities of color, and exacerbate[d] the wealth gap between black and white families.”⁹³ Although this lending appeared to be somewhat different from the redlining of the past, the outcome was the same—minority groups were targeted and exploited.

B. *The FHA and the ECOA*

Plaintiffs have used both the FHA and the ECOA to combat different types of lending discrimination.⁹⁴ The Department of Housing and Urban Development (“HUD”) regulates the implementation of the FHA, and the Federal Reserve Board (“FRB”) regulates the ECOA.⁹⁵ Congress enacted the FHA in 1968 as Title VIII of the Civil Rights Act of 1968,⁹⁶ amended in 1988,⁹⁷ and its purpose is to provide “fair housing throughout the United States.”⁹⁸ Section 3605 of the FHA makes it “unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of

89. Nier & St. Cyr, *supra* note 16, at 942, 944.

90. *Id.*

91. *Id.* at 946.

92. *Id.* at 945 (“Subprime loans also move more quickly into foreclosure than prime loans do.”).

93. *Id.* at 946, 948 (predatory lending leads to “increased debt, lost equity, increased foreclosures, and neighborhood devaluation.”).

94. See Dane, *supra* note 78.

95. Fair Housing Act, 24 C.F.R. § 100.1 (2013); Equal Credit Opportunity Act, 12 C.F.R. § 202.1 (2013).

96. Civil Rights Act of 1968, Pub. L. No. 90-284, 82 Stat. 73.

97. Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (codified at 42 U.S.C. § 3601).

98. Fair Housing Act, 42 U.S.C. § 3601 (2012).

race, color . . . or national origin.”⁹⁹ The FHA regulations provide specific examples of some prohibited practices.¹⁰⁰

Likewise, Congress enacted the ECOA in 1974 as Title VII, an amendment to the Consumer Protection Act,¹⁰¹ and was later amended in 1976.¹⁰² The ECOA’s original purpose was to “make credit available with fairness, impartiality, and without discrimination on the basis of sex or marital status.”¹⁰³ However, the 1976 amendment added language to prevent discrimination based on race, color, religion, and national origin.¹⁰⁴ The ECOA regulations provide specific examples of some practices that are prohibited.¹⁰⁵ Together, the FHA and ECOA provide comprehensive legislation against lending discrimination.¹⁰⁶

C. *Lending Discrimination Causes of Action*

To protect minority borrowers effectively, it is necessary to understand what lending discrimination is, and how to prove a lending discrimination case. There are three recognized categories of lending discrimination. The first category is overt discrimination.¹⁰⁷ This occurs when a prohibited factor is clearly the basis for a lender’s decision.¹⁰⁸ Today, there are fewer instances of overt discrimination because lenders are more aware of the requirements imposed on them by the FHA and ECOA, and realize that there are significant consequences for discriminatory behavior.¹⁰⁹

The second category of lending discrimination is disparate treatment.¹¹⁰ This occurs when a lender uses a prohibited factor, such as race, as a basis to treat applicants differently;¹¹¹ however, this type is more difficult to prove than overt discrimination, and often requires the use of “testers” to provide evidence that a lender has discriminated in treatment.¹¹²

99. 42 U.S.C. § 3605 (2012).

100. See 24 C.F.R. §§ 100.120, 100.130, 100.400 (2013).

101. Equal Credit Opportunity Act, Pub. L. No. 93-495, 88 Stat. 1500.

102. Equal Credit Opportunity Act Amendments of 1976, Pub. L. No. 94-239, 90 Stat. 251.

103. Equal Credit Opportunity Act, Pub. L. No. 93-495, § 502, 88 Stat. 1500.

104. Equal Credit Opportunity Act Amendments of 1976, Pub. L. No. 94-239, § 701, 90 Stat. 251; Equal Credit Opportunity Act, 15 U.S.C. § 1691 (2012).

105. Equal Credit Opportunity Act, 12 C.F.R. §§ 202.4(b), 202.5–202.7 (2013).

106. See Schwemm, *supra* note 85, at 326–27; Dane, *supra* note 78, at 546–50.

107. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266-01, 18268 (Apr. 15, 1994) (to be codified at 24 C.F.R. pt. 100).

