

**SUBPRIME COMMUNITIES: REVERSE
REDLINING, THE FAIR HOUSING ACT AND
EMERGING ISSUES IN LITIGATION
REGARDING THE SUBPRIME MORTGAGE
CRISIS**

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As the nation struggles to find its bearings in the current financial crisis and venerable pillars of Wall Street crumble, hundreds of billions of dollars will be spent to shore up the financial system and re-capitalize credit markets. The spark that lit the blaze was the collapse of the subprime mortgage market, a daisy chain of inflated assets, speculative fervor, investor exuberance and unregulated and unchecked excess. While the eyes of Washington are directed toward Wall Street, there is much talk of the need to prop up Main Street as well, and nowhere is this more apparent than in communities and neighborhoods across the United States that have felt the first wave of the financial crisis hit: home upon home of foreclosed properties, abandoned and neglected, their hollow silence hard to ignore.

Many of these communities are communities of color. Lured by the temptation of credit, an economic necessity all-too-often denied such communities in the past, many found themselves saddled with unaffordable loans and backbreaking debt. Much of the rise in the homeownership rate in the United States over the past ten years was fueled by a rise in that rate among African-Americans and Latinos, a product of the expansion of the subprime mortgage market.¹ As a result, as many subprime borrowers fall into delinquency and foreclosure, since a disproportionate share of such loans were made in communities of color, a disproportionate share of the foreclosures will also fall on such communities. With that will come a parade of harmful consequences: abandoned homes, reduced property values, increased crime and a loss of equity and assets.

Municipalities across the United States are trying to develop effective responses to the fallout in their communities from the collapse of the subprime mortgage market, funding housing counseling programs and foreclosure mediation and regulating the maintenance of foreclosed and abandoned homes.² Another intervention that may prove promising is the prosecution of affirmative civil actions, designed either to punish lenders who allegedly engaged in discriminatory subprime lending practices or

¹ John Kiff & Paul Mills, *Money for Nothing and Checks for Free: Recent Developments in U.S. Subprime Mortgage Markets* 4 (Int'l Monetary Fund, Working Paper No. WP/07/188, 2007), available at <http://www.imf.org/external/pubs/ft/wp/2007/wp07188.pdf>.

² Rebuild.org Finance News, Rebuild.org, *Municipalities Respond to Foreclosure Crisis*, REBUILD.ORG, June 23, 2008, <http://www.rebuild.org/news-article/> (under "News Archive" in the right column, click "June 2008"; then click "Municipalities Respond to Foreclosure Crisis") (last visited Oct. 25, 2008).

those failing to maintain their portfolio of foreclosed homes. A case of the first type has been filed in Baltimore;³ cases of the second type have been filed in Cleveland and Buffalo.⁴

In some ways, these cases are innovative. They are brought by cities, rather than individual borrowers, to rectify or mitigate the harms caused by subprime borrowers in those cities' constitutive communities. In others, they are consistent with efforts of private actors to bring such litigation in this and other contexts.

This article is an attempt to assess the challenges faced by litigants, including municipalities, when bringing actions to remedy acts of past discrimination in the subprime mortgage market. The first case brought on behalf of a municipality as a whole was filed in early January 2008, by the Mayor and City Council of Baltimore, to remedy the impacts of what is alleged to have been discrimination in subprime lending within city limits.⁵ Baltimore, whose low- and moderate-income communities of neat row houses owned by working class homeowners have been ravaged by foreclosures generated by unaffordable subprime loans, has sued the largest lender in the Baltimore market, Wells Fargo, alleging racial discrimination in the marketing and selling of subprime home mortgages.⁶

This article reviews some of the emerging issues in discrimination law, as there is a growing body of lawsuits directed at "reverse redlining," the practice of targeting borrowers of color for loans on unfavorable terms.⁷ As the following discussion shows, courts are struggling with the problems posed by reverse redlining and the challenges it raises to existing anti-

³ Donna Leinwand, *Cities Suing Lenders in Strategy Against Foreclosures*, USA TODAY, May 16, 2008, at 15A.

⁴ *Id.*

⁵ Libby Lewis, *Baltimore Blames Lender for Wave of Foreclosures*, NPR, Jan. 11, 2008, <http://www.npr.org> (enter "Baltimore Blames Lender for Wave" in the search box; then click on the first link under "Search Results") (last visited Oct. 25, 2008).

⁶ The cities of Cleveland and Buffalo have taken a different tack, suing banks and other entities for their risky lending practices, which, it is alleged, created a public nuisance: a wave of foreclosures, resulting in a rash of poorly maintained properties throughout these cities and depleted tax bases and increases in municipal liabilities. Because these suits proceed on a very different theory, public nuisance, a review of that litigation is beyond the scope of this analysis. Compare Leinwand, *supra* note 3, at 15A (stating the approaches of Cleveland and Buffalo), with Lewis, *supra* note 5 (stating the approach of Baltimore).

⁷ Reverse redlining involves targeting residents "within certain geographic boundaries, often based on income, race, or ethnicity," and giving those targeted borrowers "credit on unfair terms." S. REP. NO. 103-169, at 21 (1994), as reprinted in 1994 U.S.C.C.A.N. 1881, 1905.

discrimination jurisprudence. A first wave of cases was filed in which allegations of reverse redlining were raised, and the courts' handling of such cases attempted to develop a new approach to such allegations, one that departed from existing anti-discrimination approaches to lending discrimination in some significant ways. A second wave of such cases, detailed below, appears to utilize, effectively, existing anti-discrimination jurisprudence in assessing the legality of reverse redlining practices. The argument central to this piece is that this jurisprudence is useful to combat reverse redlining, and litigants and the courts should learn well from this second wave of cases that have been successful in addressing the unique challenges posed by reverse redlining allegations. Although some tensions within anti-discrimination doctrine still exist, and these tensions are outlined in detail below, it is still the case that existing anti-discrimination frameworks are effective in combating reverse redlining and should be utilized to do just that.

This article is structured as follows: In Part I, I will describe the impact of the subprime mortgage crisis on municipalities across the country due to rising foreclosures and the increasing number of neglected and abandoned foreclosed properties within city limits. This section will conclude with an overview of the impact of subprime lending on communities of color. In Part II, I will describe the allegations and claims raised in the Baltimore litigation. In Part III, I will describe the state of the law with respect to the Fair Housing Act's ability to address the extension of loans on disadvantageous terms to borrowers of color and other protected classes. In Part IV, I will assess emerging issues in anti-discrimination law with respect to the challenged lending practices, with a prescription for how courts can best address the Baltimore litigation and other, similar lawsuits that might be filed in the future, either by municipalities, state attorneys general or private litigants.

I. THE SUBPRIME MORTGAGE CRISIS AND LOCAL COMMUNITIES

A. The Impact

The fallout from the subprime mortgage crisis and the rise of foreclosures that has followed (and will continue) will be significant. First and foremost, there will be a deep decline in property values, which leads to a reduction in the tax base and

less revenue for local governments. Because foreclosed properties are often sold at a loss, this can impact the valuation of those properties for tax purposes. But the reduction in property values is felt beyond those foreclosed properties, as appraisals take into account the reduced sale price for foreclosed homes when considering the value of neighboring properties. One study that estimated the impact of foreclosures in the City of Chicago in the late 1990s showed that single family homes within one eighth of a mile of a foreclosed home were reduced from between 0.9% and 1.136% per foreclosure.⁸ As a result, the cumulative impact of each foreclosed property was to reduce the value of neighboring properties by a total of between \$159,000 and \$371,000.⁹ That study estimated further that foreclosures filed in Chicago in 1997 and 1998 reduced property values in the city as a whole by between \$598 million and \$1.39 billion.¹⁰ Recent studies predict a range of losses to homeowners across the country due to the current rise in foreclosures from between \$356 billion to \$1.2 trillion in home values nationally.¹¹

Properties rendered vacant after foreclosure also reduce property values of those properties and neighboring homes in other ways. Lawn maintenance and routine repairs are ignored, leaving properties that are unattractive and dispiriting. They also become a magnet for crime, like drug activity and arson. These forces can lead neighbors to wish to sell their homes, at depressed values, but they also can act as a drain on municipal services, with local governments having to spend more on police and fire services to respond to criminal activity in these properties, even to cut lawns.¹² In addition to reducing the tax

⁸ DAN IMMERGLUCK & GEOFF SMITH, WOODSTOCK INST., *THERE GOES THE NEIGHBORHOOD: THE EFFECT OF SINGLE-FAMILY MORTGAGE FORECLOSURES ON PROPERTY VALUES* 9 (2005), *available at* http://www.nw.org/foreclosuresolutions/reports/documents/TGTN_Report.pdf.

⁹ *Id.* at 11.

¹⁰ *Id.* at 13.

¹¹ *See* THE PEW CHARITABLE TRUSTS, *DEFAULTING ON THE DREAM: STATES RESPOND TO AMERICA'S FORECLOSURE CRISIS* 10 (2008), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Subprime_mortgages/defaulting_on_the_dream.pdf (predicting \$356 billion loss in home value due to rise in foreclosures); GLOBAL INSIGHT, *THE MORTGAGE CRISIS: ECONOMIC AND FISCAL IMPLICATIONS FOR METRO AREAS 2* (2007), *available at* <http://www.usmayors.org/metroeconomies/1107/report.pdf> (predicting \$1.2 trillion total loss in home values due to the subprime mortgage crisis).

¹² WILLIAM C. APGAR ET AL., *THE MUNICIPAL COST OF FORECLOSURES: A CHICAGO CASE STUDY* 10-11 (2005), http://www.995hope.org/content/pdf/Apgar_Duda_Study_Full_Version.pdf (last visited Oct. 25, 2008).

base due to a drop in property values for foreclosed properties and those properties near them, often homeowners not paying their mortgages also do not pay their taxes (especially where a portion of their monthly bank payments are supposed to go to an escrow for the payment of their taxes). Cities often forego significant tax arrears payments that they might recover through the trouble and expense of foreclosing on the tax liens they hold by selling their liens for pennies on the dollar.¹³ One study of the impact of the subprime mortgage crisis estimated that ten representative states stood to lose a total of \$6.6 billion in tax revenue in 2008 alone.¹⁴

Municipalities are also often left to deal with the problem of properties abandoned by homeowners and banks alike. At times, they must undertake the expense of seizing and demolishing properties ravaged by arson and vandalism. One estimate of the drain on municipal coffers due to when demolition is required places the cost to a municipality at over \$34,000 per building, while the average cost to municipalities for each foreclosure, whether demolition is required or not, was estimated at \$7,000.¹⁵

B. Key Elements of the Subprime Crisis that Brought About these Impacts

As I have attempted to explain elsewhere,¹⁶ some of the key

¹³ WILLIAM C. APGAR & MARK DUDA, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM 7 (2005), http://www.995hope.org/content/pdf/Apgar_Duda_Study_Short_Version.pdf (last visited Oct. 25, 2008).

¹⁴ GLOBAL INSIGHT, *supra* note 11, at 5.

¹⁵ APGAR ET AL., *supra* note 12, at 23.

¹⁶ See generally Raymond H. Brescia, *Capital in Chaos: The Subprime Mortgage Crisis and the Social Capital Response*, 56 CLEV. ST. L. REV. 271 (2008) (attributing the causes of the subprime mortgage crisis to, among other factors, the deregulation of the mortgage industry). For an historical perspective on the lead up to the current crisis, see generally EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 9-35 (2007) (analyzing trends in homeownership from the 1940s to the 2000s); *Possible Responses to Rising Mortgage Foreclosures: Hearing Before the H. Comm. on Fin. Serv.*, 110th Cong. (2007) (statement of Sheila C. Bair, Chairman Fed. Deposit Ins. Corp.) [hereinafter *Bair Testimony*] (looking at trends in securitization, *inter alia*, within the past ten years); *Mortgage Market Turmoil: Causes and Consequences: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. (2007) (testimony of Roger T. Cole, Director, Div. of Banking Supervision and Regulation) [hereinafter *Cole Testimony*] (discussing the consequences of subprime lending, as well as steps taken by the Federal Reserve to remedy the situation); Allan N. Krinsman, *Subprime Mortgage Meltdown: How did it Happen and How will it End*, 13 J. STRUCTURED FIN. 1 (2007) (looking at what

features of the subprime mortgage market that have led to its ultimate demise include the following: First, the lack of accountability in the mortgage origination industry led to an emphasis on the quantity of mortgages sold and securitized and not the quality or viability of the borrower, creating perverse incentives and weakened underwriting criteria, non-existent oversight, and complicit ratings agencies.¹⁷ Second, there was an imbalance in information – “information asymmetries” as the economists call it – between prospective borrowers and the mortgage industry representatives with whom they came in contact, notably mortgage brokers and mortgage originators. Third, as has been well documented, underwriting standards weakened significantly in the later years of the housing boom, as brokers and originators sought to tap whatever markets there were for potential borrowers, regardless of their viability as such. The drive to make loans and sell them off as securities was motivated by both an insatiable appetite in the market for investing in securities backed by U.S. mortgages as well as a desire on the part of brokers and originators to generate their own fees for packaging such loans. All this was carried out with little regard for the prospects of these mortgages, which led to lending to borrowers who, if sensible underwriting criteria had been used, might otherwise not have obtained loans.¹⁸ Admittedly, some borrowers are not completely blameless. There are those who took on loans they knew they could not afford once the interest rates reset to higher levels, believing that ever-increasing home values would allow them to refinance their way out of their mortgage and enter into a new one by tapping into

gave rise to the subprime mortgage market as well as characteristics of the market); Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 FED. RES. BANK OF ST. LOUIS REV. 31 (2006). For more recent assessments of the current financial crisis and its relation to the fallout from the subprime market's collapse, see ROBERT J. SHILLER, *THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT* 29-38, 87-113 (2008) (beginning with the history of the subprime crisis then discussing solutions to the subprime crisis that have been tried or proposed); MARK ZANDI, *FINANCIAL SHOCK: A 360° LOOK AT THE SUBPRIME MORTGAGE IMPLOSION, AND HOW TO AVOID THE NEXT FINANCIAL CRISIS* (2008).

