ENFORCEMENT OF THE FAIR HOUSING ACT OF 1968

HEARING

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

JUNE 12, 2008

Serial No. 110–183

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CONTENTS

JUNE 12, 2008

Page

OPENING STATEMENTS

WITNESSES

LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING

ENFORCEMENT OF THE FAIR HOUSING ACT OF 1968

THURSDAY, JUNE 12, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE CONSTITUTION,
CIVIL RIGHTS, AND CIVIL LIBERTIES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:09 a.m., in room 2141, Rayburn House Office Building, the Honorable Jerrold Nadler (Chairman of the Subcommittee) presiding.

Present: Representatives Conyers, Nadler, Davis, Wasserman Schultz, Scott, Watt, Franks, and Jordan.

Also Present: Representative Green.

Staff present: David Lachmann, Majority Subcommittee Chief of Staff; LaShawn Warren, Majority Counsel; Tracie Powell, CBC Fellow; Caroline Mays, Majority Professional Staff Member; Paul Taylor, Minority Counsel; and Crystal Jezierski, Minority Counsel.

Mr. NADLER. This hearing of the Subcommittee on the Constitution, Civil Rights, and Civil Liberties will come to order.

Without objection, the Chair will be authorized to declare a recess of the hearing. The Chair anticipates doing so only in the event there are votes during the hearing, which hopefully there won't be.

I now recognize myself for 5 minutes for an opening statement.

Today we continue our oversight of the Department of Justice's Civil Rights Division by examining the enforcement of the Fair Housing Act of 1968. We are also joined by representatives of the Department of Housing and Urban Development, which also has an enforcement role, and a distinguished panel of witnesses to discuss the state of fair housing enforcement.

The right to be treated equally, free from discrimination, in all matters affecting access to housing is one of the fundamental rights guaranteed by law. One only has to look at unequal access to good housing, the current foreclosure crisis, continuing segregation of our communities, and predatory lending practices that appear to have treated communities of color more harshly than other communities, among other disturbing patterns, to understand the dangerous impact that housing discrimination can and does have on this Nation.

Housing discrimination is everyone's problem. It divides our society, it affects the stability of our communities, and has even helped to disrupt our capital market. More than anything, it is unjust and has no place in a decent society.

Laws prohibiting discrimination in housing—whether rental housing, homeownership or access to fair credit—are important. But they are useless if not vigorously enforced.

That is the purpose of today's hearing. I look forward to the testimony of our witnesses. I am especially interested in determining whether we can do a better job enforcing the laws we have and whether there are gaps in current law that need to be addressed by Congress.

I want to welcome our witnesses, and I look forward to your testimony.

I will now recognize for an opening statement the Ranking minority Member, the gentleman from Arizona.

Mr. FRANKS. Well, thank you, Mr. Chairman.

And thank you all for being here today.

Mr. Chairman, today we are here to conduct oversight over the housing section of the Department of Justice, which continues, in my judgment, to vigorously enforce the Nation's laws against discrimination in housing.

Chairman Conyers and representatives of the civil rights groups held a press conference regarding the current mortgage debate on March 19th of this year. And at that event, Mr. Chairman, not a single speaker, not even Chairman Conyers, accused the Department of Justice of being lax in their prosecution of legitimate housing market discrimination cases.

But less than a month later, Speaker Pelosi, on the 40th anniversary of the Fair Housing Act, took the opportunity to suddenly claim that Federal inaction in enforcing the housing discrimination laws has contributed to the current mortgage crisis, especially predatory lending practices.

That claim is belied, Mr. Chairman, by the Justice Department's expansive efforts in prosecuting mortgage lending discrimination cases under Federal law. And I am glad we have the opportunity to rebut that claim today.

The Fair Housing Act prohibits discrimination in residential real estate transactions. The Equal Credit Opportunity Act prohibits creditors from discriminating in any aspect of a credit transaction. Under the Department of Justice Operation Home Sweet Home initiative, the department conducted a record-high number of fair housing tests in fiscal year 2007 to uncover housing discrimination.

The disproportionate number of minorities that receive subprime loans in part is a result of the actions taken by Congress long ago when it passed the Community Reinvestment Act in 1977. That act was designed to direct easier credit to lower-income communities, and it has done that.

That act requires the Federal Reserve Board and other financial regulators to rate banks on their lending practices within low-to moderate-income areas within their service areas. A bank's failure to make loans in such areas may cause regulators to halt bank expansion plans until the institution alters its lending practices.

Consequently, banks and thrifts have increased their lending to low-and moderate-income borrowers. That is the basic premise. And although subprime lending is, to a degree, outside the act's purview because such lending has been undertaken in large part by financial service companies other than banks and thrifts, loans provided by bank affiliates can be counted to determine whether the bank is meeting the credit needs of their community.

If they are included and if the affiliate is a subprime lender, such subprime affiliate loans could be included in a bank's performance rating. Indeed, institutions evaluated under the act issued about half of subprime mortgage loans, many of them of the riskier variety.