108. *Id.*

109. See Dane, *supra* note 78, at 537; Schwemm, *supra* note 85, at 328.

110. Policy Statement on Discrimination in Lending, 59 Fed. Reg. at 18268.

111. *Id.*

112. Schwemm, *supra* note 85, at 329.

The third category of recognized discrimination is disparate impact.¹¹³ This occurs when a lender applies a policy equally to all applicants, but the policy results in a discriminatory effect on a prohibited factor.¹¹⁴ Because overt discrimination is all but non-existent, and disparate treatment is not applicable to the situation in Richmond, this Note will only focus on disparate impact.

There is a new regulation that “formalizes [HUD’s] long-held recognition of discriminatory effects liability under the Act [the FHA] and, for purposes of providing consistency nationwide, formalizes a burden-shifting test for determining whether a given practice has an unjustified discriminatory effect”¹¹⁵ The rule, effective on March 18, 2013, and codified in 24 C.F.R. Section 100.500, provides that “[a] practice has a discriminatory effect where it actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, . . . or national origin.”¹¹⁶ The purpose of this regulation is to cover two types of discriminatory effects: “(1) harm to a particular group of persons by a disparate impact; and (2) harm to the community generally by creating, increasing, reinforcing, or perpetuating segregated housing patterns.”¹¹⁷

The regulation then provides what constitutes a prima facie case and discusses the burden-shifting framework.¹¹⁸ In a typical disparate impact claim, there is generally only one component to a prima facie case.¹¹⁹ The plaintiff must show that “a challenged practice caused or predictably will cause a discriminatory effect.”¹²⁰ A plaintiff cannot merely assert or provide their general perception that a policy disproportionately excludes people on a prohibited basis,¹²¹ and must generally present statistical evidence showing that higher percentages of minorities are excluded than are non-minorities.¹²² Notably, discriminatory intent is not required.¹²³

113. Policy Statement on Discrimination in Lending, 59 Fed. Reg. at 18268.

114. *Id.*; Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. 11460-01, 11460 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100); Fair Housing Act, 24 C.F.R. § 100.500(a) (2013); Stephen M. Dane, *Disparate-Impact Analysis in the Mortgage Lending Context*, 115 BANKING L.J. 900, 906 (1998).

115. Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. at 11460.

116. 24 C.F.R. § 100.500(a).

117. Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. at 11469.

118. See 24 C.F.R. § 100.500(c).

119. *Id.* § 100.500(c)(1); Schwemm, *supra* note 85, at 331.

120. 24 C.F.R. § 100.500(c)(1).

121. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266-01, 18269 (Apr. 15, 1994) (to be codified at 24 C.F.R. pt. 100); Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. at 11472.

122. Schwemm, *supra* note 85, at 331; Policy Statement on Discrimination in Lending, 59 Fed. Reg., at 18269.

123. 24 C.F.R. § 100.500(c)(1).

After the plaintiff demonstrates that a lender's policies have a discriminatory impact, the burden shifts to the defendant-lender to demonstrate that "the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the defendant;"¹²⁴ however, the interests cannot be "hypothetical or speculative."¹²⁵ Afterwards, even if the lender has successfully provided a legitimate, nondiscriminatory reason for the practice, a plaintiff may still prevail by demonstrating that "the substantial, legitimate, nondiscriminatory interest(s) supporting the challenged practice could be served by another practice that has a less discriminatory effect."¹²⁶ Again, this evidence cannot be "hypothetical or speculative."¹²⁷ If the plaintiff cannot provide a less-discriminatory alternative method to address the defendant's legitimate interests, the case fails because the defendant has provided a legally sufficient justification for the disparate impact.¹²⁸

D. *Understanding Disparate Impact*

Because disparate impact allows a legitimate justification of discriminatory practices as a defense, fully understanding disparate impact requires a discussion of how the courts should interpret these terms. For example, it is important to explore which justifications tend to be "substantial, legitimate, and nondiscriminatory;" along with how strict the standard is for evaluating if a "challenged practice could not be served by another practice that has a less discriminatory effect;" and lastly, what "hypothetical or speculative" means.¹²⁹

HUD has clarified its regulation regarding the implementation of the FHA's discriminatory effects standard. First, HUD clarified two of the terms in the phrase "substantial, legitimate, and nondiscriminatory" from 24 C.F.R. Section 100.500(b)(1)(i). HUD defines "substantial" as "a core interest of the organization that has a direct relationship to the function of that organization."¹³⁰ HUD also states that determining which "goals, objectives, and activities" are substantial enough to qualify as a legitimate justification for discrimination is a "case-specific, fact based inquiry."¹³¹ One commentator asked HUD to include examples of interests that would meet the necessary standard but HUD declined to do this, choosing only to reiterate that it is a "case specific inquiry."¹³² Additionally, the term "legitimate"

124. *Id.* § 100.500(c)(2).