¹⁷ Brescia, *supra* note 16, at 291-92, 301.

¹⁸ *The Role of Secondary Market in Subprime Mortgage Lending: Hearing Before the H. Subcomm. on Financial Instrument and Consumer Credit*, 110th Cong. 104-05 (2007) (testimony of Warren Kornfeld, Managing Director of Moody's Investment Serv.) [hereinafter *Kornfeld Testimony*]; Cole Testimony, *supra* note 16, at 4; SHILLER, *supra*, note 16, at 5-6; Krinsman, *supra* note 16, at 13-15; Kiff & Mills, *supra* note 1, at 4.

the increased equity in their homes.¹⁹

Brokers and lenders unabashedly fed this demand, and the demand of the investors for more mortgage-backed securities, by packaging loans aggressively, and collecting their fees with each new mortgage made and pooled. Borrowers would become repeat players, returning to the same brokers and originators who sold them their previous loan, generating fees on top of fees for these actors. Sitting atop these schemes were the ratings agencies, blessing these complicated and risky portfolios with little regard for their prospect of failure.

But, as the following discussion shows, even this is not the whole story.

C. The Discriminatory Roots of the Subprime Mortgage Crisis

One of the most significant – and under-reported – phenomena in the rise and fall of the subprime mortgage market has been the role that subprime lending in communities of color has played in the collapse of this market. Because of the history of discrimination in certain communities,²⁰ there was a lack of viable lending alternatives and less of a familiarity with the mortgage market, which also led otherwise viable borrowers to accept unfavorable mortgage terms. They could have avoided such terms if the market functioned well and borrowers had complete information about the options available to them were they able to tap the broader market. Furthermore, based on the relative risk of lending to some of these borrowers, and their lack of understanding of the true impact of the exotic mortgages they were assuming (with enticing “teaser rates” and opaque rules regarding the methods for adjusting the interest rate), such borrowers, whether they represented truly unreasonable risks or were otherwise legitimate potential borrowers, were sold mortgages with toxic terms and unmanageable obligations.²¹

¹⁹ Brescia, *supra* note 16, at 292, 295.

²⁰ For a history of discrimination in the home mortgage market in particular and the housing market in general, see DAN IMMERGLUCK, CREDIT TO THE COMMUNITY: COMMUNITY REINVESTMENT AND FAIR LENDING POLICY IN THE UNITED STATES 87-108 (2004); *see also* Adam Gordon, *The Creation of Homeownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks*, 115 YALE L.J. 186, 209-11 (2005) (discussing how the regulatory system denied most African-Americans the opportunity to buy homes).

²¹ *See* Chomsisengphet & Pennington-Cross, *supra* note 16, at 32 (discussing the increased costs associated with subprime loans).

There is no question that the trend in the subprime market – to sell riskier loans with more onerous terms – as the housing market started to weaken had a disproportionate impact on communities of color. As of 2006, the national homeownership rate hit an all-time high of nearly 69%, with much of this expansion the result of an increase in homeownership in communities where there were lower homeownership rates to begin with: African-American and Latino communities.²² Indeed, more than half of the mortgages taken out by African-American families in 2005 had subprime features (as compared to the industry average of 20%), and 40% of Latino families taking out mortgages in 2005 were also subprime borrowers.²³

A federal study of Home Mortgage Disclosure Act (HMDA) data analyzing mortgage refinance loans made in 1998 found that 39% of residents from upper income African-American neighborhoods refinanced their mortgages using subprime products as opposed to only 6% of residents of upper income white neighborhoods. Even worse, residents of low-income white neighborhoods utilized subprime products to refinance their mortgage only 18% of the time. Thus, upper-income residents of African-American neighborhoods were twice as likely to utilize subprime refinance products as even residents of low-income white neighborhoods.²⁴ More recent research on this phenomenon found similar patterns and concluded that such disparities were not accidental.²⁵

A recent analysis of 2006 HMDA data revealed similar discrepancies between the prevalence of subprime loans being extended to whites as compared to those being extended to

²² Kiff & Mills, *supra* note 1.

²³ Robert B. Avery et al., *Higher-Priced Home Lending and the 2005 HMDA Data*, FED. RES. BULL. A123, A159-60 (2006), available at <http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf>.

²⁴ U.S. DEP'T OF HOUS. & URB. DEV. & U.S. DEP'T OF TREASURY, CURBING PREDATORY HOME MORTGAGE LENDING: A JOINT REPORT 48 (2000), available at www.huduser.org/publications/pdf/treasrpt.pdf [hereinafter HUD-Treasury Report].

²⁵ CALIFORNIA REINVESTMENT COALITION ET AL., PAYING MORE FOR THE AMERICAN DREAM: THE SUBPRIME SHAKEOUT AND ITS IMPACT ON LOWER-INCOME AND MINORITY COMMUNITIES 4-5 (2008), available at <http://nedap.org/documents/MultistateHMDARreport-Final21.pdf> (analyzing activity of “high-risk” lenders – entities that had failed and had generated more than 50% of their loans as subprime loans – in seven metropolitan areas and finding that over 40% of the loans by these entities were in predominantly minority neighborhoods while only 10% of their loans were in predominantly white neighborhoods, “suggest[ing] that these neighborhoods were targeted by high-risk lenders . . .”).

African-Americans and Latinos.²⁶ For example, while evidence of higher-priced/subprime lending was present in 53.7% of the home purchase loans made to blacks in 2006, only 17.7% of the loans made to non-Hispanic whites could be considered higher-priced.²⁷ Controlling for borrower characteristics, and the possible differences between lenders' use of different underwriting criteria, reduced the prevalence of subprime loans to blacks to 30.3%, which still reflects a 12.6% difference between loans made to blacks and those made to non-Hispanic whites.²⁸ As between Latinos and non-Hispanic whites, and controlling for these same factors, Latinos were likely to enter into a subprime home purchase loan 24% of the time, as compared with 17.7% for whites.²⁹

With respect to mortgage refinance agreements, again controlling for borrower characteristics and the potential for discrepancies between lenders, the prevalence of subprime refinance loans extended to blacks was 33%, and for non-Hispanic whites was 25.7%, a difference of 7.3% that is unexplained except for the race of the borrower.³⁰ With respect to Latinos, there is a discrepancy of 4%—from 29.7% as compared to 25.7% for whites.³¹ As the data cited in the Baltimore litigation show, since a disproportionate share of foreclosures can be traced to subprime mortgages, a disproportionate share of foreclosure actions have involved – and will involve in the near future – borrowers of color.

Borrowers in the prime market are less likely to fall prey to subprime lending schemes because such borrowers have greater experience with the mortgage market, have more mortgage options available to them, and are more likely to have access to traditional lending institutions subject to greater regulatory oversight.³² Subprime borrowers, on the other hand, may have less experience with mortgage products, may be unaware of better options in the market, may not have ready access to a full range of mortgage products, and often come from communities where non-traditional lending institutions flourish due to the

²⁶ Robert B. Avery et al., *The 2006 HMDA Data*, 93 FED. RES. BULL. A73, A95 (2007), *available at* <http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf>.

²⁷ *Id.*

²⁸ *Id.* at A95-96.

²⁹ *Id.* at A96.

³⁰ *Id.*

³¹ Avery, *supra* note 26, at A96.

³² HUD-TREASURY REPORT, *supra* note 24, at 17.

absence of banks and other more highly regulated entities there.³³

II: A MUNICIPAL LAWSUIT UNDER THE FAIR HOUSING ACT TO
REMEDY THE IMPACTS OF THE SUBPRIME MORTGAGE CRISIS:
MAYOR AND CITY COUNCIL OF BALTIMORE V. WELLS FARGO BANK,
N.A., ET AL.³⁴

On January 8, 2008, the Mayor and the City Council of the City of Baltimore, on behalf of the city, filed an action in federal district court in Maryland, alleging that Wells Fargo Bank and its affiliate, Wells Fargo International, engaged in a systematic pattern of “reverse redlining” in Baltimore’s predominantly African-American neighborhoods by targeting such communities for subprime loans on terms that compared unfavorably to loans made in predominantly white communities within city limits.³⁵ The lawsuit alleges that such conduct violates the Fair Housing Act.³⁶

The complaint describes statistical data that reveal the disparate effects of the defendants’ subprime lending and foreclosure activity within the City of Baltimore. The plaintiffs allege the following:

- Half of Wells Fargo’s foreclosures from 2005 to 2006 were in census tracts with greater than 80% of the population African-American and two-thirds were in tracts that were over 60% African-American, while only 15.6% of foreclosures were in tracts that were less than 20% African-American. It is also alleged that these patterns

³³ See, e.g., Kathleen C. Engel & Patricia A. McCoy, *The CRA Implications of Predatory Lending*, 29 *FORDHAM URB. L.J.* 1571, 1583-84 (2002) (recognizing that the failure of the traditional lenders to serve communities of color allows predatory lending to target such communities). See generally Alvaro Cortes et al., *Efforts to Improve Homeownership Opportunities for Hispanics: Case Studies of Three Market Areas* (2006), available at http://www.huduser.org/Publications/PDF/hisp_homeown2.pdf (studying practices of Latino communities in three urban settings and finding that the lack of information about the mortgage process was the most significant barrier to homeownership and access to home mortgage financing). See also Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 *N.Y.U. L. REV.* 513, 534-40 (2005) (providing overview of economic reasons for failure of the mortgage market to serve certain communities).

³⁴ Complaint, Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A., in *SUBPRIME CREDIT CRISIS: EVERYTHING YOU NEED TO KNOW NOW* 1149 (PLI Corporate Law Practice, Course Handbook Series No. 16949, 2008) [hereinafter *Compl.*].

³⁵ *Id.* at 1152-53.

³⁶ 42 U.S.C. §§ 3601-19 (2006).

were nearly identical in 2000-2004, and again in 2007.³⁷

- The likelihood that a foreclosure will occur with respect to a Wells Fargo loan in a predominantly African-American neighborhood is four times the likelihood that such a loan will go into foreclosure in a predominantly white neighborhood, while the average foreclosure rate in Baltimore for all loans was nearly half that of the foreclosure rate of loans in predominantly African-American neighborhoods.³⁸

The plaintiffs allege that the following facts reveal the disproportionate impact of Wells Fargo's practices:

- In 2006, Wells Fargo made "high cost" loans to 65% of its African-American mortgage customers but only 15% of its white customers; in 2005, of 54% and 14%, respectively; and in 2004, 31% and 10%, respectively. With respect to refinance loans, from 2004-2006, an African-American borrower was 2.5 times more likely to be in a high cost refinance loan than a white borrower.³⁹
- That the pricing of loans had a harmful effect on African-American borrowers, because as Wells Fargo priced the interest rate on the loan, it increased the interest rate for smaller mortgages, while decreasing it for larger mortgages. This had a disproportionate impact on African-American borrowers, who tended to seek loans of smaller value.⁴⁰ Evidence of this impact, it is alleged, can be seen in the fact that borrowers from predominantly African-American census tracts were twice as likely as borrowers from predominantly white census tracts to seek loans of lower value, and thus, of greater relative expense. And borrowers from predominantly white census tracts were six times as likely to seek loans of higher value than borrowers from predominantly African-American census tracts.⁴¹
- That Wells Fargo originated adjustable rate mortgages, without utilizing effective underwriting criteria, to borrowers from predominantly African-American

³⁷ *Compl.*, *supra* note 34, at 1167.

³⁸ *Id.* at 1170.

³⁹ *Id.* at 1172-73.

⁴⁰ *Id.* at 1176-77.

⁴¹ *Id.* at 1177. The plaintiffs submitted evidence that these pricing disparities were similar to pricing disparities in Philadelphia. *Id.* at 1180.

neighborhoods in Baltimore. It is further alleged that “[t]he fact that these loans would result in delinquency, default [sic] and foreclosures for many borrowers was, or should have been, clearly foreseeable to Wells Fargo at the time the loans were made.”⁴²

- That Wells Fargo had a higher cap on the interest rate of adjustable rate mortgages for borrowers from predominantly African-American neighborhoods (14.13%) when compared to the cap on such loans to borrowers in predominantly white neighborhoods (13.61%).⁴³
- That Wells Fargo’s loans in predominantly African-American communities went to foreclosure after closing faster than those from predominantly white neighborhoods. Plaintiffs alleged that “[t]he faster time to foreclosure in African-American neighborhoods is consistent with underwriting practices in the African-American community that are less concerned with determining a borrower’s ability to pay and qualifications for the loan than they are in maximizing short-term profit.”⁴⁴

Based on these actions, the plaintiffs alleged that the City of Baltimore has been harmed because these practices have resulted in a decrease in property tax revenue; an increase in abandoned and vacant homes; “[a rise] in criminal and gang activity as abandoned and vacant homes become centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities”; an increase in “expenditures for police and fire protection . . . to secure abandoned and vacant homes . . . to acquire and rehabilitate vacant properties; and . . . for administrative, legal and social services.”⁴⁵

In the end, the complaint alleges damages and costs to the City of Baltimore “in the tens of millions of dollars,”⁴⁶ and seeks a declaratory judgment, a permanent injunction, compensatory and punitive damages, and attorney’s fees and costs.⁴⁷

The central theory upon which the Baltimore complaint is based posits that when a company disproportionately markets

⁴² *Compl.*, *supra* note 34, at 1180-81.

⁴³ *Id.* at 1181.

⁴⁴ *Id.* at 1182.

⁴⁵ *Id.* at 1185.

⁴⁶ *Id.* at 1186.