So as we proceed with this discussion, we need to frankly address the effects of that act of 1977, which encouraged banks, through their affiliates that could be subprime lenders, to make riskier loans more easily available to low-income communities.

As recently reported in National Review magazine, Countrywide is one of the biggest players in the subprime mortgage industry and has aggressively pushed subprime mortgages.

For decades, the left advanced more credit for homeownership among the poor and especially among poor minorities. Their biggest policy success was the Community Reinvestment Act, passed in 1977 and updated several times.

The L.A.-based Spanish-language publication, *La Opinion*, named Countrywide "Corporation of the Year" for its work with Hispanics. In 2005, Countrywide won the "Best in Minority Lending" award from the Lending Industry Diversity Conference.

Everything changed when the flip side of easy credit became apparent. *The New York Times* made the shocking discovery that when minorities disproportionately take out the riskiest mortgage, they disproportionately experience foreclosures as well.

The result of Congress' action unfortunately hurt many consumers that were supposed to be helped. And I hope we can explore these and other issues at the hearing today and make sure the current mortgage market tension is not repeated in the future.

We need fair lending practices, Mr. Chairman. We need to never discriminate against anyone. But we need to make sure that our policies don't make things worse for those that we ostensibly are trying to help.

And, with that, I yield back.

Mr. NADLER. I thank the gentleman.

And I now will yield for an opening statement 5 minutes to the distinguished Chairman of the full Committee, the gentleman from Michigan.

Mr. CONYERS. Well, I ask that my statement be put in the record, Chairman Nadler.

Mr. NADLER. Without objection.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES

Although it's been nearly 40 years since the Fair Housing Act banned housing discrimination, complaints alleging unfair treatment of minorities, the disabled, families, and other groups are increasing. Of an estimated 3.7 million fair housing violations annually, approximately 2 million involve race discrimination.

Admittedly, some progress has been made in reducing levels of residential segregation and discrimination since the passage of the Act. But let's face it—most Americans still live in communities largely divided by race and ethnicity.

Thus, the obvious question I have for our witnesses—particularly in light of the ever-escalating mortgage crisis—is what actions have Justice and HUD taken to ensure that the Fair Housing Act is enforced effectively?

The facts clearly underscore the need for greater enforcement. Let me highlight three particular concerns.

First, despite claims that the Administration has continued vigorous enforcement of the FHA, the Government's caseloads and charges have steadily decreased and relatively few cases have been brought on behalf of racial and ethnic minorities, particularly pattern and practices cases.

HUD's own data suggests that out of approximately 3.7 million annual fair housing violations, the Department, for example, only processed 11,000 complaints in 2006, which is less than one-half of 1% of the total estimated number of housing violations.

Second, I sense that DOJ's longstanding commitment to combat race discrimination in housing has steadily declined over the years. The Department filed fewer fair housing cases in the past two years than in previous years.

Look, we're not talking about thousands of cases or even hundreds of cases being filed. In 2007, for example, the DOJ filed only 35 fair housing cases. In 2006, it filed 31 cases. In contrast, the DOJ filed 42 cases in 2005, and and 53 cases in 2001. And, of the 31 housing and civil enforcement cases DOJ brought in 2006, only eight involved claims of race discrimination.

Beyond this, I am troubled by Attorney General Mukasey's recently announced refusal to create a national taskforce to combat the country's mortgage fraud crisis. Doesn't he read the newspapers or listen to the television news reports about rampant fraud and predatory lending by brokers and lenders?

Finally, we just learned that HUD's mortgage policy may have actually helped to fuel the subprime mortgage crisis that is at the heart of today's turbulent economy. *The Washington Post* reported Tuesday that, while regulators warned that subprime lenders were saddling borrowers with mortgages they could not afford, HUD stuck with an outdated policy that allowed Freddie Mac and Fannie Mae to count billions of dollars they invested in subprime loans as a public good that would foster affordable housing.

I want to know from our witnesses why the number of discrimination cases filed by DOJ has declined, even as the number of complaints has risen. I also hope to learn if, in fact, HUD irresponsibly continued policies that helped create the mortgage crisis we find ourselves in today.

Many people forget that Dr. King focused heavily on fair housing issues, with a keen recognition of what costs our society would pay for continued patterns of discrimination and segregated living. Passage of the Fair Housing Act was a fitting tribute to his efforts in this regard.

The Fair Housing Act is now one of the most powerful tools in our civil rights arsenal; but a tool is only effective when wielded with skill and intent.

I look forward to hearing from or witnesses today as we seek to determine whether the federal government is wielding this tool effectively.

Mr. CONYERS. I am looking for the press release or the press hearing that my friend, the Ranking Member, Trent Franks, referred to where nobody made a peep about enforcement of discrimination in housing, the March 19 press conference with civil rights leaders on the subprime crisis. But I will get to that, because I am here to confess the error that I said nothing, I didn't make a peep, because I am going to make a big peep this morning.