125. *Id.* § 100.500(b)(2).

126. *Id.* § 100.500(c)(3).

127. 24 C.F.R. § 100.500(b)(2).

128. *Id.* § 100.500(b)(1)(i)–(ii).

129. *Id.* § 100.500(b)(2), (c)(2)–(3).

130. Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11460–01, 11470 (Feb. 15, 2013) (to be codified at 24 C.F.R. pt. 100).

131. *Id.*

132. *Id.* at 11471.

requires that the interest be objectively genuine and not false, fabricated, or pretextual.¹³³ HUD specifically rejected the term “business necessity” already used in other areas of discrimination law because HUD was concerned that courts and litigants would misinterpret that standard to apply only to businesses rather than the “full scope of practices covered by the Fair Housing Act, which applies to individuals, businesses, nonprofit organizations, and public entities.”¹³⁴ It is important to note that, although HUD rejected the language of “business necessity,” the statute requires that a defendant show the “challenged practice is necessary” to achieve a legitimate interest.¹³⁵ HUD used the word “necessary” in 24 C.F.R. Section 100.500(b)(1)(i) because this broad language best achieves the goal of the FHA, and it is consistent with the historical disparate impact doctrine that also required it be necessary.¹³⁶

Second, HUD clarified the requirement that the defendant’s “challenged practice could not be served by another practice that has a less discriminatory effect” from 24 C.F.R. Section 100.500(b)(1)(ii). HUD declined to articulate a standard to use to interpret this language. Commenters suggested adding language that would help clarify the parameters of this requirement, such as saying that the less discriminatory practice be “equally effective” or “at least as effective”; however, HUD decided not to elaborate on the requirement. HUD stated that adding a standard such as “equally effective” would be inappropriate given the “wider range and variety of practices covered by the Act that are not readily quantifiable.”¹³⁷ HUD emphasized that in proving that a less discriminatory alternative exists, the plaintiff must also show that the alternative “effectively address the lender’s concerns” that are allegedly being protected or advanced by the discriminatory practice.¹³⁸

Third, HUD clarified the terms “hypothetical or speculative” as used in 24 C.F.R. Section 100.500(b)(2). HUD stated that this language excludes relationships that are imagined out of “speculation, hypothesis, generalization, stereotype, or fear”—the defendants must provide actual evidence that there is a relationship between an appropriate interest and the challenged practice.¹³⁹

133. *Id.* at 11470.

134. *Id.* (“[Business necessity has been used with] judicial interpretations of the Fair Housing Act, with HUD’s regulations governing Fannie Mae and Freddie Mac, and with the Joint Policy Statement.”).

135. 24 C.F.R. § 100.500(b)(1)(i).

136. Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. at 11470–71; 12 C.F.R. § 1002.6(a)(2) (Supp. I 2014).

137. Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 78 Fed. Reg. at 11473.

138. *Id.* at 11473.

139. *Id.* at 11471.

Since its enactment, there have been only a few cases interpreting 24 C.F.R. Section 100.500. In *Boykin v. Gray*, the court granted the defendant's motion for summary judgment on a disparate impact claim.¹⁴⁰ In *Boykin*, the plaintiff claimed that the city violated the FHA by closing down a ninety-bed homeless shelter because the closure disproportionately affected African-Americans and Hispanics.¹⁴¹ The court determined that the statistical evidence proffered by the plaintiff was inadequate to show a disparate impact.¹⁴² The statistics focused on the fact that minorities were overrepresented in the city's homeless population.¹⁴³ However, the court emphasized that because the homeless shelter only had ninety beds, only a small proportion of the homeless population felt the negative impact of its closure.¹⁴⁴ Moreover, the shelter's closure was not the result of an adverse policy, but a new policy that the city believed would better serve the homeless population.¹⁴⁵