⁴⁷ *Compl.*, *supra* note 34, at 1188-89.

and packages subprime loans to communities of color, such a practice violates the Fair Housing Act.⁴⁸ This seemingly creative theory is not novel, however, and several federal district courts have looked at this issue from a number of different perspectives. The following section is dedicated to understanding how this issue has been addressed to date by the courts. I will attempt to raise critical questions about the viability of such claims under the Fair Housing Act (FHA). As the following discussion shows, these issues are relevant in the context of a municipal lawsuit raising allegations of discrimination under the FHA. To date, however, since the Baltimore litigation is the first of its type, the following discussion will describe the approaches courts have taken when addressing allegations of reverse redlining in the context of private lawsuits brought by individual mortgagors, and, in certain cases, by mortgagors seeking to serve as class representatives of borrowers related to particular lenders. As will be apparent from this discussion, the challenges posed by reverse redlining claims are not unique to municipal lawsuits, and would arise in municipal suits as well as suits by private mortgagors raising FHA violations in the execution of their mortgages. Since the Baltimore litigation is the first of its kind, the following discussion will therefore address those issues that have arisen, to date, in subprime litigation filed on behalf of private mortgagors in which challenges under the FHA to reverse redlining practices have been raised. The evolving FHA jurisprudence around reverse redlining will ultimately be applicable in private as well as municipal litigation, and this discussion is instructive for both classes of cases.

III. HOW THE FAIR HOUSING ACT AND CASE LAW CONSTRUING IT DEFINE AND ADDRESS REVERSE REDLINING

The practice at which the Baltimore litigation is directed has come to be known as “reverse redlining.” The term “redlining” derives its origins from lending practices where bankers would literally draw a red line on maps, identifying the communities – typically communities of color – where the bank would not extend credit.⁴⁹ “Reverse redlining,” on the other hand, refers to the

⁴⁸ *Id.* at 1187.

⁴⁹ BLACK’S LAW DICTIONARY 1305 (8th ed. 2004). *See also* Rashmi Dyal-Chand, *Exporting the Ownership Society: A Case Study on the Economic Impact of Property Rights*, 39 RUTGERS L.J. 59, 82 n.116 (2007) (referring to Senator William Proxmire’s description of redlining).

practice of targeting particular communities for abusive lending practices.⁵⁰

A number of different factors allow reverse redlining practices to thrive in certain communities. First, there must be pent up demand for credit. This is usually a product of a legacy of discrimination, where traditional lenders have failed to serve a particular community. Second, a relatively low-level of knowledge about credit products must be prevalent, which can also be a consequence of the absence of traditional lenders in a particular community. Third, a slim market of lending options exists, where a borrower has few options and fewer alternative sources of credit.

The perception of fewer lending options, which can be a product of a prospective borrower failing to appreciate the market and his or her options within it, can have the same effect as not having real credit options: i.e., a borrower, because of prior experiences with rejection, may choose what is seen as the first viable credit offer without appreciating that better opportunities might be available in the open market. And finally, there must be a market dominated by abusive lenders looking to take advantage of unsophisticated borrowers and placing a premium on their own profits, as opposed to engaging in sound, and non-discriminatory, lending practices.⁵¹ Because many of these factors are present in low and moderate-income communities of color across the United States, such practices, in theory, would tend to be concentrated in such communities. The history of the last decade of subprime lending proves that this was certainly the case.

A. Legislative Structure of the Fair Housing Act

Reverse redlining is lending discrimination. When it occurs in communities of color, it is the extension of credit on unfavorable terms based on a borrower's race. While there is a range of fair lending laws that address the issue of extension of credit on unfavorable terms,⁵² most of the attention paid to date with

⁵⁰ Susan E. Hauser, *Predatory Lending, Passive Judicial Activism, and the Duty to Decide*, 86 N.C. L. REV. 1501, 1509 n.39 (2008) (defining the practice of "reverse redlining").

⁵¹ See, e.g., HUD-TREASURY REPORT, *supra* note 24, at 17-18 (outlining reasons why predatory lending can flourish in certain communities); Engel & McCoy, *supra* note 33.

⁵² See, e.g., Truth in Lending Act (TILA), 15 U.S.C. § 1601-1615 (2006); Home Ownership and Equity Protection Act (HOEPA), 15 U.S.C. §§ 1639, 1648 (2006); Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691(a)-(f) (2006). See also

respect to the fair lending laws and their relationship to reverse lending has been on the Fair Housing Act (FHA). Indeed, the Baltimore litigation described above raises only a single claim, i.e., that the alleged conduct falls under the prohibitions of the FHA. Accordingly, I will address directly only the relationship between the language of the FHA and reverse redlining, and then follow with a discussion of the manner in which judges have begun to interpret such claims arising under the FHA's prohibitions.

There are several portions of the FHA relevant to mortgage discrimination. The first, titled "Discrimination in residential real estate-related transactions,"⁵³ provides as follows:

(a) In general. It shall be 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 race, color, religion, sex, handicap, familial status, or national origin.

(b) 'Residential real estate-related transaction' defined. As used in this section, the term 'residential real estate-related transaction' means any of the following:

(1) The making or purchasing of loans or providing other financial assistance-

(A) for purchasing, constructing, improving, repairing, or maintaining a dwelling; or

(B) secured by residential real estate.

(2) The selling, brokering, or appraising of residential real property.

Some of this language was added in the 1988 amendments to the FHA to ensure that it covered "all conceivable lending-related activities."⁵⁴

In addition, section 3604(b) makes it unlawful "[t]o discriminate against any person in the terms, conditions, or

12 C.F.R. § 226 (2008) (providing many of TILA's notice requirements can be found in what is known as "Regulation Z").

⁵³ 42 U.S. § 3604(b) (2000).

⁵⁴ Craig Ulrich, *The Fair Housing Amendments Act Of 1988: New Litigation Tools for Housing Advocates*, 46 BUS. LAW. 333, 336 (1990). See also Robert G. Schwemm, *Introduction to Mortgage Lending Discrimination Law*, 28 J. MARSHALL L. REV. 317, 321 (1995) (noting that 1988 FHA amendments "strengthened and broadened the provisions of the 1968 Fair Housing Act that prohibited lending discrimination."). For an overview of the 1988 amendments to the FHA, see generally Gary L. Jewel, *The Fair Housing Amendments of 1988: More Powerful and Easier to Use (for Complainants)*, ABA BANK COMPLIANCE 25 (1992); Warren L. Dennis, *The Fair Housing Act Amendments of 1988: A New Source of Lender Liability*, 106 BANKING L.J. 405 (1989).

privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin.”⁵⁵ The phrase “discrimination . . . in the provision of services . . . in connection [with ‘the terms, conditions or privileges of sale . . . of a dwelling’]” has been interpreted to extend the protections of the FHA to discrimination in mortgage lending.⁵⁶ As shown below, these provisions of the FHA have been extended to reverse redlining, at least by lower federal courts.

B. Anti-Discrimination Jurisprudence

Courts recognize that both Title VII⁵⁷ and Title VIII⁵⁸ “are part of a coordinated scheme of federal civil rights laws enacted to end discrimination”⁵⁹ and that “the Supreme Court has held that both statutes must be construed expansively to implement that goal.”⁶⁰ Accordingly, the burden-shifting approaches to litigation in which discrimination in the employment context is challenged under Title VII have been adopted in, and adapted to, the context of a claim under Title VIII (the FHA).⁶¹ Unfortunately, circuit courts have been inconsistent in their handling of such cases,⁶² and it

⁵⁵ 42 U.S.C. § 3604(b).

⁵⁶ See, e.g., Robert G. Schwemm & Michael Allen, *For the Rest of Their Lives: Seniors and the Fair Housing Act*, 90 IOWA L. REV. 121, 146, 210 (2004) (noting consistent judicial interpretations of 42 U.S.C. §3604(b) extending to mortgage discrimination) (internal citations omitted).

⁵⁷ 42 U.S.C. § 2000e-17 (2000).

⁵⁸ 42 U.S.C. § 3601-19 (2000).

⁵⁹ *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 935 (2d Cir. 1988), *aff'd on other grounds*, 488 U.S. 15 (1988). See also *Graoch Associates v. Louisville/Jefferson County Metro Human Relations Comm'n*, 508 F.3d 366, 372 (6th Cir. 2007) (concluding that claims under the FHA should generally be evaluated “by analogizing them to comparable claims under Title VII.” (citation omitted)).

⁶⁰ *Huntington Branch*, 844 F.2d at 935. The Second Circuit in *Huntington Branch* cited the Supreme Court’s precedents in *Trafficante v. Metropolitan Life Ins. Co.*, 409 U.S. 205 (1972), and *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971) for the proposition that the FHA “must be generously construed to foster integration,” and that “Title VII should be interpreted broadly to achieve equal employment opportunity.” *Huntington Branch*, 844 F.2d at 935.

⁶¹ See, e.g., Comment, *Applying the Title VII Prima Facie Case to Title VIII Litigation*, 11 HARV. C.R.-C.L. L. REV. 128, 158-60 (1976) (discussing the statutory construction and interpretation of Title VII and Title VIII).

⁶² Compare *Mountain Side Mobile Estates P’ship v. Sec’y of Hous. and Urban Dev.*, 56 F.3d 1243, 1254-55 (10th Cir. 1995) (employing the Supreme Court’s analysis in *Griggs* to interpret Title VIII pursuant to the Civil Rights Act of 1991), and *Smith v. Town of Clarkton*, 682 F.2d 1055, 1065 (4th Cir. 1982) (“Proof of discriminatory effect is, of course, sufficient to prove a violation of

would appear that this is the case mostly because the amendments to Title VII, codified in the Civil Rights Act of 1991, did not also amend Title VIII. Courts sometimes struggle, as will be seen below, with gauging the extent to which the 1991 changes to Title VII should be adopted within the context of Title VIII cases, where Congress was silent on the topic and choose not to amend Title VIII while doing so to Title VII.⁶³ A review of the current state of Title VII law is helpful at this time, to help set the stage for the Title VIII discussion to follow.

In the absence of direct evidence of discrimination, a Title VII plaintiff may prove discrimination in the employment context either by evidence of disparate treatment or disparate impact.⁶⁴ These two approaches are similar in many ways, but have their subtle and not-so-subtle differences. Furthermore, Congress, in passing the Civil Rights Act of 1991, reacted to several decisions of the Supreme Court in the Title VII context, and effectively overturned those decisions in which the Court had made raising claims of employment discrimination through these approaches more difficult.⁶⁵ For the purposes of the following discussion of

Title VII.” (citation omitted)), *with* Metro. Hous. Dev. Corp. v. Vill. Of Arlington Heights, 588 F.2d 1283, 1290 (7th Cir. 1977) (“[r]efus[ing] to conclude that every action which produces discriminatory effects is illegal.”).

⁶³ See Thomas P. Vartanian et al., *Disparate Impact Discrimination: Fair Lending at a Crossroads*, 49 CONSUMER FIN. L.Q. REP. 76, 80 (1995) (highlighting the scope of the Civil Rights Act of 1991 and subsequent judicial interpretations).

⁶⁴ A Title VII plaintiff need not pursue a claim using the burden-shifting approach if he or she can establish direct evidence of discrimination. *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 511 (2002) (holding that where “plaintiff is able to produce direct evidence of discrimination, he may prevail without proving all the elements of a prima facie case.”); *Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 121 (1985) (holding that “the *McDonnell Douglas* test is inapplicable where the plaintiff presents direct evidence of discrimination.”). A third method for proving discrimination is available in cases in which there is an alleged “mixed motive” for the defendant’s actions – i.e., where a prohibited classification was one of several reasons, some of them legitimate, for the challenged action. There a plaintiff must only show that race, or some other protected classification, was a “motivating factor” for the challenged decision. 42 U.S.C. § 2000e-2(m) (2000). Since no plaintiff raising allegations of reverse redlining under the FHA has yet to attempt to utilize the mixed motive approach to a discrimination claim under the FHA, this approach will not be discussed at length in this piece.

⁶⁵ Through the 1991 amendments to Title VII, Congress, among other things, responded to the Supreme Court’s decision in *Price Waterhouse v. Hopkins*, 490 U.S. 228, 258 (1989), in which the Court held that a defendant could escape liability if it could show that it would have taken the challenged employment decision even in the absence of any discriminatory animus. First, the amendment reads that “an unlawful employment practice is established when the complaining party demonstrates that race, color, religion, sex, or national

the FHA, it is critical to recognize that when Congress intervened to repudiate certain Supreme Court precedents in the Title VII context by amending Title VII, it did not amend Title VIII along similar lines.

The burden-shifting approach to Title VII cases in the context of a claim in which discriminatory treatment under Title VII is alleged requires that the plaintiff in such an action must show, ultimately, that the defendant was motivated by discriminatory intent for its action. To do so, the plaintiff must first show the following:

- (i) that he belongs to a racial minority; (ii) that he applied and was qualified for a job for which the employer was seeking applicants; (iii) that, despite his qualifications, he was rejected; and (iv) that, after his rejection, the position remained open and the employer continued to seek applicants from persons of complainant's qualifications.⁶⁶

After establishing a prima facie case of discrimination by meeting this test, the burden then shifts to the defendant to proffer a non-discriminatory reason for its action. If the defendant is able to meet this burden of production, the burden shifts back to the plaintiff, and “[t]his burden now merges with the ultimate burden of persuading the court that [the plaintiff] has been the victim of intentional discrimination.”⁶⁷ This can be accomplished directly by “persuading the court that a discriminatory reason more likely motivated the employer or indirectly by showing that the employer’s proffered explanation is unworthy of credence.”⁶⁸

origin was a motivating factor for any employment practice, even though other factors also motivated the practice.” 42 U.S.C § 2000e-2(m). Second, it created an affirmative defense through which a defendant can attempt to demonstrate that it “would have taken the same action in the absence of the impermissible motivating factor” § 2000e-5(g)(2)(B). In such case, the court “shall not award damages or issue an order requiring any admission, reinstatement, hiring, promotion, or payment” § 2000e-5(g)(2)(B)(ii). With these changes, the legislature repudiated the *Price Waterhouse* view that illegal discrimination has not occurred if the same action would have been taken absent the discrimination. Instead, Congress clarified that even if other factors motivate a decision, when prohibited discrimination forms any part of the decision, the law has been violated. However, employers who can show that they would have made the same employment decision in the absence of the improper motive will “avoid any liability.” Melissa Hart, *Subjective Decisionmaking and Unconscious Discrimination*, 56 ALA. L. REV. 741, 759, 762 (2005).