This is one of the most disturbing trends in our history. We were talking it over with LaShawn Warren and others. Three and a half million annual fair housing violations, according to HUD's own data. Last year, DOJ filed 35 fair housing cases. In 2006, they filed 31 cases. In 2005, they filed 42 cases. In 2001, they filed 53 cases.

Now, for years and years, we have been saying, how come we can't get rid of the inner city, the ghettos, the places in urban America that nobody will live in but those that are forced to live there? And at the rate that we are going, there will be people sitting in this hearing room with the same representatives from DOJ and HUD, and there will be somebody replacing all of us up here, and we will be saying the same thing. Because, at the rate we are going, this problem will never be solved.

The reason we can't get rid of inner cities and slums and ghettos is because, if we are hitting 3.7 million violations—at least 1.7 million are directly racially connected to race problems; the rest are other problems, and I am in the process of finding out what the other problems are—it is arithmetically impossible to ever eliminate the slums. We will be doing this forever.

So, Trent, I owe you a debt of thanks for pointing out how slack I have been on this matter, even as recently as March 19th. Well, I am glad—that is what makes this Committee so unique. We work together. This is great.

This is an incredible situation that requires the Department of Justice and Housing to really get to the bottom of it. So I congratulate both my Chairman and Ranking Member for holding the hearing here today, and I thank you.

Mr. NADLER. I thank the gentleman.

In the interest of proceeding to our witnesses and mindful of our busy schedules, I ask that other Members submit their statements for the record.

Mr. WATT. Mr. Chairman?

Mr. NADLER. The gentleman is recognized.

Mr. WATT. I wanted to ask unanimous consent to make a brief opening statement.

Mr. NADLER. Without objection.

Mr. WATT. And it will be brief. And, actually, this is spontaneous. It was not planned. It was provoked by some of our Ranking Member's comments, because I think he has left the wrong impression that this is somehow a conspiracy of the left to increase homeownership in this country and thereby drive African-Americans and other minorities to subprime lenders. I think that would be a terribly wrong impression to allow to stand on the record.

There is and has been a very aggressive effort of many of us to increase homeownership because we recognize that homeownership in our community is the primary means of gaining wealth. We don't have stocks and bonds and retirement accounts. So, historically in our community, a means of getting any wealth is to own a home. And we have been unapologetic advocates of increased homeownership in minority communities.

But to leave the impression that we condone disproportionate numbers of African-Americans and other minorities being given subprime loans, many of whom would have qualified for prime loans had they not been discriminated against, is to leave a very erroneous impression.

And to not acknowledge the complicity, the active participation in that by this Administration would be equally inaccurate, because it was HUD that suggested that subprime loans be given CRA credit by lenders.

It was HUD that looked the other way while they should have been regulating lenders when we were crying out to them as Members of the Congressional Black Caucus and on the Financial Services Committee, on which I sit and into which I introduced the first predatory lending bill three Congresses ago, not in the middle of this crisis.

It would be in error to leave that impression on our record in this communities.

And it would be in error to leave the impression that this Department of Justice has not been complicit in it, because as recently as last week, the Attorney General made a decision that he is not going to set up a special unit to look into all of the fraud and misrepresentation and predatory lending practices that took place that led to this economic crisis. And we have been crying out for the Attorney General to take the lead on that, and he has refused to do it.

I know the Chair wants to move forward with the hearing, but I didn't come in here planning to make this statement. I just want the Chair to know that this was provoked. It was not premeditated. And for us to allow those kinds of statements and innuendoes that it was somehow our fault that we are being discriminated against and channeled to particular communities and channeled to predatory lenders and subprime loans is just irresponsible if we allow that to be any statement in this Committee or any other Committee of this Congress.

And I thank the Chairman for allowing me this opportunity to correct the record, or at least give a balance to it, from what our Ranking Member has said.

Thank you. I yield back.

Mr. NADLER. Thank you.

And I ask that other Members submit their statements for their record. Without objection, all Members will have 5 legislative days to submit an opening statement for the record.

We will now turn to our first panel of witnesses.

As we ask questions of our witnesses, the Chair will recognize Members in the order of their seniority on the subcommittee, alternating between majority and minority, provided the Member is present when his or her turn arrives. Members who are not present when their turn begins will be recognized after the other Members have had the opportunity to ask their questions. The Chair reserves the right to accommodate a Member who is unavoidably late or only able to be with us for a short time.

Your written statements will be made part of the record in its entirety. I would ask each of you to summarize your testimony in 5 minutes or less. To help you stay within that time, there is a timing light at your table. When 1 minute remains, the light will switch from green to yellow, and then red when the 5 minutes are up.

I will now introduce our first panel.

Jessie Liu has served as deputy assistant attorney general in the Civil Rights Division of the Department of Justice since December 2007. Her duties include supervising the division's Housing and Civil Enforcement section, which enforces the Fair Housing Act of 1968.