In *Mt. Holly Gardens Citizens in Action, Inc. v. Township of Mount Holly*, the third circuit vacated and remanded a grant of summary judgment to the defendants on a disparate impact FHA claim.¹⁴⁶ Plaintiffs claimed that the town destroyed existing homes in a neighborhood occupied predominately by minorities and replaced them with more expensive homes.¹⁴⁷ The court held that the statistical evidence provided was sufficient to satisfy the prima facie case. The plaintiffs used census data to show that 23% of African-American households and 32% of Hispanic households in Mount Holly would be destroyed, as compared to 3% of white households.¹⁴⁸ Moreover, after the new homes were built, only 21% of the minority households would be able to afford them, as opposed to 79% of white households.¹⁴⁹

After establishing a prima facie case, the township stated that its justification was "alleviating blight"—which is clearly a legitimate interest. However, the issue then becomes whether the city could have

140. *Boykin v. Gray*, 986 F.Supp.2d 14, 23 (D.D.C. Sept. 30, 2013).

141. *Id.* at 16.

142. *Id.* at 19–20 ("The fundamental defect in the plaintiffs' argument is that the adverse impact of which they complain was suffered not by the entire homeless population in the District of Columbia, nor even by a significant portion of its more than 6,000 members. . . . Rather, the loss of La Casa Shelter—which had just ninety beds—was felt by a much smaller subset of that population.").

143. *Id.*

144. *Id.* at 21.

145. *Boykin*, 986 F.Supp.2d at 21.

146. *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mt. Holly*, 658 F.3d 375, 377 (3d Cir. 2011).

147. *Id.*

148. *Id.* at 382.

149. *Id.*

used a less discriminatory alternative.¹⁵⁰ The court stated that the disagreement among residents, policy makers, and experts raised a question of material fact, and therefore, summary judgment was improper.¹⁵¹

IV. LENDERS' THREATS AGAINST CITIES SEEKING TO USE EMINENT DOMAIN

To determine if disparate impact is likely to work to prevent lenders from following through on their threats to withhold or drastically limit credit to regions seeking to use eminent domain to seize mortgage notes, we must go through the steps discussed above.¹⁵² First, we must identify the facially neutral policy and demonstrate that “[the] challenged . . . [policy] caused or predictably will cause a discriminatory effect” based on race.¹⁵³ Second, we must anticipate and counter possible “nondiscriminatory interests” that the lenders will proffer.¹⁵⁴ Lastly, we must identify “another practice that has a less discriminatory effect” that could also serve the lenders’ nondiscriminatory interest.¹⁵⁵

Here, the facially neutral policy at issue is the lenders’ threat against Richmond, and similar cities, that they will either refuse to extend credit entirely, or raise interest rates so drastically that accessing credit would be, effectively, impossible.¹⁵⁶ This policy is facially neutral because there is nothing to indicate that lenders would consider race when determining to extend or deny credit to the citizens in Richmond. Rather, the policy seems like a blanket denial of credit to all citizens of Richmond in response to the city’s actions.

Having identified a facially neutral policy, next we must show that these threats will have a discriminatory effect on minorities. “Gluckstern said on the Center for American Progress panel last week that . . . ‘[t]he communities we are furthest along with in these talks are mostly communities of color’”¹⁵⁷ Moreover, a report by the Woodstock Institute found that in Chicago, “[b]orrowers in communities of color are more than twice as likely as are borrowers in white communities to have little to no equity in their homes,” and that “[a]lmost three times as many properties in communities of color are severely underwater compared to properties in white communi-

150. *Id.* at 385 (although this case was decided before 24 C.F.R. § 100.500, the court followed the appropriate burden-shifting framework, except for the least discriminatory alternative).

151. *Mt. Holly Garden*, 658 F.3d at 386–87.

152. *See supra* Part II Section C.

153. Fair Housing Act, 24 C.F.R. § 100.500(c)(1) (2013).

154. § 100.500(c)(2).

155. § 100.500(c)(3).

156. *See supra* Part I Section C.

157. Prior, *supra* note 35.

ties.”¹⁵⁸ In addition to the Woodstock Report, a study conducted by the Pew Research Center found that “[f]rom 2005 to 2009, the median level of home equity held by Hispanic homeowners declined by half—from \$99,983 to \$49,145”; while “black homeowners . . . [fell] from \$76,910 in 2005 to \$59,000 in 2009”; and “white homeowners, . . . [fell] from \$115,364 in 2005 to \$95,000 in 2009.”¹⁵⁹ Therefore, this data suggests that home equity was affected more severely in minority communities than it was in white communities.