⁶⁶ *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 802 (1973).

⁶⁷ *Texas Dep’t of Cmty. Affairs v. Burdine*, 450 U.S. 248, 254-56 (1981).

⁶⁸ *Id.* at 256.

In a case in which a discriminatory disparate impact is alleged under Title VII, a plaintiff bears the initial burden of establishing that a challenged employment practice has an adverse impact on members of a protected class.⁶⁹ This can be accomplished by the use of statistical evidence showing a statistically significant difference in the treatment of different classes of individuals, some protected by Title VII and others not.⁷⁰ If the plaintiff meets this burden, the burden then shifts to the defendant to “demonstrate that the challenged practice is job related for the position in question and consistent with business necessity”⁷¹ The primacy of the “business necessity” language was clarified through the 1991 amendments to Title VII; with those changes, Congress repudiated the Supreme Court’s position in *Wards Cove Packing v. Atonio*,⁷² that all defendant had to show was that a “legitimate business interest” was behind the challenged practice or policy. Furthermore, the 1991 amendments also ensured that the burden of production *and* persuasion shifted to the defendant to establish a “business necessity” behind the challenged practice.⁷³ Should the defendant satisfy these burdens, the plaintiff then must show that there was an alternative method to meet the business need of the company available to the defendant that was equally valid, but less discriminatory in effect.⁷⁴

Circuit courts from across the country, in the context of an action under Title VIII in which discrimination is alleged, have adopted the essential aspects of disparate treatment and disparate impact approaches to establishing liability, with some critical differences. These differences flow mostly from the shift in Title VII law that occurred as a result of the 1991 amendments, which were not also made to Title VIII. First, courts are conflicted as to whether a defendant must prove a “business necessity” for the challenged housing practice or whether some legitimate business interest is all that is required in the context of a case in which disparate impact is alleged.⁷⁵

⁶⁹ 42 U.S.C. § 2000e-2(k)(1)(A)(i).

⁷⁰ *See, e.g.*, *Kennel v. Dover Garage, Inc.*, 816 F. Supp. 178, 189 (E.D.N.Y. 1993) (discussing statistics as a means of establishing a prima facie case of disparate impact discrimination).

⁷¹ 42 U.S.C. § 2000e-2(k)(1)(A)(i).

⁷² *Wards Cove Packing Co., Inc. v. Atonio*, 490 U.S. 642, 660 (1989).

⁷³ 42 U.S.C. § 2000e-2(k)(1)(A)(i).

⁷⁴ 42 U.S.C. § 2000e-2(k)(1)(A)(ii); *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 425 (1975).

⁷⁵ *Compare Kovacevich v. Kent State Univ.*, 224 F.3d 806, 830 (6th Cir. 2000) (finding defendant must show a “legitimate business reason” for challenged practice), *and Mountain Side Mobile Estates v. HUD*, 56 F.3d 1243, 1257 (10th

Second, courts have developed several different tests for use in the disparate impact setting.⁷⁶ Third, courts are in conflict as to who bears the burden of persuasion with respect to the defendant's ultimate showing of the purpose behind its practices and the availability of suitable, non-discriminatory alternatives.⁷⁷ Another aspect of the FHA doctrine that might, in theory, remain undecided is whether, under principles announced by the Supreme Court in *Smith v. City of Jackson*,⁷⁸ a theory of recovery based on disparate impact is still available under Title VIII, given the failure of Congress to amend Title VIII when it amended Title VII.⁷⁹

Attempting to resolve all of these issues is both beyond the scope of this article and also not necessary for the purposes of this discussion.⁸⁰ As the following discussion shows, several of the

Cir. 1995) (finding defendant's proffer of "legitimate, non-pretextual justifications" for its actions sufficient to meet its burden), *with Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 988 (4th Cir. 1984) (finding defendant "must prove a business necessity sufficiently compelling to justify the challenged practice.") (internal citations omitted). *See also* Peter E. Mahoney, *The End(s) of Disparate Impact: Doctrinal Reconstruction, Fair Housing and Lending Law, and the Anti-Discrimination Principle*, 47 EMORY L.J. 409, 472 (1998) (describing conflicting rulings on defendant's business defense in FHA cases); John F. Stanton, *The Fair Housing Act and Insurance: An Update and the Question of Disability Discrimination*, 31 HOFSTRA L. REV. 141, 187-89 (2003) (discussing the circuit split on whether a defendant must show compelling business necessity to rebut a plaintiff's showing of disparate impact).

⁷⁶ *See, e.g.*, Mahoney, *supra* note 75 (identifying competing disparate impact standards); Vartanian et al., *supra* note 63, at 79-80 (noting the absence of a uniform approach for disparate impact claims under Title VIII); Stanton, *supra* note 75, at 184-86 (describing the tests for proving disparate impact). It is not clear whether these tests present differences in substance rather than differences in form alone. *See, e.g.*, Robert G. Schwemm, *Housing Discrimination Law and Litigation*, §10:7 (2002) (noting two different standards unlikely to produce different results).

⁷⁷ *Graoch Assocs. v. Louisville/Jefferson County Metro Human Relations Comm'n*, 508 F.3d 366, 387-90 (6th Cir. 2007) (Moore, J., concurring in part and dissenting in part) (describing tension between different circuit precedents with respect to burden of proof and production in disparate impact cases).

⁷⁸ *Smith v. City of Jackson*, 544 U.S. 228 (2005).

⁷⁹ Defendants in several of the cases discussed below have raised the issue that in *Smith*, the Supreme Court found that the failure of Congress to amend the Age Discrimination in Employment Act (ADEA) when it amended Title VII meant that a disparate impact theory of recovery is narrower under the ADEA. *Smith*, 544 U.S. at 240-43. Despite the holding in *Smith* with respect to the ADEA, circuit courts from across the country have continued to consider disparate impact cases under the FHA. *See, e.g.*, *Budnick v. Town of Carefree*, 518 F.3d 1109, 1113-14 (9th Cir. 2008) (involving the denial of a special use permit for a multi-level retirement community); *Affordable Housing Dev. Corp. v. City of Fresno*, 433 F.3d 1182, 1195 (9th Cir. 2006).

⁸⁰ It will be assumed that disparate impact is a viable theory of recovery

courts that have attempted to assess the reverse redlining claim against the backdrop of Title VIII jurisprudence, such as it is, have struggled with how to fit such a claim within this jurisprudence. Several discrete questions will be raised by this analysis. First, what is the appropriate test (or tests) to apply in the context of a reverse redlining case, whether disparate treatment or disparate impact is alleged? It seems apparent in the case law that some of these courts have established a single test regardless of the approach. Second, can a plaintiff establish “direct evidence” of discrimination through allegations of racial targeting as a means of side-stepping the burden shifting framework? Third, what are the appropriate methods for establishing disparate impact through statistical evidence? These and other questions will be addressed in the following sections.

C. Approaching Reverse Redlining as a Violation of the Fair Housing Act

The reverse redlining problem raises a new challenge for the Title VII/Title VIII framework, and several of the federal district courts that have faced this issue have attempted to articulate a new standard that a reverse redlining plaintiff must meet to establish his or her prima facie case. Conceptually, the approach under this framework actually appears to raise more questions than it answers; indeed, in the end, the framework might not be suited to address the many different forms of reverse redlining that have appeared in the context of the subprime mortgage crisis. Moreover, since no courts have yet grappled with the role of a defendant’s proffer of evidence within the burden shifting analysis, we are left to anticipate what defenses will be raised.

The following is a review of those cases that have addressed issues of reverse redlining in the modern era of subprime lending. Some of them have developed a new framework for assessing the strength of a reverse redlining plaintiff’s prima facie case. Others have tracked existing Title VII/Title VIII approaches more closely. At the time of the publication, no federal appellate court

under the FHA; no court has yet to determine that it is not. In fact, all eleven U.S. Circuit Courts of Appeals have recognized that a disparate impact theory of recovery is available under the FHA, and several courts have reached this conclusion after the Supreme Court’s decision in *Smith*. See Nat’l Cmty. Reinvestment Coal. v. Accredited Home Lenders Holding Co., 573 F. Supp. 2d 70, 78-79 (D.D.C. 2008) (citing cases).

has yet to address the issue of the application of federal anti-discrimination laws to claims of reverse redlining. Despite this, several district courts from across the country appear to be developing an approach for dealing with these cases, appropriately making analogies to lending discrimination involving denials of credit and Title VII actions involving discrimination in the workplace. As the following discussion shows, however, some of these decisions appear to impose a higher burden on a reverse redlining plaintiff above that which is well established in the anti-discrimination jurisprudence, and fail to provide proper guidance to such a plaintiff as to how statistical evidence of a disparate treatment or impact might be utilized to establish a prima facie case of discrimination.

In the first reverse redlining case under Title VIII to articulate a new standard for assessing the strength of the plaintiffs' prima facie case, *Matthews v. New Century Mortgage Corp.*,⁸¹ four elderly women brought claims of reverse redlining when they were trapped in home equity loan scams.⁸² This scam included brokers inflating the borrowers' incomes and employment status (in several instances, without the borrowers' knowledge, the brokers created fictitious small businesses and even made up fake business cards for the applicants and placed them in their application files), and securing loans against their home equity at very high rates, and at a loan amount that was far greater than the plaintiffs were aware.⁸³ The defendants were mortgage banks that had originated the home equity loans in question. The plaintiffs challenged the conduct of defendants as reverse redlining, bringing claims under both 42 U.S.C. §§ 3604(b) and 3605 of the FHA; the ECOA; TILA; state statutory provisions;

⁸¹ *Matthews v. New Century Mortgage Corp.*, 185 F. Supp. 2d 874, 886 (S.D. Ohio 2002) (analogizing the standard to a Title VII claim, but only requiring that plaintiff show that the "lender refused to transact business on fair terms."). A previous case, *Honorable v. Easy Life Real Estate Systems*, 100 F. Supp. 2d 885, 887, 892 (N.D. Ill. 2000), raised issues of reverse redlining but the court did not use the traditional Title VII/Title VIII frameworks when denying defendants' motions for summary judgment based on plaintiffs' "exploitation theory" of discrimination, a theory rooted in 7th Circuit jurisprudence. See, e.g., *Clark v. Universal Builders, Inc.*, 706 F.2d 204, 206 (7th Cir. 1983). No other court has utilized this approach to reverse redlining. For a description of exploitation theory and its potential application in a reverse redlining setting, see Benjamin Howell, *Exploiting Race and Space: Concentrated Subprime Lending as Housing Discrimination*, 94 CAL. L. REV. 101, 137-42 (2006).

⁸² *Matthews*, 185 F. Supp. 2d at 886.

⁸³ *Id.* at 877-82. It is unclear from the decision whether the proceeds of the loans were ever given to the plaintiffs, and plaintiffs' race and/or ethnicity is not mentioned in the court's opinion.

and common law theories.⁸⁴

Despite the fact that the *Matthews* court found that home equity loans are not covered by the language of § 3604(b), it denied a motion to dismiss the remaining claims, finding that reverse redlining was actionable under § 3605 of the FHA, as well as ECOA and TILA.⁸⁵ The court found that under this provision of the FHA, for a plaintiff to establish a prima facie case of actionable discrimination in the context of a reverse redlining claim, she must show the following:

(1) that she is a member of a protected class; (2) that she applied for and was qualified for loans; (3) that the loans were given on grossly unfavorable terms; and (4) that the lender continues to provide loans to other applicants with similar qualifications, but on significantly more favorable terms . . . In the alternative, if the plaintiff presents direct evidence that the lender intentionally targeted her for unfair loans on the basis of sex and marital status, the plaintiff need not also show that the lender makes loans on more favorable terms to others.⁸⁶

A similar set of standards was offered for the ECOA claim with reverse redlining as its focus, and the court found that a claim under ECOA in such a context could withstand a motion to dismiss if the plaintiffs could show that “they were discriminated against in the terms of their credit based on the [sic] sex, marital status or age.”⁸⁷ Accordingly, the court denied the motion to dismiss with respect to all of the plaintiffs’ claims, except for the claim under §3604(b) of the FHA, which the court granted.⁸⁸

Most recently, in *Barkley v. Olympia Mortgage Co.*,⁸⁹ Judge Dearie of the Eastern District of New York denied motions to dismiss filed by the multiple defendants in this action, including mortgage banks, real estate companies, and attorneys who were assigned to assist the plaintiffs by the mortgage companies, and

⁸⁴ *Id.* at 881-82.

⁸⁵ *Id.* at 893.

⁸⁶ *Id.* at 886-87 (internal citations omitted). It would appear that the court was heavily influenced by a student note written on the subject, where this test was first developed. See Frank Lopez, *Using the Fair Housing Act to Combat Predatory Lending*, 6 GEO. J. ON POVERTY L. & POL’Y 73, 99 (1999) (examining solutions to the predatory lending problem). In that note, however, the author’s intention was to state that this standard was to be utilized in disparate treatment cases only, not as a single test under both disparate treatment and disparate impact approaches. *Id.*

⁸⁷ *Matthews*, 185 F. Supp. 2d at 887.

⁸⁸ *Id.* at 893.

⁸⁹ *Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007).

real estate appraisers.⁹⁰ The complaint alleged that the defendants engaged in a “property flipping” scheme to sell properties in great disrepair to African-American borrowers.⁹¹ Because of inflated appraisals, these properties were beyond the borrowers’ means. Once the properties were purchased by the plaintiffs, the underlying mortgages were either sold in the secondary mortgage market based on those inflated appraisals, or federally insured, which would allow the lenders to recover the insurance based on the inflated purchase price for the home. The court recounted what was at the heart of the plaintiffs’ contentions:

Plaintiffs allege that defendants targeted persons of limited financial means and savvy who had never before purchased homes (citation omitted). They claim that United Homes reached out to such customers by billing itself as a ‘one-stop shop’ for first-time homebuyers (citation omitted). According to the complaints, once these buyers signed on with United Homes, they were handed off to cooperating lenders and lawyers, who rushed the transactions to completion at breakneck speed so that plaintiffs had little time to seek independent advice (citation omitted).