Before she joined the Civil Rights Division, Ms. Liu served as an assistant U.S. attorney for the District of Columbia. She also has worked in the National Security Division of the Office of the Deputy Attorney General at the Department of Justice.

Prior to her service at the department, Ms. Liu practiced law with the firm of Jenner & Block and served as a Federal judicial clerk. Ms. Liu earned her law degree from Yale Law School, where she was an editor of the Yale Law Journal; her undergraduate degree, summa cum laude, from Harvard University.

Kim Kendrick is the assistant secretary in HUD's Office of Fair Housing and Equal Opportunity. Ms. Kendrick was formerly the senior counselor for the secretary and advised and represented Secretary Alphonso Jackson on a wide variety of HUD programs, policies and strategies.

Before joining the Bush administration, Ms. Kendrick was the general counsel for Covenant House Washington. From 1998 to 2002, she served as a regional administrator for the District of Columbia's Housing Authority. As HUD's assistant general counsel for insured housing and community development litigation from 1990 to 1995, Ms. Kendrick was responsible for nationwide Federal court litigation involving challenges to HUD's programs, policies and procedures. Ms. Kendrick provided agency offices counsel and advice concerning actual potential litigation regarding, among other issues, FHA single and multifamily mortgage insurance programs and the Community Development Block Grant program.

A native of Pittsburgh, she received her bachelor of arts in sociology from Bowdoin College in New Brunswick, Maine, and a law degree from the University of Pittsburgh Law School.

I am pleased to welcome both of you.

It is the custom of the Committee to swear in witnesses. Would the witnesses please stand and raise your right hands?

[Witnesses sworn.]

Mr. NADLER. Let the record reflect that the witnesses answered in the affirmative.

You may be seated. Thank you.

The first witness I will recognize for 5 minutes is Ms. Liu.

TESTIMONY OF JESSIE K. LIU, DEPUTY ASSISTANT ATTORNEY GENERAL, CIVIL RIGHTS DIVISION, DEPARTMENT OF JUSTICE

Ms. LIU. Mr. Chairman, Ranking Member Franks, Members of the Subcommittee, it is a pleasure to appear before you this morning to represent the Department of Justice and the dedicated professionals of the Housing and Civil Enforcement Section of the Civil Rights Division, who work so hard to ensure nondiscriminatory access to housing, credit and public accommodation. I am pleased to report on some of the outstanding accomplishments of that section.

This April, we commemorated the 40th anniversary of the Fair Housing Act, landmark legislation that outlawed discrimination on the basis of race, color, national origin or religion in the sale, rental or financing of housing. Since the original act was passed in 1968, Congress has reaffirmed and expanded this country's commitment to fair housing by extending the act's protections to include sex, disability, familial status and providing for much-needed enforcement tools.

Although we have made progress over the last 40 years, there can be no question that housing discrimination exists today. Since

2001, the division has filed 248 cases to enforce the civil provision of the Fair Housing Act and obtained significant relief.

In 2006, the Attorney General launched Operation Home Sweet Home, an initiative to combat housing discrimination focused on improving and expanding our fair housing testing program. Last fiscal year, we conducted more than 500 paired tests all across the country, 20 percent more than in any previous year.

These tests are already producing new cases and significant results. For example, this January, we filed suit, alleging that the owner and operators of an apartment complex in Roseville, Michigan, engaged in a pattern or practice of denying apartments to African-Americans by falsely telling them that no apartments were available. In addition to that case, we have filed and settled three other cases based upon testing evidence just since last September.

We also have achieved significant results in cases stemming from complaints filed with HUD. Just last month, we settled a particularly egregious case in which we alleged that the landlord of a housing complex in Virginia Beach, Virginia, imposed more restrictive rules on African-American tenants, verbally harassed African-American tenants with slurs and epithets, and evicted tenants by enforcing a limit of two children per family. The settlement we obtained requires the landlord to pay up to $319,000 to victims of discrimination and a $42,000 civil penalty.

The division's enforcement of the Fair Housing Act protections against discrimination based on disability is also a vital element of our work. Since fiscal year 2005, we have obtained settlements requiring more than 14,500 apartments throughout the country to be made accessible to persons with disabilities under the Fair Housing Act.

Cases alleging systemic sexual harassment by landlords also have been a priority. During this Administration, we have filed three times as many system sexual harassment cases under the Fair Housing Act as the same time period in the prior Administration. And we have achieved substantial relief for the victims of this kind of discrimination. Just in the past year, our sexual harassment settlements have provided for over $1 million in monetary damages and civil penalties.

In this brief statement, I have had time to highlight just a few of the division's many fair housing cases and investigations. But these examples demonstrate the division's ongoing and steadfast commitment to doing its part to eradicate housing discrimination and bring relief to victims of discrimination.

We look forward to working closely and cooperatively with this Committee in its efforts to protect the fair housing rights of all Americans.

I thank you, and I look forward to your questions.