Furthermore, according to census data, the targeted cities have large minority populations. For example, in Richmond, according to the 2010 census data, only 17.1% of its population responded that they were both white and neither Hispanic nor Latino; this is in contrast to the overall 40.1% in California.¹⁶⁰ This discrepancy indicates that an enormous percentage of Richmond’s population is either a racial or an ethnic minority. Similar to Richmond, several other California cities also have a white, non-Hispanic population that is far below the expected percentage when considering the overall census data for California.¹⁶¹ This racial discrepancy is also present when comparing the racial composition of the City of North Las Vegas (31.2% white, non-Hispanic) to the overall population of Nevada (54.1%).¹⁶²

Considering the discrepancy between the overall white, non-Hispanic population of these states and the white, non-Hispanic populations of the cities threatened by banks and lenders, it seems clear that a policy refusing to extend credit to an entire city like Richmond would have a disparate impact on minorities. Here as in *Mt. Holly Gardens*, if the City of Richmond filed suit to prevent lenders from instituting a credit freeze, the census data would likely be strong enough to establish a cognizable claim of disparate treatment, and would therefore allow Richmond to, at a minimum, survive a motion to dismiss.

Moreover, these threats affect all citizens within the city. Unlike in *Boykin*, where the closure of one moderate-sized homeless shelter

158. Spencer Cowan & Katie Buitrago, *Struggling to Stay Afloat: Negative Equity in Communities of Color in the Chicago Six Count Region*, WOODSTOCK INSTITUTE (Mar. 2012), available at http://www.woodstockinst.org/sites/default/files/documents/stayingafloat_policybrief_mar2012_0.pdf.

159. Rakesh Kochhar et al., *Wealth Gaps Rise to Record Highs Between Whites, Blacks, and Hispanics*, PEW RESEARCH SOCIAL & DEMOGRAPHIC TRENDS at *2, 4 (July 26, 2011), <http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/>.

160. *State & County QuickFacts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/06/0660620.html> (last visited Jan. 26, 2014).

161. *State & County QuickFacts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/06/0664000.html> (last visited Jan. 26, 2014) (These cities and their corresponding white, non-Hispanic population percentages are: Sacramento (34.5%); Pomona (12.5%); El Monte (4.9%); Oakland (25.9%); and Salinas (15.5%)).

162. *State & County QuickFacts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/32/3251800.html> (last visited Jan. 26, 2014).

only affected a small portion of the homeless population, here the lenders' threats are against the entire city. Indeed, if the lenders refuse to extend credit or raise the interest rates, every citizen will be affected by this moratorium, either directly or indirectly.

The second step in the burden-shifting framework requires that lenders provide legitimate interests that support the threatened policy. There are plausible explanations for the lenders' desire to limit credit availability to the City of Richmond: the first, and perhaps the more likely reason of the two, is to retaliate against Richmond for undermining the authority of the financial system; and the second explanation is that the lenders believe that they are losing money, and will continue to lose money if the city government is free to seize any future notes the lenders issue. While the first explanation—retaliation—may be an understandable motive, it is not a legally justifiable defense to discrimination. And, although the second interest may initially appear legitimate, closer examination reveals that it is merely speculative and impulsive.

Interestingly, lender retaliation has already occurred. After initial approval of the eminent domain plan, Richmond needed to refinance its municipal bonds. These bonds are important for a city because cities "depend on them to finance public projects like roads, schools and utilities [and] [b]eing unable to sell or refinance bonds to lower interest rates could hurt a city's ability to meet its long-term obligations."¹⁶³ The bonds Richmond sought to refinance had an A- rating; a rating that would normally interest lenders very much—but not this time. Councilman Nat Bates insisted that Richmond's eminent domain plan was "exactly the reason the bonds were rejected," claiming that it was necessary for Richmond to "get back in good graces with financial institutions."¹⁶⁴ Ultimately, the municipal bond debacle cost the city "nearly \$4 million in lost savings,"¹⁶⁵ and could cost them much more if Wall Street continues to refuse their bonds. This behavior by the lenders provides insight into what they think about this situation. If lenders are willing to refuse to refinance highly-rated bonds, how far will they go to get back at Richmond?