Defendants did more than merely dupe unsuspecting consumers, according to plaintiffs. They contend that defendants exploited New York City’s racially segregated housing market and engaged in ‘reverse redlining,’ the practice of intentionally extending credit to members of minority communities on unfair terms (citation omitted). Specifically, plaintiffs allege that United Homes concentrated its business in minority census tracts and targeted minorities for the alleged scam by creating advertisements that featured minority homebuyers and selectively running these ads in minority communities (citation omitted).⁹²

Plaintiffs claimed that they were targeted for the fraudulent scheme because of their race based on several of defendants’ actions, such as showing prospective borrowers homes only in communities of color; directing advertising at prospective borrowers of color by the use of an ethnic newspaper popular among the West Indian community in New York City, when advertising did not take place in other newspapers in the media company that served white neighborhoods; pairing borrowers with African-American salesmen; and directing their buyer outreach to find African-American borrowers.⁹³ The court found

⁹⁰ *Id.* at *23.

⁹¹ *Id.* at *1.

⁹² *Id.* at *2.

⁹³ *Id.* at *11.

that, “[t]aken together, these allegations permit the inference that defendants sought to lure minority homebuyers into the fraudulent transactions.”⁹⁴ The court also noted that because of such an inference, “a factfinder might determine that defendants had harbored ill will toward racial minorities, or that they had used race as a proxy, doing business exclusively with minorities out of the biased perception that those individuals would be especially vulnerable to fraud.”⁹⁵ The court cited these findings to deny the defendants’ motions to dismiss with respect to the plaintiffs’ claims under the Civil Rights Act of 1866.⁹⁶

With respect to the plaintiffs’ claims under the FHA, the *Barkley* court recited and adopted the four-part test articulated by the court in *Matthews*.⁹⁷ The court found further that because of the allegations of racial targeting in the execution of the alleged scheme, the plaintiffs could overcome the defendants’ motions to dismiss.⁹⁸ Such evidence of targeting, the court found, was sufficient to establish the fourth element of the *Matthews* test, even in the absence of disparate treatment or disparate impact.⁹⁹ I shall return to this issue below.¹⁰⁰

To sum up, courts following *Matthews* have found that, in order to establish a prima facie case of discrimination, a plaintiff in a reverse redlining case must establish: “(1) that she is a member of a protected class; (2) that she applied for and was qualified for loans; (3) that the loans were given on grossly unfavorable terms; and (4) that the lender continues to provide loans to other applicants with similar qualifications, but on significantly more favorable terms.”¹⁰¹ “In the alternative, if the plaintiff presents direct evidence that the lender intentionally targeted her for unfair loans on the basis of sex and marital status, the plaintiff need not also show that the lender makes loans on more favorable terms to others.”¹⁰² Also, in *Barkley*, defendants asserted that the fourth element of the test utilized in *Matthews* could only be established by proof of discriminatory impact or discriminatory

⁹⁴ *Barkley*, 2007 WL 2437810 at *11.

⁹⁵ *Id.*

⁹⁶ *Id.* at *12.

⁹⁷ *Id.* at *15.

⁹⁸ *Id.*

⁹⁹ *Barkley*, 2007 WL 2437810 at *13.

¹⁰⁰ See *infra* Part IV.D. (stating that targeting is sufficient to establish the fourth element of the *Matthews* test even without disparate treatment or impact).

¹⁰¹ *Matthews v. New Century Mortgage Corp.*, 185 F. Supp. 2d 874, 886 (S.D. Ohio 2002).

¹⁰² *Id.* at 886-87.

treatment; the *Barkley* court agreed with the court's analysis in *Matthews*, however, in accepting evidence of targeting in lieu of evidence of either discriminatory impact or treatment.¹⁰³

More recent cases in which allegations of reverse redlining have been raised have failed to track the *Matthews* model and have not applied the *Matthews* test in determining whether the plaintiffs could establish a prima facie case of discrimination. In those cases, in which motions to dismiss were all denied in just the last few months, the plaintiffs there have attacked the tendency of subprime lenders to utilize discretionary and subjective techniques in pricing the subprime loans offered to borrowers of color. All of these cases, described below, have been filed as class actions against subprime lenders, or the affiliates of prime lenders that engaged in subprime lending, alleging that the discretionary pricing practices had a disparate impact on the cost of loans extended to minority borrowers. The plaintiffs have utilized existing disparate impact analysis and have departed from the approach urged in *Matthews*. For the reasons set forth in the next section, it is respectfully submitted that the approach of these more recent cases would appear to be more consistent with the present state of Title VII/Title VIII jurisprudence.

The first decision to be generated from this more recent wave of cases was the decision on the defendants' motion to dismiss in the case of *Ramirez v. Greenpoint Mortgage Funding, Inc.*¹⁰⁴ There, plaintiffs alleged that Greenpoint had an objective set of criteria it used for determining the price of loans, but also a subjective component to its pricing that permitted the bank to increase the cost of the loans and to tack on additional fees, even when such additional charges were not related to any assessment of the credit risk of the borrower. The plaintiffs alleged that these practices were more likely to occur with respect to minority borrowers as opposed to white borrowers with similar qualifications; as such, the plaintiffs alleged that these practices violated both the ECOA and the FHA.¹⁰⁵ The plaintiffs relied on statistical data about the prevalence of subjective risk-based pricing both in the general community and also with respect to

¹⁰³ *Barkley*, 2007 WL 2437810 at *13. In at least one other reported reverse redlining case, the court also followed the basic *Matthews* approach. *See, e.g.*, *Munoz v. Int'l Home Capital Corp.*, 2004 WL 3086907, at *4 (N.D.Cal. May 4, 2004).

¹⁰⁴ *Ramirez v. Greenpoint Mortgage Funding, Inc.*, 2008 WL 2051018, at *1 (N.D.Cal. May 13, 2008).

¹⁰⁵ *Id.* at *1-2.

Greenpoint's own lending practices. These practices were revealed through an analysis of Greenpoint's HMDA data, which, the plaintiffs' alleged, tended to show disparities in loan pricing as between borrowers of color and similarly situated whites. The court found that these allegations were sufficient to establish that the bank's activities had a disparate impact on minority borrowers, and to overcome the defendant's motion to dismiss.¹⁰⁶

In *Miller v. Countrywide Bank, N.A.*,¹⁰⁷ on facts similar to those in *Ramirez*, the district court denied defendants' motion to dismiss, where the plaintiffs had shown that Countrywide, together with its subsidiaries joined in the suit, engaged in discretionary pricing of loans that bore no relation to the relative credit risks of the borrowers, and yet were more often applied to raise the costs associated with loans to African-American borrowers.¹⁰⁸ The court described the plaintiffs' allegations as follows: "Plaintiffs have identified the practice at issue: establishing a par [interest] rate keyed to objective indicators of creditworthiness while simultaneously authorizing additional charges keyed to factors unrelated to those criteria. Plaintiffs allege that the net effect of that discretionary pricing policy yields a discriminatory result."¹⁰⁹

The plaintiffs alleged further that African-American borrowers were three times more likely to obtain a high-priced home purchase mortgage and two times more likely to receive a high-priced refinance mortgage than whites.¹¹⁰ The defendants argued that the plaintiffs failed to allege with specificity that they were given loans with higher interest rates than similarly situated whites, and thus the claims should fail.¹¹¹ The court rejected this position, finding:

The alleged facts give rise to a fair inference that African-American borrowers are charged higher fees and rates than similarly situated white borrowers. This is especially so in light of the individual [sic] named plaintiffs' allegations, which expressly state that they were steered into less advantageous sub-prime loan terms despite being eligible for prime-market loans.¹¹²

The court recognized that the defendants' position was that the plaintiffs had failed to show that the disparity was caused by any

¹⁰⁶ *Id.* at *5.

¹⁰⁷ *Miller v. Countrywide Bank, N.A.*, 571 F. Supp. 2d 251 (D. Mass. 2008).

¹⁰⁸ *Id.* at 254.

¹⁰⁹ *Id.* at 257.

¹¹⁰ *Id.* at 258.

¹¹¹ *Id.* at 258.

¹¹² *Miller*, 571 F. Supp. 2d at 259.

discriminatory policy carried out by the defendants. It concluded, however, in denying the defendants' motion to dismiss, that any arguments about causation needed to be resolved "at later stages in the proceeding" and not at the motion to dismiss stage.¹¹³

Most recently, in *Taylor v. Accredited Home Lenders, Inc.*,¹¹⁴ plaintiffs raised allegations of disparate discretionary pricing by defendants, but this evidence was mostly of the general variety, citing to national reports about discriminatory lending practices, as well as studies of local HMDA data within the city of Birmingham, AL (the plaintiff's city of residence), which included data from the defendants.¹¹⁵ While finding that the plaintiff had raised allegations sufficient to establish a disparate impact from the defendants' practices, the court explained the plaintiff's position regarding the data presented, and upon which the court based its decision, as follows: "[p]laintiff maintains her statistical allegations in her complaint implicate Defendant, because the [HMDA] data, which is derived from a list of subprime lenders, including Defendant, was used by various studies and reports."¹¹⁶ Of the three recent cases, this statistical evidence would appear to be the weakest used to establish a case of disparate impact, at least at the motion to dismiss stage.

The more recent reverse redlining claims clearly chart a different course than those earlier cases cited above. In *Ramirez, Miller, and Taylor*, the plaintiffs had presented statistical evidence that tended to show a disparate impact on borrowers of color from the defendants' practices of discretionary pricing. The plaintiffs in these cases had alleged, some more explicitly than others, that the discrepancies in loan terms could not be justified by a legitimate analysis of borrower risk; rather, they alleged, with varying degrees of specificity, that the lenders' activities were different with respect to similarly situated borrowers, based on the race of those borrowers. In *Ramirez*, this allegation is specific; in *Miller*, the court infers it. In *Taylor*, the court seems to go a step further, by allowing the plaintiff to use analysis of the practices of banks "that use credit pricing systems structured like that of [the defendants]"¹¹⁷ that tended to show that discretionary pricing impacted similarly situated borrowers differently based

¹¹³ *Id.*

¹¹⁴ *Taylor v. Accredited Home Lenders, Inc.*, 2008 WL 4446551, at *1 (S.D. Cal. Sept. 19, 2008).

¹¹⁵ *Id.* at *6.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

on their race. What follows is an attempt to synthesize, where possible, these decisions and chart an appropriate course for courts reviewing reverse redlining claims.

IV: EMERGING ISSUES IN REVERSE REDLINING LITIGATION UNDER THE FHA

As the previous discussion shows, reverse redlining claims involve a new gloss on the old problem of lending discrimination. Instead of the typical scenario, where an otherwise qualified borrower is rejected for a loan based on his or her membership in a class protected by statute, in the reverse redlining context, a loan is extended to the borrower, but on unfavorable terms. The challenge for those seeking to extend FHA protections to credit approvals, even if done on unfavorable terms, will be to establish that such lending was either on account of that borrower's race or other protected status, or that lenders engaged in practices that had a discriminatory impact on members of a protected class or classes. Consistent with holdings in prior cases that determine the statistical thresholds necessary to establish a prima facie case of lending discrimination, the statistical information alleged in the Baltimore complaint sufficiently proves lending on unfavorable terms.¹¹⁸ Several issues are raised by the reverse redlining cases and their impact on the Baltimore suit, and that suit, on its own, raises numerous important issues, not the least of which is the Mayor and City Council's standing to raise the allegations of a violation of the FHA.¹¹⁹

¹¹⁸ *Compl.*, *supra* note 34, at 1152. For a description of the legal thresholds for establishing statistically significant disparate treatment, see *infra*, Part IV.C.2.

¹¹⁹ The Supreme Court and several lower courts have recognized a municipality's cognizable interest under the FHA in challenging practices that reduce the local tax base. See *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91, 111 (1979) (holding standing conferred on municipality where racial steering in housing allegedly reduced property values and diminished the local tax base); *Village of Bellwood v. Dwivedi*, 895 F.2d 1521, 1525 (7th Cir. 1990) (finding that the question of a municipality's standing in a case of racial steering is "settled" in the affirmative in light of *Gladstone*, *supra*); *Heights Cmty. Congress v. Hilltop Realty Inc.*, 774 F.2d 135, 138-39 (6th Cir. 1985) (citing *Gladstone*, *supra*, and recognizing municipality's standing to sue in case alleging racial steering in housing based on diminution in the tax base from such practice). For a contrary argument, see Jonathan L. Entin & Shadya Y. Yazback, *City Governments and Predatory Lending*, 34 *FORDHAM URB. L.J.* 757, 762-69 (2007) (arguing that municipalities might not have standing to pursue claims of predatory lending against their constituents).

For the purposes of this analysis, I will limit my discussion to the following issues: 1) As a threshold issue, what is the appropriate test to apply in a case under the FHA alleging reverse redlining based on a disparate impact analysis; 2) What are the likely contexts in which reverse redlining might arise, and how can we distinguish between practices we would encourage in otherwise underserved communities and predatory conduct; 3) How do we measure disparate impact in such a setting (i.e., where alleged predatory conduct is targeted to a particular community), and what are the appropriate statistical benchmarks regarding that disparate impact that would establish a prima facie case under the FHA; and 4) How should courts deal with the likely defenses based on business justification for subprime lending, an issue no court has addressed to date. Each of these questions will be addressed in turn below. Following this discussion, I will attempt to identify the optimal approaches that might be used by courts moving forward when faced with litigants raising claims of reverse redlining that would offer judges the ability to account for the particular nuances of the practice and yet fit well within existing Title VII/Title VIII jurisprudence.