[The prepared statement of Ms. Liu follows:]

PREPARED STATEMENT OF JESSIE K. LIU

STATEMENT OF

JESSIE K. LIU
DEPUTY ASSISTANT ATTORNEY GENERAL
CIVIL RIGHTS DIVISION
U.S. DEPARTMENT OF JUSTICE

Before the
SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, and CIVIL LIBERTIES
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

Hearing Entitled

"ENFORCEMENT OF THE FAIR HOUSING ACT OF 1968"

June 12, 2008

Mr. Chairman, Ranking Member Franks, and Members of the Subcommittee, it is an honor to appear before you today to discuss the Civil Rights Division's fair housing and lending enforcement.

In my role as a Deputy Assistant Attorney General for the Civil Rights Division, I oversee the Housing and Civil Enforcement Section, which is charged with ensuring non-discriminatory access to housing, credit, and public accommodations. We understand the importance of these opportunities to American families, and we work hard to meet this weighty responsibility. The Division is strongly committed to enforcing the Fair Housing Act, the Equal Credit Opportunity Act, Title II of the Civil Rights Act of 1964, the Religious Land Use and Institutionalized Persons Act, and the Servicemembers Civil Relief Act.

This April, we commemorated the fortieth anniversary of the Fair Housing Act – landmark legislation that outlawed discrimination on the basis of race, color, national origin, or religion in the sale, rental, or financing of housing. On several occasions since the original Act was passed in 1968, Congress has reaffirmed and expanded this country's commitment to fair housing by extending the Act's protections to include sex, disability, and familial status and providing for much-needed enforcement tools.

The right protected by the Act – to be free from discrimination in housing – is at the heart of the American dream, and for forty years, the Department of Justice has worked to make that dream a reality for all Americans. Since 2001, the Department has brought more than 200 cases based on discrimination because of race, color, national origin, sex, religion, disability, or familial status. We have required landlords, real estate companies, builders, architects and engineers, lenders, and local governments to implement non-discriminatory policies and procedures. We have obtained millions of dollars of compensation for victims of discrimination. And, although criminal enforcement is not the subject of today's hearing, I would be remiss if I did not note that we have convicted dozens of defendants who have threatened families by burning crosses and committing other acts of violence outside their homes.

Although we have made progress over the last forty years, there can be no question that housing discrimination exists today. Just a sample of recent cases confirms the work still to be done. In one case, a landlord refused to rent to an African-American mother and daughter because of what his other tenants would think. In another case, a landlord replaced a tenant's rent and refused to make repairs to her unit when her African-American boyfriend moved in with her. In another case, a local government retaliated against an employee who promoted an affordable housing development that would be welcoming to African Americans. And in yet another case, a new landlord decided to systematically terminate the leases of long-time Hispanic tenants under the guise of making renovations. Each of these cases was investigated and charged by the Department of Housing and Urban Development. The Housing and Civil Enforcement Section then litigated and successfully settled them.

But these cases are just the tip of the iceberg. Over the years, discrimination, particularly race and national origin discrimination, has become more difficult to detect, as more and more housing providers have learned that even discriminatory statements are illegal. A rental agent who treats a prospective African-American, Hispanic, Asian-American, or Native-American tenant politely but falsely tells him or her that no apartment is available violates the Fair Housing Act. Unfortunately, the prospective tenant is not likely even to know that he or she has been the victim of discrimination, much less complain about it.

Two years ago, the Department of Justice launched Operation Home Sweet Home, an initiative specifically designed to combat these more hidden forms of discrimination. As part of the initiative, we committed additional resources to our fair testing program and enhanced our targeting. By conducting multiple paired tests in the same location, we can find and collect evidence against the landlord who politely lies about the availability of an apartment because of a prospective tenant's race, national origin, sex, religion, disability, or familial status.

Operation Home Sweet Home is achieving significant results. In fiscal year 2007, we conducted more than 500 paired tests, exceeding by more than 20 percent the highest number of tests conducted in any previous year since the program's inception. The testing program also is producing new cases. We are currently litigating a case alleging a pattern or practice of discrimination against African Americans in Roseville, Michigan. Another case on behalf of African Americans based on testing evidence is in pre-suit negotiations. In addition, during fiscal year 2007, Operation Home Sweet Home resulted in the first pattern or practice discrimination case ever brought by the Civil Rights Division on behalf of Asian Americans based on evidence from our testing program. That case, *United States v. Pine Properties* (D. Mass.), was settled in January 2008, with the defendants agreeing to pay up to $158,000 in monetary relief. Operation Home Sweet Home also has resulted in pattern or practice discrimination cases on behalf of families with children and guide-dog users.

During fiscal year 2007, the Housing and Civil Enforcement Section obtained settlements and judgments in fair housing and fair lending cases requiring the payment of a total of over $7 million in monetary damages to victims of discrimination and civil penalties to the government. These cases involve a wide range of vulnerable victims of discrimination.