Although more legally sound than retaliation, a defense premised on the lenders' claims of lost money would fail because it is hypothetical and speculative. Fear of losing money is certainly a substantial, legitimate, nondiscriminatory interest. However, here, it is uncertain whether there would be an actual loss, and if so, how much that loss would be. The city and MRP plan to give the lenders fair market value for the mortgage notes that they seize. The loss of money that the lenders are discussing is based on the presumption that the home-

163. Said, *supra* note 72.

164. *Id.*

165. *Id.*

owners who are still current on their payments will not default.¹⁶⁶ However, empirical evidence suggests that “80 percent of underwater mortgages owned by private-label securities will end up defaulting.”¹⁶⁷ If homeowners default on their outstanding loans, the lenders will only get fair market value, or perhaps less, from the foreclosure sale. This outcome would place the lenders in a position similar to, or worse than, the situation resulting from eminent domain. Ultimately, the high probability of homeowner default on current mortgages would likely make this interest fail to persuade a court that discriminatory practices were necessary or legal.

Assuming *arguendo*, that courts accept the lenders interests as valid, we will proceed to the last step: showing that the legitimate interests “could be served by another practice that has a less discriminatory effect.”¹⁶⁸ As discussed above, the evidence supporting this alternative practice cannot be “hypothetical or speculative.”¹⁶⁹ It is possible that there are many alternative practices that could protect the lenders’ financial interest, but the most promising alternative is a compromise between the city and the lenders. Lenders could voluntarily reduce the principal on all of the loans that the city would have otherwise seized, resulting in an affordable monthly payment that reduces the likelihood of default.

In essence, Richmond’s plan is to invoke the power of eminent domain to reduce the principal amounts owed on every loan. Therefore, rather than denying credit to an entire city, a less-discriminatory alternative practice would be for the lenders to reach a compromise with the city wherein the city does not seize the mortgage notes, and the lenders reduce the principals on the loans by a significant amount, but not all the way down to fair market value of the property.

A compromise like this would keep homeowners in their homes; a scenario where everyone wins. First, the lenders continue to receive the monthly payments from the homeowners and, because the monthly payments are lower, the likelihood of default is reduced; thus, the lender may actually make more money over time than they would have if the overvalued principle had not been reduced. Second, the city lessens the chance that the homeowner will default, and by keeping homes occupied, the city gets property taxes, prevents blight caused by vacant and unmaintained homes, and ensures the stability of the local economy.

Understandably, lenders are hesitant to reduce the principals on loans because they write off a large chunk of money when they do this, so they do not want to set a precedent of writing down principals whenever home values go down. However, the proposed compromise

166. See Harkinson, *supra* note 10.

167. *Id.*

168. Fair Housing Act, 24 C.F.R. § 100.500(c)(3) (2013).

169. § 100.500(b)(2).

is a solution to a widespread acute problem that we, as a society, hope will not happen again. It is not a go-to solution whenever housing values drop in one neighborhood. The housing market crash was a national crisis that affected hundreds of thousands of homeowners and this extreme situation requires a solution that reaches outside of the box.

V. CONCLUSION

The prevalence of redlining in the early and middle 20th century created a housing vacuum in many minority communities, which created the “underworld of real estate finance,”¹⁷⁰ where the only option available to potential borrowers were subprime mortgages offered by unscrupulous lenders.¹⁷¹ African-American borrowers were “6.1% to 34.3% more likely than white borrowers to receive a higher rate [of interest on a] subprime mortgage.”¹⁷² Thus, when the housing bubble burst, homeowners not only lost the equity in their homes, but were also stuck with exorbitant interest rates and monthly payments that they simply could not afford.¹⁷³ It is estimated that towards the end of 2008 nearly 7.6 million homes were underwater, with another 2.1 million on the cusp.¹⁷⁴ Because their homes were now underwater, it was too difficult to sell or refinance, so homeowners either had to struggle to try to remain in their homes or simply walk away.¹⁷⁵

MRP came up with a solution for cities that still have many homeowners who are stuck with underwater homes.¹⁷⁶ Their plan—to use eminent domain to force lenders to sell the mortgage notes of 624 underwater homes in Richmond, California—has caused a lot of controversy and has greatly upset lenders.¹⁷⁷ Historically, the government could only use eminent domain to seize tangible property to build structures for public use, but under the Court’s most recent interpretation of “public use,” the government can seize property to promote economic development.¹⁷⁸ MRP and the mayor of Richmond argue that seizing underwater mortgage notes qualifies as a lawful exercise of the state’s eminent domain power because vacant

170. Swire, *supra* note 15, at 801.

171. Marcia Johnson, *Will the Current Economic Crisis Fuel a Return to Racial Policies That Deny Homeownership Opportunity and Wealth?*, 6 THE MODERN AMERICAN 25, 29 (2010).