A. Defects in the Matthews's Approach to Reverse Redlining

There are several problems posed by the *Matthews* test. First, no account is made for the fact that courts apply a different test based on allegations of disparate impact or disparate treatment; instead, the courts using the *Matthews* Test seem to indicate that the fourth element of the test could be met by evidence coming under either approach,¹²⁰ as opposed to recognizing that each factual approach usually entails a different test. Second is the requirement that the plaintiffs prove that they were given loans on “grossly unfavorable terms” and that loans were made to other applicants on “significantly more favorable terms.”¹²¹ Finally, and this is more a complication than a problem, targeting (rather than disparate treatment or impact) would appear at first blush to pose a unique challenge in the context of a reverse redlining

¹²⁰ See *Munoz v. Int'l Home Capital Corp.*, 2004 WL 3086907, at *4 (N.D.Cal. May 4, 2004) (highlighting where the court held the *Matthews* test fulfilled, even though the plaintiffs could not show that similarly situated people obtained loans on more favorable terms, as long as it was obvious that defendants targeted the plaintiffs' class for unfair loans based on race).

¹²¹ *Matthews*, 185 F. Supp. 2d at 886.

case. A reframing of the concept of targeting, which the second wave of cases attempts to do, and which I shall try to undertake in Section B below, is appropriate when assessing the legality of defendants' behavior where reverse redlining is alleged. The first two of these issues, creating a single test and imposing heightened requirements on plaintiffs, are discussed in the next section.

1. Creating a Single Test:

It is unclear whether the *Matthews* line of cases has been utilizing a disparate treatment or disparate impact analysis, or some hybrid of the two, when reviewing claims of reverse redlining. While it would appear from the language of the *Matthews* test that the court there was applying a disparate treatment test, the court in *Barkley* seemed to say, at defendants' suggestion, that the question of whether disparate treatment or disparate impact was alleged would only be an appropriate inquiry when applying the fourth element of the *Matthews* test.¹²² Although the *Barkley* court went on to find that allegations of targeting constituted sufficient allegations concerning disparate treatment, it did not disabuse defendants of the notion that it is with respect to the fourth element of the *Matthews* test that plaintiffs' allegations regarding disparate treatment or disparate impact are assessed.¹²³

While there is clearly a great degree of overlap between the different tests used in the disparate treatment and disparate impact contexts, courts looking at traditional Title VII and Title VIII actions have not utilized a single test. Instead, as is well established, they have applied a different standard of proof based on whether disparate treatment or disparate impact allegations have been raised. Given the district court precedents following *Matthews* to date on the issue of reverse redlining, the plaintiff wishing to allege disparate impact, like the plaintiffs in the Baltimore litigation, are left to guess at what is the appropriate standard to use in such a context.

Despite the different tests that circuit courts across the country have used in the context of a claim under the FHA, depending on whether the plaintiff is alleging a claim grounded in disparate impact or disparate treatment, those courts addressing claims of

¹²² *Barkley*, 2007 WL 2437810 at *14.

¹²³ *Id.* at *14-15.

reverse redlining that have followed the *Matthews*'s approach appear to have failed to make a distinction between the two tests depending on the nature of the claim. There may be an understandable confusion over which test to apply, given that in a reverse redlining case, the facts unique to this type of case – that a loan has been extended on unfavorable terms – might appear different from the traditional discrimination claim, *i.e.*, one in which a loan is denied, a job applicant or housing applicant is rejected, or an employee is passed over for promotion.

Regardless, these courts seem uncertain as to how to classify the nature of the alleged discrimination, and seem to collapse the different tests into a single framework, then turn to the nature of the allegations to assess the extent to which the reverse redlining plaintiffs can meet one of the elements of that framework, depending on whether they are presenting an impact or a treatment claim. There seems to be little support in the jurisprudence under either Title VII or Title VIII for such an approach.

There are two possible reasons for the confusion with the doctrine: 1) that these trial courts are unable to reconcile the apparent confusion among the circuit courts around the proper elements of a disparate impact claim; or 2) that trial courts are challenged by the fact that reverse redlining requires an approach to the anti-discrimination jurisprudence that might not square with its traditional frames, given the nature of the practice. I will take up the issue of an appropriate test or tests that courts might consider in section E., below, but I now turn to the specific language of the *Matthews* test, to identify other ways where that test diverges from the doctrine and the law of employment and housing discrimination.

2. Requiring Allegations Beyond Existing Title VIII Requirements:

As stated above, the *Matthews* test injects language not present in the traditional analysis of Title VII and Title VIII cases. Most notably, the test requires that the plaintiffs prove that they were given loans on “grossly unfavorable terms” and that loans were made to other applicants on “significantly more favorable terms.”¹²⁴ This language is not present in the language of FHA, nor can it be justified by reliance on case law interpreting either

¹²⁴ *Matthews*, 185 F. Supp. 2d at 886.

Title VII or Title VIII.¹²⁵ There is no apparent reason for the use of this language, unless, in some way, as suggested above, the court was trying to collapse disparate impact and a disparate treatment analysis into a single framework, in which case such language might indicate a difference in-kind between a loan extended to a member of a protected class, and one extended to a member in a non-protected class. From such a qualitative difference, perhaps it could be suggested that discriminatory intent may be inferred. Perhaps, also, the court was trying to anticipate defenses, and that a significant qualitative difference in-kind between two loans would help to overcome a defendant's proffer of a defense of business necessity. In either case, or for some other reason that is not apparent from the decisions of the courts that have adopted it, it is clear that this language is superfluous at best, and would certainly impose a burden not placed there by the statute nor adopted in analogous case law. Moreover, if indeed it represents an attempt either to assess the quality of the discrimination or, similarly, to anticipate and overcome potential defenses, it is a theory that goes too far, and upsets the burden-shifting analysis typically utilized in Title VII and Title VIII litigation.

B. Understanding Reverse Redlining Contexts

Another issue that has arisen in the reverse redlining context is these courts' approach to what they have identified as racial targeting: the marketing of certain products to communities of color. But marketing to a certain community is not necessarily an indication that any invidious discrimination is occurring. Hundreds of community lenders, seeking to overcome the failure of the lending market to serve communities of color, have reached

¹²⁵ The *Matthews* court cited to the Sixth Circuit's decision in *Michigan Protection and Advocacy Service, Inc., v. Babin*, 18 F.3d 337 (1994), when it created its test to be applied in the context of a reverse redlining case. *Babin* did not involve reverse redlining, however; rather, it dealt with a straightforward mortgage discrimination case. Moreover, the operative language in that decision does not include the "grossly unfavorable" or "significantly more favorable" terminology. There, the court found as follows:

[t]o state a claim for relief under § 3605 [of the FHA], the plaintiffs must plead that (1) they were a member of a protected class; (2) they attempted to engage in a 'real estate-related transaction' with [defendants], and met all relevant qualifications for doing so; (3) [defendants] refused to transact business with the plaintiffs despite their qualifications; and (4) the defendants continued to engage in that type of transaction with other parties with similar qualifications.

Id. at 346 (citation omitted).

into such communities, explicitly and unapologetically, to bring, as one organization puts it, “credit where credit is due.”¹²⁶

Thus, there are several different scenarios through which lending in communities of color can and has come about. Much of it is legitimate, but some of it is not. The different scenarios consist of different combinations of actors offering different mortgage products. Some of the actors are motivated by noble desires,¹²⁷ others by profit, which itself is certainly not illegal. Some groups engage in lending in communities of color in such a way that ensures that such communities have access to credit on fair terms. Still, there are others that pursue this profit in such a way that preys on prospective borrowers of color, taking affirmative steps to market their loans in communities of color, and offer borrowers their loans on terms that are less favorable than those offered to similarly situated white borrowers. This last scenario constitutes reverse redlining. As the jurisprudence on reverse redlining develops, an effective method for distinguishing between benign and invidious targeting will be critical to ensure that the theory does not align itself against practices that should be encouraged and not weighted down with frivolous litigation.

The extent to which the anti-discrimination laws can address those actors engaged in invidious discrimination is clearly a question courts will be asked to address in the coming months, as more city governments consider filing lawsuits like the one commenced by elected officials in Baltimore, and more subprime borrowers assert defenses, or bring affirmative litigation, in which allegations of reverse redlining are raised. Yet, as the previous discussion shows, courts addressing the issue of reverse redlining appear to have struggled to come up with a coherent legal approach to the issue, and have yet to square such an approach with existing Title VIII jurisprudence. The following is an attempt to describe the different contexts in which reverse

¹²⁶ Founded in 1994 in Washington Heights in New York City, Credit Where Credit Is Due (CWCID) is an organization dedicated to providing financial education to the primarily Latino community in Upper Manhattan, in coordination with the lending opportunities available through a local credit union. CWCID’s website can be viewed at <http://www.cwcid.org> (last visited Nov. 19, 2008). That CWCID explicitly targets its services to a primarily Latino community might, under a “direct evidence” approach, raise questions about whether its activities might be caught up in such a wide net.

¹²⁷ See, e.g., Community Reinvestment Fund (CRF), www.crfusa.com (last visited Nov. 19, 2008), an organization extending credit to low-income community organizations as part of a genuine attempt at community development.

redlining claims may arise and to explore ways that Title VII and Title VIII jurisprudence can address such scenarios and ways in which the doctrine might need to adapt to rein in conduct that would appear to violate the law, but where well-established doctrine might seem ill suited to address that conduct.

There are several different scenarios in which lending can occur in communities of color. First, a traditional lending institution can extend its services into communities of color, while also serving predominantly white communities. Second, a traditional lending institution can create an affiliate to lend in communities of color. Third, a non-traditional lender can extend its services to communities of color, while also serving predominantly white communities. Fourth, a non-traditional lender can target the provision of its services to communities of color, while engaging in limited lending in predominantly white communities. Fifth, a community-based lender can target the provision of its services primarily to communities of color. The extent to which any of these scenarios leads or may lead to discriminatory conduct is the subject of the following discussion; the extent to which Title VIII jurisprudence might apply to each scenario is also addressed.

•*Scenario One: Traditional lending institution serving communities of color and predominantly white communities.*

In this scenario, a traditional lender, one that is subject to federal oversight, review under the Community Reinvestment Act¹²⁸ and the disclosure requirements of the Home Mortgage Disclosure Act,¹²⁹ among other federal statutes and regulations, sees an opportunity to serve an underserved market, most likely a community of color, and begins to market its lending products within that community.¹³⁰ It uses the same underwriting criteria

¹²⁸ 12 U.S.C. §§ 2901-2908 (2006).

¹²⁹ 12 U.S.C. §§ 2801-2811 (2006).

¹³⁰ Unfortunately, most subprime lending was not undertaken by traditional banking institutions. One measurement of this phenomenon is the extent to which subprime lending is or is not covered by the Community Reinvestment Act, a federal law covering traditional, depository institutions subject to federal oversight. See Ben S. Bernanke, Chairman, Fed. Reserve Sys., Address at the Community Affairs Research Conference, Washington, D.C.: The Community Reinvestment Act: Its Evolution and New Challenges (Mar. 30, 2007) (asserting that two thirds of subprime lending is not covered by the Community Reinvestment Act (citation omitted)), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20070330a.htm>. See also U.S. DEPT OF THE TREASURY, THE COMMUNITY REINVESTMENT ACT AFTER FINANCIAL MODERNIZATION: A BASELINE REPORT 91-93 (2000) (analyzing HMDA

it uses with its white customers and its customers from predominantly white communities. It engages in risk-based pricing of its mortgage products such that a disproportionate share of subprime products are sold within the communities of color it serves. Putting aside the issue of whether the underwriting criteria is itself discriminatory in impact or effect, a topic addressed in Section D, below, courts would be well-positioned to take up the issue of whether the lending practices of this bank violate the FHA, and existing doctrine could be used to attack the potentially discriminatory conduct.

One can see how a civil rights plaintiff would be in a strong position to challenge this practice using well-worn anti-discrimination methods. There is both a pool of candidates who it would be alleged were given loans on unfavorable terms, who are members of a class of borrowers protected under the statute, as well as a pool of members not within that protected class who were also given loans, perhaps on more favorable terms. If there is some evidence that the disparate treatment of these borrowers was the product of discriminatory acts, then a straightforward disparate treatment analysis could be utilized to establish a prima facie case of discrimination.¹³¹ If one is left with a disparate impact analysis, the existing disparate impact framework could easily be utilized to establish a prima facie case of discrimination. Of course, the defendant would have its opportunity to establish a non-discriminatory basis for its action, under a disparate treatment analysis, or that there was a business necessity behind the challenged practice, if a disparate impact analysis is utilized. This scenario is the scenario alleged by the plaintiffs in the Baltimore litigation, and it does not seem to stretch Title VIII jurisprudence.

•*Scenario Two: A traditional lending institution creates an affiliate to lend in communities of color.*

In this scenario, a traditional lending institution creates an affiliate to lend in communities that institution traditionally has not served. The bank can choose whether the activities of the affiliate are covered for the purposes of the CRA. The targeted

data from 1993 through 1998 and finding that two thirds of the increase in subprime lending to low- and moderate-income communities during this period was from subprime lenders not covered by the CRA whereas only 15% of these loans were originated by CRA-covered institutions), available at http://www.novoco.com/low_income_housing/resource_files/research_center/crareport.pdf.

¹³¹ See, e.g., *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 802 (1973) (establishing the requirements for a prima facie claim of disparate treatment).

borrowers are from traditionally underserved communities and the bank sees an opportunity to bring certain products it traditionally does not offer its prime customers to that underserved community, which, for the purposes of this discussion, we are assuming is a community of color. Here, the affiliate bank does not lend in predominantly white communities. Such an approach to the community of color – the creation of an affiliate bank that offers mostly subprime loans to prospective borrowers within that community – might strain existing Title VII/Title VIII jurisprudence. Under traditional approaches under these laws, we look for unfavorable treatment of members of protected groups when measured against the treatment of unprotected groups. In this scenario, if we look only at the conduct of the affiliate, disregarding the primary lending institution's record of serving predominantly white communities, we cannot find a suitable pool against which to measure the treatment of protected classes. There is some safety in existing anti-discrimination jurisprudence in this scenario, where courts have chosen to expand the pool of individuals and classes to weed out discriminatory conduct. With this scenario, it would be appropriate to consider the acts of the primary lending institution, to measure the treatment of borrowers of color against the larger pool of borrowers served by the primary institution.