Clearly, race and national origin discrimination in housing is an ongoing problem. Fortunately, the Division continues to enjoy significant success in its pattern or practice race discrimination cases under the Fair Housing Act. For example, in March 2007, we obtained a judgment in *United States v. Matusoff Rental Company* (S.D. Ohio) that the defendant had engaged in a pattern or practice of discrimination on the basis of both race (against African Americans) and familial status. The *Matusoff* judgment requires the defendant to pay a total of $405,000 in compensatory damages and $130,000 in punitive damages to twenty-six individual victims of discrimination. This is the second largest damage award the Department ever has obtained in a Fair Housing Act case. Also in March 2007, a federal court in Nevada entered a consent decree in *United States v. Bonanza Springs* (D. Nev.), a race, disability, and familial status discrimination case, providing for $450,000 in monetary relief.

In August 2007, the court in *United States v. General Properties Company, LLC* (E.D. Mich.), entered a consent order providing for $725,000 in monetary relief to resolve the Division's allegations that the owners and operators of an apartment complex in Livonia, Michigan, had discriminated against African-American prospective tenants. In May 2008, the court in *United States v. Henry* (E.D. Va.), entered a consent order requiring the landlord of a subsidized housing complex to pay up to $361,000 to settle the Division's lawsuit alleging that the defendant imposed more restrictive rules and regulations on African-American tenants than on other tenants; verbally harassed African-American tenants with racial slurs and epithets; and evicted tenants by enforcing a limit of two children per family. In addition, we currently are litigating several other pattern or practice cases involving race and national origin discrimination.

The Division's enforcement of the Fair Housing Act's protections against discrimination based on disability are a vital element of the President's New Freedom Initiative to provide and enhance community-based opportunities for individuals with disabilities. The Fair Housing Act requires that multi-family housing constructed after 1991 include certain features to make it usable by, and accessible to, persons with disabilities. Twice a year since 2005, we have held a Multi-Family Housing Access Forum, intended to assist developers, architects, and others understand the Act's accessibility requirements and to promote a dialogue between the developers of multi-family housing and persons with disabilities and their advocates. Our most recent Access Forum events were held in Miami in November 2007 and in Seattle in May 2008.

In addition to these proactive outreach efforts, the Division actively litigates cases involving housing that is not designed and constructed in accordance with the Fair Housing Act and the Americans with Disabilities Act. In January 2008, the Division settled a case alleging systemic violations of the Fair Housing Act's multi-family housing accessibility requirements for $175,000 in monetary relief plus retrofitting of the inaccessible features. During fiscal year 2007, we filed six accessibility cases, settled seven such lawsuits, and obtained favorable summary judgment rulings in two accessibility cases. The Housing and Civil Enforcement Section also actively monitors compliance with the consent decrees in these cases. During calendar year 2007, we distributed $700,000 and more than $1 million, respectively, to victims in two disability discrimination cases. We also continue to monitor the creation of more than 14,500 new accessible housing opportunities in twenty-six States resulting from settlements entered since October 2004.

Moreover, the Division vigorously enforces the Fair Housing Act's requirement that local governments not discriminate against group homes for persons with disabilities. For example, in March 2008, the Division obtained favorable rulings on behalf of group homes for youth with disabilities in the District of Columbia and group homes for persons in recovery from alcohol or drug addiction in Boca Raton, Florida. Last fall, working with private plaintiffs, we ended contentious litigation over Sarasota County, Florida's treatment of group homes for persons in recovery or with mental illness. The settlement allows the group homes to continue to operate and requires the county to pay $760,000 in monetary relief – our largest monetary settlement ever in a group home case.

Another active area in our Fair Housing Act enforcement has been cases alleging systemic sexual harassment by landlords. During this Administration, the Civil Rights Division has filed almost three times as many housing-related systemic sexual harassment cases than in the prior Administration. Sexual harassment by a landlord is particularly disturbing because the perpetrator holds both the lease and a key to the apartment. For example, in April 2008, the court entered our consent decree providing for $250,000 in monetary relief to resolve a lawsuit alleging that the owner of rental properties in Missouri had subjected female tenants to unwanted verbal sexual advances, unwanted physical sexual advances, forcible physical contact, and threats of eviction when they refused or objected to his sexual advances. In March of this year, we obtained a consent decree requiring the property managers, owner, and a maintenance man at two other Missouri apartment complexes to pay $75,000 in damages to aggrieved persons, as well as a $20,000 civil penalty.

Although most sexual harassment cases brought by the Housing and Civil Enforcement Section involve claims against landlords under the Fair Housing Act, in October 2007, the Division resolved its first-ever case alleging systemic sexual harassment in lending in violation of both the Fair Housing Act and the Equal Credit Opportunity Act. In *United States v. First National Bank of Pontotoc, Mississippi* (N.D. Miss.), we alleged that a former bank vice president used his position to sexually harass female borrowers and applicants for credit, including home mortgage loans, and that the bank was liable for those actions. The consent decree requires the defendants to pay $250,000 to fifteen identified victims, up to $50,000 for any additional victims, and $50,000 to the United States as a civil penalty. The settlement also requires the bank to make changes to its policies and practices to prevent and detect any future harassment.