172. Nier & St. Cyr, *supra* note 16, at 947.

173. *Id.* at 946.

174. Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 31 (2009).

175. *Id.*

176. *Home*, *supra* note 31.

177. Gibson, *supra* note 32; DePillis, *supra* note 30.

178. Fawcett, *supra* note 21, at 494; *Kelo v. City of London*, 545 U.S. 469, 472, 489 (2005).

homes cause blight, and alleviating that blight is essential to promoting Richmond's economic development.¹⁷⁹

The lenders, however, are upset at the prospect of only getting paid fair market value on a loan that was originally worth much more, so they have been threatening to stop extending credit or drastically raise interest rates in cities investigating MRP's proposed plan.¹⁸⁰ Wall Street has already begun to carry out these threats by refusing to refinance Richmond's highly rated municipal bonds, which Richmond had not had trouble refinancing in the past.¹⁸¹

If the lenders do carry out their threats and make credit unavailable or impracticable for citizens to access, the FHA and the ECOA will protect the cities targeted by the credit freeze because the lenders' actions would have a discriminatory effect on minorities. To show discriminatory effect, first the city will need to demonstrate that the lenders' threats of denying credit or raising interest rates "[have] caused or predictably will cause a discriminatory effect" based on race or ethnicity.¹⁸² In Richmond's case, the city will be able to demonstrate this because census data shows that Richmond has a large minority population.¹⁸³ Moreover, the Woodstock Institute Report found that "[a]lmost three times as many properties in communities of color are severely underwater compared to properties in white communities."¹⁸⁴

Second, after Richmond proves its *prima facie* case, the burden will then shift to the lenders to demonstrate that "the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the defendant."¹⁸⁵ Moreover, the interests cannot be "hypothetical or speculative."¹⁸⁶ The financial interest that the lenders will proffer will fail because it is too speculative. The lenders presume that they will lose money because the homeowners are still preforming on their mortgages; however, data suggests that "80 percent of underwater mortgages owned by private-label securities will end up defaulting."¹⁸⁷ Thus, when the homeowner defaults, the lender will get fair market value or less from the foreclosure sale, which would be equal to or less than what the city would give them through eminent domain.

Third, assuming *arguendo* that the court allows this financial interest to carry the lenders' burden, the city would then have to demon-

179. DePillis, *supra* note 30; Dewan, *supra* note 29.

180. SIFMA, *supra* note 69; *Media Statements*, *supra* note 68; Shenn, et al., *supra* note 40.

181. Said, *supra* note 72.

182. Fair Housing Act, 24 C.F.R. § 100.500(c)(1) (2013).

183. *State & County QuickFacts*, *supra* note 160.

184. Cowan & Buitrago, *supra* note 158.

185. 24 C.F.R. § 100.500(c)(2).

186. *Id.* § 100.500(b)(2).

187. Harkinson, *supra* note 10.

strate that the “interest(s) supporting the challenged practice could be served by another practice that has a less discriminatory effect.”¹⁸⁸ Richmond will likely prevail because there is an alternative practice that would serve the lenders’ financial interest. The lenders could voluntarily reduce the principal on all of the loans that Richmond would have been able to seize to an amount that would result in an affordable monthly payment, thereby reducing the likelihood of default. The financial interest of the lenders would be sufficiently served because they would continue to receive the monthly payments from the homeowner; and because the monthly payments are lower, the likelihood of default is reduced, so over time the lender may actually make more than the fair market value of the home. Because this alternative interest would be sufficient, the city’s claim of disparate impact under the FHA and the ECOA would succeed and the lenders’ threats would be unlawful.

Therefore, if lenders were to implement a credit freeze, Richmond, and other similarly situated cities, could sue the lenders for violation of the FHA and the ECOA. Ultimately, because the lenders’ threats are unlawful, cities like Richmond should continue to investigate and analyze MRP’s plan to determine if it is a reasonable solution to the underwater mortgage problem. These cities should do what is in the best interests of their citizens and should not be afraid to stand up to Wall Street.

188. 24 C.F.R. § 100.500(c)(3).