•*Scenario Three: A non-traditional lender serves communities of color, while also serving predominantly white communities.*

This scenario is similar to Scenario One. Evidence of disparate treatment or disparate impact, when compared to treatment of white customers of the bank would establish the plaintiffs' prima facie case under existing anti-discrimination jurisprudence.

•*Scenario Four: A non-traditional lender serves communities of color exclusively, or predominantly.*

In this scenario, if there is a large enough pool of white borrowers from which to draw a comparison between the treatment of borrowers of color and white borrowers, then the analysis under Scenario One is appropriate, and traditional anti-discrimination jurisprudence can be utilized effectively, assuming a prima facie case can be established. If, however, as might be more likely, a non-traditional lender is created to serve communities of color precisely because of the market failure in the community and the likelihood that such borrowers can be targeted for toxic products, it would seem apparent that such

treatment of the borrowers is “on account of” their race. Yet traditional anti-discrimination analysis would seem ill suited to address such treatment, because there is no pool against which to measure the treatment of protected classes as opposed to unprotected classes.

The lower courts wrestling with this issue have ultimately turned to a case from the late 1960s involving allegations of “blockbusting,” the practice of playing on racial fears and driving white homeowners to sell their homes at lower values, while reselling to minority purchasers at inflated prices.¹³² In *Contract Buyers League v. F&F Investment*, there were no similarly situated white purchasers against which to measure the alleged discriminatory conduct.¹³³ Nevertheless, the court there expressed a willingness to assess the discriminatory conduct, despite the absence of a pool of white purchasers who were not discriminated against; otherwise such conduct would remain outside of the law.¹³⁴

As described below, however, the use of the blockbusting analogy is not necessary. Existing anti-discrimination jurisprudence offers approaches that are useful that might be better suited to fitting reverse redlining analysis within that jurisprudence. The first would analyze the jurisprudence with respect to causality, and the second, which would likely have to follow the first, would utilize time-honored statistical analysis, one in which an appropriate pool of similarly situated prospective borrowers is identified that would assist in establishing whether a disparate impact is present.

- Scenario Five: A community-based lender targets the provision of its services primarily to communities of*

¹³² *Contract Buyers League v. F & F Inv.*, 300 F. Supp. 210, 214 (N.D. Ill. 1969), *aff'd sub nom. Baker v. F & F Inv.*, 420 F.2d 1191 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Although the *Matthews* court did not explicitly mention *Contract Buyers League*, it cited to *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7, 20 (D.D.C. 2000) for the proposition that targeting of a racial minority, standing alone, would permit such practices to evade review if the defendant did not serve non-minority communities. *See Matthews*, 185 F. Supp. 2d at 886-87 (citing *Hargraves* for the proposition that “if the plaintiff presents direct evidence that the lender intentionally targeted her for unfair loans on the basis of sex and marital status, the plaintiff need not . . . show that the [defendant] makes loans on more favorable terms to others.”). The *Hargraves* court, in turn, had cited the *Contract Buyers League* decision for that approach. *Hargraves*, 140 F. Supp. 2d at 20 (citing *Contract Buyers League* for the proposition that “it is not necessary that the defendant make loans on more favorable terms to anyone other than the targeted class.”).

¹³³ *Contract Buyers League*, 300 F. Supp. at 216.

¹³⁴ *Id.*

color.

A review of Scenario Four raises the question: how would we differentiate a predatory subprime lender, one that seeks to take advantage of members of communities of color who may not have access to traditional lending sources by offering them products that are not competitive with products for which those members might otherwise qualify, from a community-based lender that has as its mission serving otherwise underserved markets? The community-based lender might also offer subprime loans to borrowers that would not otherwise qualify for prime loans, or might serve as a conduit to traditional lenders that will only engage in risk-based lending with the prospective borrowers identified by the community-based organization. As the following discussion shows, developing a workable distinction between these two scenarios will be critical if the anti-discrimination laws are to prohibit unlawful practices while preserving the viability of worthy and lawful efforts.

C. Adapting Existing Approaches to Reverse Redlining's Abuses

1. Traditional Notions of Causality as Applied to Targeting

In both Scenarios Four and Five (non-traditional lender serving only communities of color and a community-based lender, respectively), it is possible that targeting of prospective borrowers of color occurred with respect to both lending institutions. Targeting certain communities for the provision of services because of the racial makeup of the targeted community would seem to constitute a decision made “on account” of the race of the inhabitants of such communities. Does such evidence constitute “direct evidence” of discrimination, sufficient on its own, to establish a plaintiff’s *prima facie* case under the FHA? Establishing that a particular entity targeted services to a community of color, standing alone, is hardly sufficient to create an inference that discrimination occurred in violation of the FHA, unless some adverse decision was made with respect to the prospective borrower on account of that borrower’s race, or some other protected classification.¹³⁵ Furthermore, in order to violate the FHA, one must “discriminate . . . in the terms, conditions or privileges” of a covered transaction, because of race, color,

¹³⁵ See 42 U.S.C. § 3604 (2000) (requiring that discrimination be based upon a person’s race, color, religion, sex, familial status or national origin to violate the FHA).

religion, sex, handicap, familial status, or national origin.¹³⁶ To “discriminate” requires that there is some adverse action taken against a person based on a protected classification.¹³⁷

A finding that targeting alone occurred is not sufficient on its face to determine that discrimination occurred. Where one is faced with a lender that serves only a class of borrowers protected by the FHA, however, there is no ready pool of prospective borrowers who are not members of a protected class against which to measure any differences between the treatment of the protected class by the defendant-lender and its treatment of the non-protected class. For this reason, once a finding of targeting is established, the plaintiff must also establish that the lender has taken some adverse action against a protected group of borrowers that would not have been taken against a non-protected group of similarly situated prospective borrowers.

There are two important issues that FHA litigation raises at this juncture. First, as discussed above, some courts are unclear on what standard should be applied to determine whether discrimination has occurred “on account of” a protected classification under the FHA.¹³⁸ Should courts apply a “but for” test, where courts ask if not for some discriminatory animus, the challenged decision would not have been made? Should courts ask whether invidious discrimination was a “motivating factor” in the determination to take a challenged decision? If some “direct evidence” of discrimination is produced, will plaintiffs shift the burden to defendants of establishing some non-discriminatory motive for their action, consistent with pre-1991 amendments jurisprudence? If so, what qualifies as direct evidence?

Several of the district courts in the modern reverse redlining cases outlined above have determined that evidence of targeting itself establishes direct evidence of discrimination, without an apparent determination that the loans made were on unfavorable terms. These courts have denied defendants’ motions seeking

¹³⁶ § 3604(b).

¹³⁷ § 3604. More specifically, the FHA bars discrimination on the basis of race, color, religion, sex, handicap, familial status, or national origin. *Id.*

¹³⁸ Courts have applied similar yet different standards when discrimination has occurred “on account of” a protected classification under the FHA. *See Barkley*, 2007 WL 2437810 at *13 (finding that the burden-shifting framework used in *McDonnell Douglas* should be applied). *See also Matthews*, 185 F. Supp. 2d at 886 (finding that the same factors required for a Title VII claim must be met); *Hargraves*, 140 F. Supp. at 20 (requiring only that plaintiffs show “that the defendants’ lending practices and loan terms were ‘unfair’ and ‘predatory,’ and that the defendants either intentionally targeted on the basis of race, or that there is a disparate impact on the basis of race.”).

dismissal of the reverse redlining complaints based on evidence of targeting. While the facts alleged in these cases would seem to establish strong evidence that the borrowers involved in those cases received loans on unfavorable terms, and plaintiffs have made allegations in their complaints that such loans were indeed made on unfavorable terms, as of yet, no court has reached a determination that the loans made in these reverse redlining cases were on unfavorable terms when compared to loans made to similarly situated borrowers who were not members of a protected class. The courts faced with this dilemma have stated that when there is no readily identifiable class of non-protected borrowers against which to measure a defendant's treatment, to fail to recognize targeting as itself establishing a prima facie case of discrimination would mean that the defendant's acts would be beyond review.¹³⁹ This is not necessarily the case, and existing anti-discrimination jurisprudence provides a useful avenue for scrutinizing this conduct, offering a means by which we can distinguish illegal from entirely legal conduct. The more recent cases reflect this more traditional path. And as the following discussion shows, when there is no ready pool of borrowers the lender serves those who are not members of the plaintiff's protected class, the plaintiff must identify another source of prospective borrowers to assess the actions of the lender. And existing anti-discrimination jurisprudence provides a meaningful way to approach this problem.

2. Utilizing Statistical Evidence to Establish a Prima Facie Case of Discrimination

In the first Supreme Court case to recognize the use of a disparate impact analysis, *Griggs v. Duke Power*,¹⁴⁰ the Court also recognized the ability of plaintiffs to use evidence of statistically significant differences between the treatment of members of a protected group and members of a non-protected group. The early precedents after *Griggs* established that plaintiffs could use general population statistics to establish evidence of the

¹³⁹ See, e.g., *Matthews*, 185 F. Supp. 2d at 886-87; *Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810, *14 (E.D.N.Y. Aug. 22, 2007) (noting that "courts have justified allowing evidence of intentional targeting in lieu of evidence of disparate treatment or impact because to hold otherwise would allow predatory lending schemes to continue as long as they are exclusively perpetrated upon one racial group.>").

¹⁴⁰ *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971).

disparate impact of allegedly discriminatory policies.¹⁴¹ More recent Supreme Court precedent has narrowed the use of statistics in establishing evidence of discrimination, insisting that plaintiffs derive their statistics from a pool of individuals that are similarly situated to the plaintiff class.¹⁴²

Given this narrower use of statistics in the Title VII context, courts have required a match between the characteristics or qualifications of the plaintiff class, and those of the pool against which the plaintiffs' approval rating will be measured.¹⁴³ If dealing with a group of applicants for a particular job who have been rejected, for example, one would measure their qualifications only against an applicant pool of others "similarly situated": i.e., the percentage of protected and unprotected classes among a potential applicant pool in the general population that are otherwise qualified for the position. In other words, if an applicant pool of qualified applicants is 25% African-American, and African-Americans are hired only at a rate of 10%, that would constitute a significant statistical disparity that could establish a prima facie case under a disparate impact theory.¹⁴⁴

Reverse redlining does not always lend itself to a simple application of the rules regarding the use of statistical evidence,

¹⁴¹ See *Int'l Bhd. of Teamsters v. U.S.*, 431 U.S. 324, 339 n.20 (1977) (finding that "[e]vidence of longlasting and gross disparity between the composition of a work force and that of the general population thus may be significant" as an indicator of purposeful discrimination). See also *Johnson v. Pike Corp. of Am.*, 332 F. Supp. 490, 494 (C.D. Cal. 1971) (illustrating *Griggs'* approval of statistical evidence to a survey indicating that "minority group members suffer wage garnishments substantially more often than others . . .").

¹⁴² See *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 997 (1988) (indicating that statistics that were not based on individuals similarly situated to the plaintiff's class "would be of little probative value"). See also *Wards Cove Packing Co., Inc. v. Atonio*, 490 U.S. 642, 650-51 (1989) (indicating a proper statistical comparison required the statistics to be derived from a pool of individuals of similar composition to the plaintiff's class); *Hazelwood Sch. Dist. v. U.S.*, 433 U.S. 299, 308 (1977) (same).

¹⁴³ See *Watson*, 487 U.S. at 997; *Wards Cove*, 490 U.S. at 650-61; *Hazelwood Sch. Dist.*, 433 U.S. at 308.

¹⁴⁴ Courts have utilized different standards to measure statistical significance. The test applied under the Supreme Court's decision in *Castaneda v. Partida* found that a discrepancy of "two or three standard deviations" would constitute a statistically significant difference sufficient to establish an actionable disparate impact. *Castaneda v. Partida*, 430 U.S. 482, 496 n.17 (1977). Others utilize the "four-fifths" or "80% rule," whereby courts will find a statistically significant discrepancy where a test might disqualify members of a protected class, with similar qualifications to members of non-protected class, at a rate greater than 20% of the time. For a description of the 80% rule, see Elaine W. Shoben, *Disparate Impact Theory in Employment Discrimination: What's Griggs Still Good For? What Not?*, 42 BRANDEIS L.J. 597, 604 n.54 (2004).

however. In a lending discrimination case, a plaintiff could show that borrowers with similar qualifications who are not within a protected group received loans when the plaintiff, a member of a protected group, did not. These are easy comparisons to make in the case of denial of a loan and the alleged extension of a loan on discriminatory grounds when the lender has made loans to both whites and blacks, for example. In the case of loan rejections, an inference of discrimination would arise where the denial rate for blacks with similar qualifications is different in a statistically meaningful way from the denial rate of white applicants. Where a lender actually lends to both whites and blacks, as in Scenarios One and Three, above (i.e., traditional lender and non-traditional lender, both serving all communities), it would be easy to compare the loan terms of white borrowers with those of black borrowers with similar qualifications to determine whether there were any invidious distinctions made between the two groups.

With respect to Scenarios Four and Five (i.e., lenders that serve just communities of color), where loans are targeted to a discrete (and protected) group, there will be no comparable pool of candidates receiving services from the lending institution. In such cases, and using traditional approaches to the use of statistical evidence, plaintiffs would produce evidence either (1) that whites within the general population received loans on more favorable terms from other institutions; or, (2) that the plaintiffs, given their qualifications, could have received a loan on more favorable terms on the open market. This evidence could be presented through expert testimony or the evidence from other lending institutions that similarly situated whites received better loans, or that blacks would have received better loans, on the open market. Whether the market is to blame for the discrepancy (or whether discrimination was a motivating factor), and whether there were legitimate business motivations behind the disparity in lending, are issues most appropriately left to resolution once the burden has shifted to defendants to establish a non-discriminatory basis for their actions. A discussion of these questions follows.