The First National Bank of Pontotoc case is just one of the Division's lawsuits that protect the rights of Americans to purchase houses as well as to rent them. Our fair lending enforcement efforts are a key component of our fight against housing discrimination. While a lender may legitimately consider a range of factors in determining whether to provide a loan to an applicant, race or national origin has no place in this determination. "Redlining" is the term used to describe a lender's refusal to provide lending services in certain areas based on the racial makeup of the area's residents. The Division is working hard to eliminate this form of discrimination, which places a barrier between Americans and the dream of owning their own home.

During fiscal year 2007, we filed and resolved a lawsuit against Centier Bank in Indiana for violations of the Equal Credit Opportunity Act and the Fair Housing Act. In this case, we alleged Centier unlawfully refused to provide its lending products and services on an equal basis to residents of minority neighborhoods, thereby denying hundreds of loans to prospective African-American and Hispanic residents. Under the settlement agreement, the bank will open new offices and expand existing operations in the previously excluded areas, as well as invest $3.5 million in a special financing program and spend at least $875,000 on outreach, marketing, and consumer financial education in these redlined areas.

Also in fiscal year 2007, we filed and resolved three cases under the Equal Credit Opportunity Act (ECOA) involving auto lending discrimination. In August 2007, the Division filed and resolved two cases against Ford dealerships in Pennsylvania. These lawsuits alleged that the dealerships engaged in a pattern or practice of discriminating against African-American customers by charging them higher dealer markups on car loan interest rates. The consent orders in those cases provide for up to $457,000 in damages for African-American customers who were charged higher interest rates. In addition, the dealerships agreed to implement changes in their policies and practices, including new guidelines to ensure that the dealerships follow the same procedures for setting markups for all customers and that only good faith, competitive factors consistent with ECOA influence that process. In January 2007, we filed and resolved a case against Compass Bank in Alabama, alleging that the bank violated ECOA by engaging in a pattern of discrimination on the basis of marital status in thousands of automobile loans it made through hundreds of different car dealerships in the South and Southwest. Specifically, we alleged that the bank charged non-spousal co-applicants higher interest rates than similarly-situated married co-applicants. The consent decree requires the bank to pay up to $1.75 million to compensate several thousand non-spousal co-applicants whom we alleged were charged higher rates as a result of their marital status. We currently have two additional fair lending lawsuits in pre-suit negotiations.

The Housing and Civil Enforcement Section also enforces the anti-discrimination requirements of Title II of the Civil Rights Act of 1964. In March 2008, we resolved a Title II lawsuit against the owner and operator of Kokoamos Island Bar and Grill, a Virginia Beach club and restaurant. We alleged that Kokoamos discriminated against African-American patrons in a place of public accommodation by implementing a discriminatory dress code targeting African Americans and by applying the dress code in a discriminatory manner. Our consent decree requires Kokoamos to implement changes to its policies and practices in order to prevent such discrimination. We also continue to monitor compliance with our 2004 consent decree in *United States v. Cracker Barrel Old Country Stores*, which resolved our lawsuit alleging a pattern or practice of discrimination against African-American customers and prospective customers in the restaurant's seating and service practices. Cracker Barrel continues to make progress toward full compliance with the comprehensive reforms mandated by that consent decree.

In addition, the Division continues its vigorous enforcement of the Religious Land Use and Institutionalized Persons Act of 2000 (RLUIPA). The land-use provisions of RLUIPA bar zoning practices that discriminate against or impose undue burdens on house of worship and religious schools. Since 2001, the Division has reviewed 156 RLUIPA matters and has opened thirty-eight full investigations. Seventeen of these full investigations have been resolved favorably prior to the filing of a lawsuit. The Division also has filed five RLUIPA lawsuits, three of which have been resolved by consent decree, and two of which are pending.

In February 2008, the Division reached a consent decree in a suit against the City of Waukegan, Illinois, which requires that the city amend its zoning code to treat religious assemblies and non-religious assemblies equally as required by RLUIPA. The Division also obtained a favorable summary judgment ruling in October 2007 after filing an *amicus* brief in a case in which the Township of Wayne, New Jersey, had taken various actions to block the building of a mosque. The two RLUIPA cases currently pending involve alleged discrimination by the Village of Airmont, New York against Hasidic Jews seeking to build a boarding school, and the Village of Suffern, New York's denial of a permit to an Orthodox Jewish group to operate a "Shabbos House" near a hospital where Sabbath-observant Jews may stay while visiting patients on the Sabbath.