D. Anticipating the Business Necessity Defense

Once a reverse redlining plaintiff has established a prima facie case with respect to alleged discrimination, whether through a disparate treatment analysis or one based on disparate impact, the burden of production will now shift to the lender to establish,

depending on the court's view of the current status of the law under the FHA, either that there is a business necessity or a legitimate business justification behind the challenged decision or practice.¹⁴⁵ It is thus worthwhile at this juncture to attempt to anticipate the potential business justifications that lenders will likely attempt to utilize to defend against charges of reverse redlining.

A “game changing” innovation in lending, i.e., the creation of automated underwriting criteria, when coupled with the ability to establish risk-based pricing of loans, fueled the growth of the subprime market.¹⁴⁶ Some expressed hope that the automated underwriting criteria – basically, the standards used for assessing a prospective borrower's qualifications for a loan – would eliminate discrimination in lending.¹⁴⁷ Automated underwriting, with tools available to lenders to price the relative risk of borrowers, meant that more lending options would be made available to those who might not have otherwise qualified for a loan in the not-so-distant past. In theory at least, automated underwriting criteria and legitimate risk-based pricing based on objective measures of creditworthiness would not, in and of itself, constitute invidious discrimination.

A likely first line of defense for lenders charged with reverse redlining will be to allege that their underwriting criteria and risk-based pricing methodologies were legitimate bases upon which to make their decision to make loans on terms unfavorable to the plaintiff (assuming the plaintiff has established a prima facie case). Assuming that such underwriting criteria were actually used, the use of automated underwriting criteria itself raises at least two potential problems for the defendant.¹⁴⁸

¹⁴⁵ See *Kovacevich v. Kent State Univ.*, 224 F.3d 806, 830 (6th Cir. 2000) (indicating the availability of affirmative defenses to the defendant if the practice under question has a “legitimate business reason”); *Mountain Side Mobile Estates*, 56 F.3d at 1257 (finding that defendants can overcome complainants' prima facie case by evidence of “legitimate, non-pretextual justifications”); *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 988 (4th Cir. 1984) (same, but for sufficiently compelling business necessities).

¹⁴⁶ See, e.g., *Predatory Lending and Home Foreclosures – Part 4: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong. 4 (2007) (testimony of Douglas G. Duncan, Chief Economist, Mortgage Bankers Association).

¹⁴⁷ Stephen L. Ross and John Yinger, *Does Discrimination in Mortgage Lending Exist? The Boston Fed Study and Its Critics*, in THE URBAN INSTITUTE, MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 43, 67-68 (Margery Austin Turner & Felicity Skidmore eds., 1999).

¹⁴⁸ Of course, apart from attacking the underwriting criteria themselves, plaintiffs could show that objective methods were not actually used

First, there is a growing awareness that the credit scores and similar proxies for creditworthiness are potentially biased against people of color.¹⁴⁹ Consistent with a long line of Title VII cases, where test methods that appear facially neutral have a disparate impact that cannot be explained by any legitimate basis, such testing can itself serve as a basis for a finding of discrimination.¹⁵⁰ As it is likely that these cases will begin to arise, and this defense is certainly likely to be raised, more research on the issue of the legitimacy of credit scores and other methodologies as a basis for establishing the terms of a subprime loan is necessary to untangle the question of whether the use of these test scores might, itself, lend to a charge of discrimination.¹⁵¹

Another feature of automated underwriting will involve the extent to which the criteria utilized in a particular case resulted in a fixed set of loan terms that would be offered to the borrower, or whether, instead, such criteria established a range of loan options (most notably, a range of interest rates) for which the borrower might otherwise qualify. What often happened in the subprime process, especially when a mortgage broker was involved in the transaction, was that the lender would receive the information from the broker about the borrower's creditworthiness and the lender would inform the broker of the different loan terms that lender would be willing to offer the

evenhandedly in assessing the creditworthiness of prospective borrowers. This would establish that the methodologies allegedly used were mere pretexts for discrimination, i.e., where different underwriting criteria were used for white borrowers and borrowers protected under the FHA, or that loans were made to borrowers from non-protected classes with similar credentials as those from protected classes, regardless of the supposed application of the same underwriting criteria to the two groups. Establishing that a lender's professed defense to the discriminatory action was a pretext for invidious discrimination could support a finding of liability, but would not require it. *See, e.g.*, *Reeves v. Sanderson Plumbing Products, Inc.*, 530 U.S. 133, 143 (2000).

¹⁴⁹ *See, e.g.*, CHI CHI WU, CREDIT SCORING AND INSURANCE: COSTING CONSUMERS BILLIONS AND PERPETUATING THE ECONOMIC RACIAL DIVIDE 12-17 (2007) (reviewing literature documenting the fact that credit scores disfavor minority consumers), available at <http://www.consumerlaw.org/reports/content/InsuranceScoring.pdf>; FED. TRADE COMM'N, CREDIT-BASED INSURANCE SCORES: IMPACTS ON CONSUMERS OF AUTOMOBILE INSURANCE 51-54 (2007) (analyzing credit scores and showing African-Americans and Latinos, on average, having much lower credit scores than whites and Asians), available at http://www.ftc.gov/os/2007/07/P044804FACTA_Report_Credit-Based_Insurance_Scores.pdf.

¹⁵⁰ *See, e.g.*, *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971).

¹⁵¹ Admittedly, such a conclusion would likely impact millions of mortgage loans.

borrower.¹⁵² Without informing the borrower of the fact that the lender was willing to make a loan to the borrower on potentially more favorable terms than were being presented to the borrower, the broker might attempt to convince a particular borrower that less favorable terms were the best terms that broker could obtain for that borrower, regardless of the fact that the lender was actually willing to make a loan on more favorable terms to that borrower.¹⁵³

If the borrower was convinced by the broker that what was presented to that borrower was the best loan that broker could obtain, the broker would earn a commission from the lender that represented the difference between the interest on the loan the lender would have made and the one the borrower ultimately accepted.¹⁵⁴ This commission is known in the industry as the “yield spread premium”;¹⁵⁵ it is nothing more than a bribe for a broker convincing a borrower to accept a loan that is more expensive in terms of the interest rate than the loan for which that borrower was qualified, by the lender’s own admission (at least its admission to the broker). There is a growing awareness that the payment of a yield spread premium, in addition to the presence of additional charges, like pre-payment penalties and additional fees at closing, were more prevalent, during the height of the subprime boom, in loans made to African-American and Latino borrowers than to white borrowers.¹⁵⁶

Even in contexts where supposedly objective underwriting criteria are used, then, during the height of subprime lending, there was the distinct possibility that lenders utilized subjective methods for manipulating the lending process in ways that were harmful to classes protected under the FHA. Plaintiffs in reverse redlining cases should engage in aggressive discovery to determine the presence of yield spread premiums, pre-payment penalties and other closing costs in the loans made by defendant-lenders for any evidence that they could be found more often in loans made to FHA protected borrowers as opposed to similarly situated white borrowers, either in the portfolios of the lenders themselves, or in loans made to similarly situated white

¹⁵² Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 291 (2007).

¹⁵³ *Id.* at 310-12.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at 289.

¹⁵⁶ *Id.* at 296 (showing African-American and Latino borrowers paying higher yield spread premiums and other mortgage costs than white borrowers).

borrowers in the market more generally. The *Ramirez*, *Miller* and *Taylor* cases described above all involved some aspect of discretionary pricing policies that, it is alleged, had a disparate impact on minority borrowers. Prospective litigants should attempt to root out evidence of such practices wherever possible.

Another area for exploration is the presence of pre-payment penalties: fees imposed on borrowers for paying off their loans prior to maturation.¹⁵⁷ This was prevalent in the subprime market because for many borrowers, there was the expectation that they might attempt to refinance their loans in the future, which would result in them having to satisfy the outstanding principal on their current loan, even if they were refinancing with the same financial institution. One study of the presence of pre-payment penalties in subprime loans generated in 2004 found that, even controlling for many characteristics among borrowers, African-American borrowers were 31% more likely than whites to have pre-payment terms imposed on their fixed rate purchase money loans, and 34% more likely than whites to face such penalties with refinance loans.¹⁵⁸ Research such as this, controlling for such factors as income, credit score and loan-to-value ratios (some of the variables that lenders will use to price their loan offers), could serve as an excellent model for the litigant seeking to identify instances of discriminatory impact in the mortgage market.

Finding such statistical discrepancies begs one final question: how much is too much? One leading case under Title VIII in which evidence of statistical disparities were utilized is *Betsey v. Turtle Creek*.¹⁵⁹ There, the court was asked to rule on the practice of a housing developer in serving eviction notices to tenants with children in its buildings in a housing complex. The plaintiffs alleged that the practice of seeking the eviction of families with children was facially neutral but had a discriminatory impact. These practices were instituted against the residents of one of the three buildings in the building complex, the nicest of the three. Non-white residents made up two-thirds of the tenants in the building, with whites making up the other third. A comparison of the percentage of tenants in the complex receiving eviction

¹⁵⁷ Sally Pittman, *Arms, But no Legs to Stand on: "Subprime" Solutions Plague the Subprime Mortgage Crisis*, 40 TEX. TECH L. REV. 1089, 1095 (2008).

¹⁵⁸ See DEBBIE GRUENSTEIN BOCIAN ET. AL., UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 16-18 (2006) (describing how race and ethnicity effects subprime mortgage prices).

¹⁵⁹ *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 983 (4th Cir. 1984).

notices showed that over half of the non-white tenants had received eviction notices, while less than 15% of the white residents received them. When the court focused only on the eviction notices served in the one building in which the evictions were filed, nearly two-thirds of the tenants receiving eviction notices were non-white and slightly more than 25% of the white tenants received eviction notices. The court found evidence of disparate impact was “self-evident.”¹⁶⁰ The *Betsey* decision offers litigants a yardstick against which to measure practices alleged to violate Title VII. And, as in the *Ramirez, Miller and Taylor* cases, the plaintiffs in the Baltimore action appear to meet the statistical thresholds found by the court in *Betsey* that would establish a self-evident case of disparate impact.

E. Reverse Redlining within Existing Anti-Discrimination Frames

The first “wave” of reverse redlining cases, those involving targeting, attempted to address the challenge such cases pose to existing anti-discrimination jurisprudence. The courts in *Matthews* and *Barkley* attempted to address several issues that arise in such a context: e.g., what is the appropriate framework to use when applying the Fair Housing Act¹⁶¹ and Equal Credit Opportunity Act¹⁶² and how should the court deal with racial targeting by lenders that might not create a separate class of borrowers who are similarly situated but are treated better on account of their race or other protected status? To deal with the first issue, the courts created a new burden-shifting framework, adapted, to a certain extent, from traditional anti-discrimination jurisprudence. To deal with the second, they have utilized a “direct evidence” analysis to side-step the burden-shifting frameworks. As described above, it is not clear that either of these approaches are satisfactory responses to the challenges posed by the reverse redlining context. First, because the framework adopted, if implemented, would appear to pose new burdens on the plaintiff; second, because the use of targeting as “direct evidence” of discrimination could easily catch community lenders, who are not engaged in predatory lending, within its

¹⁶⁰ *Id.* at 988. The court cited both *Castenada* and *Hazelwood Sch. Dist.* in finding that the evidence of disparate treatment before the court was “easily [met]” by the standards employed by the Supreme Court in those cases. *Id.* at n.4.

¹⁶¹ 42 U.S.C. §§ 3601-3619, 3631 (2008).

¹⁶² 15 U.S.C. § 1691 (1996).

wide net.

A second “wave” of reverse redlining cases appears to address these questions differently. First, they adopt existing disparate impact analysis when determining whether a reverse redlining plaintiff can establish some discriminatory effect from a lender’s practices. Second, they utilize statistical evidence to establish that similarly situated borrowers are given more favorable loan terms. It is respectfully submitted that these approaches are consistent with existing anti-discrimination jurisprudence, more workable, and more likely to attack only invidious discrimination as opposed to beneficial policies and practices.

With these new approaches, though, challenges still remain to ensure the viability of anti-discrimination attacks on reverse redlining. First, some guidance from Congress or the Supreme Court appears necessary to determine whether disparate impact analysis is still available under the Fair Housing Act¹⁶³ in light of *Smith v. City of Jackson*.¹⁶⁴ No court has yet ruled that it is not available, but that does not mean defendants will not continue to press this defense. Second, Congress or the courts will need to clarify the appropriate method for burden-shifting in disparate impact claims under the FHA. Now, as described above, circuit courts differ on the appropriate approach with respect to shifting burdens of production and persuasion, yet another example of the impact of Congress’s failure to amend Title VIII when it amended Title VII in 1991. Third, plaintiffs will have to ensure that they are able to develop solid statistical models that can establish strong evidence of the disparate effect of lending practices on communities of color and other protected classes. Weak showings of disparate impact will only strengthen arguments that disparate impact analysis is not appropriate under the FHA. Advocates within different communities should work to develop data concerning lending practices within a community to establish typical models against which lender practices can be judged within that market.

CONCLUSION

There are many causes for the subprime mortgage crisis and the larger financial crisis it engendered. One under-reported aspect of the subprime meltdown is the likelihood that its effects

¹⁶³ See 42 U.S.C. §§ 3601-3619, 3631.

¹⁶⁴ *Smith v. City of Jackson*, 544 U.S. 228, 228 (2005).

are felt and will hit harder in communities of color because of the disproportionate proliferation of subprime products within such communities. This reverse redlining – the extension of credit on unfavorable terms as opposed to the denial of credit – would seem to challenge traditional anti-discrimination jurisprudence. While early cases addressing this issue struggled with how to fit allegations of reverse redlining within existing anti-discrimination jurisprudence, a recent round of judicial decisions seems to find more comfort in civil rights approaches to these problems. While more guidance might be necessary from the courts, and Congressional intervention might be helpful, it seems clear that cases like that filed in Baltimore, as well as the *Ramirez*, *Miller* and *Taylor* decisions and others like them that might be filed across the country, will find a developing jurisprudence that is adaptive to the facts on the ground, and offers satisfactory responses to the unseemly, illegal and ultimately destructive practice of reverse redlining.