The Division also continues to build a Servicemembers Civil Relief Act (SCRA) enforcement program. Since receiving SCRA enforcement authority in 2006, we have opened several investigations under the SCRA and have resolved the first such investigation with a favorable outcome. In addition, we have engaged in a sustained outreach effort, including visiting military bases throughout the country to inform JAG attorneys that we are actively investigating SCRA matters and stand ready to help them enforce the SCRA.

President Bush has said: "As a Nation, and as individuals, we must be vigilant in responding to discrimination wherever we find it and ensuring that minority families have access to housing." I am committed to fulfilling this pledge, and the Civil Rights Division will continue to dedicate our energy and resources to exposing and eliminating discriminatory housing and lending practices.

Thank you for the opportunity to testify today.

Mr. NADLER. I thank you.

We now recognize for 5 minutes Ms. Kendrick.

TESTIMONY OF KIM KENDRICK, ASSISTANT SECRETARY, OFFICE OF FAIR HOUSING AND EQUAL OPPORTUNITY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. KENDRICK. Thank you. Chairman Nadler, Ranking Member Franks and Members of the Subcommittee, good morning. I am Kim Kendrick, assistant secretary for the Office of Fair Housing and Equal Opportunity at the U.S. Department of Housing and Urban Development. On behalf of Secretary Steven Preston, I am truly honored to have this opportunity to testify before you today.

I would like to submit my written testimony for the record.

Forty years ago, Congress passed the Fair Housing Act and took a major step toward fulfilling Dr. King's dream of a united society. Today that landmark legislation guarantees that people can live where they want regardless of their race, color, national origin, religion, sex, familial status, and disability.

Since that time, much progress has been made. Cities and neighborhoods are much less segregated, and African-Americans and other minorities enjoy more economic opportunities than ever before. Yet discrimination persists. For the last 2 consecutive years, HUD and our State and local fair housing partners have received more than 10,000 complaints of discrimination. These are stark reminders that we still have a long way to go to fulfill America's promise of justice and equality for all.

In my role, I oversee the office of HUD that has the principal responsibility for enforcement of the Fair Housing Act. In addition to the men and women at HUD who investigate housing discrimination complaints and the attorneys at HUD that help prosecute them and the Department of Justice attorneys who file suits in Federal court, there are 108 State and local agencies that enforce the law that provides rights, remedies and procedures that are substantially equivalent to those provided under the Fair Housing Act.

Not only do we investigate complaints in an efficient manner, we also obtain significant relief for people whose rights have been violated. The department and its State and local partners reached resolution in 3,100 cases in fiscal year 2007, obtaining more than $4.7 million in monetary relief for victims of discrimination through informal resolution and conciliation.

My written statement includes several case examples that illustrate how our conciliation efforts achieve positive outcomes. But one case I will mention involves a family in Portland, Oregon, who has an autistic child.

The family asked the apartment management company to move the family to a first-floor unit as an accommodation for the son's disability so they would not disturb the neighbors. The management company refused to move the family and also refused to extend their lease when it came up for renewal. HUD conciliated this case, obtaining $40,000 in relief for the child's family, plus an additional $10,000 donation to a charitable organization that focuses on autism.

When the department learns of discrimination but no one comes forward to file a complaint, we exercise our authority to initiate investigations. To launch these investigations, which have a broad public impact, the department created an Office of Systemic Investigations within that Office of Fair Lending Division. The Fair Housing Lending Division initiates investigations when lending patterns suggest discrimination by a lender but no individual has come forward to file a complaint.

So far this year, this division has selected targets for new lending investigations based on apparent disparities in loan pricing and denial rates between minority and White, non-Hispanic loan applicants. Further, the Fair Lending Division selected an additional lending target this year based upon that lender's stated lending policy.

And because enforcement alone is not enough, we have increased our efforts to educate the public and housing providers about their rights and their responsibilities under the Fair Housing Act.

Most recently, we launched a national public service announcement campaign to educate the public about their fair lending rights. While the centerpiece of the campaign is a 30-second public service announcement, the campaign also includes a toolkit that lists resources available to help consumers learn about the homebuying process and their lending rights and a series of town-hall forums to inform the public about HUD's efforts to reduce unfair and discriminatory lending practices.

At HUD, we are committed to ensuring that each housing transaction in this country is fair and without discrimination. Thank you for the opportunity to testify before you today. And now I would like to show you our lending campaign's 30-second public service announcement.

(Video played.)

[The prepared statement of Ms. Kendrick follows:]

PREPARED STATEMENT OF KIM KENDRICK

Chairman Nadler, Ranking Member Franks, and Members of the Subcommittee, good morning. I am pleased to have the opportunity to testify before you today on the state of fair housing in the United States.

Forty years ago, in the wake of the assassination of Dr. Martin Luther King, Jr., this country passed the Fair Housing Act, which made it unlawful to discriminate in housing and housing-related transactions on the basis of race, color, religion, or national origin. Six years later, Congress expanded those protections to prohibit discrimination based on sex, and amended the law again in 1988 to prohibit discrimination against families with children and persons with disabilities.

In the past forty years, our nation has made great progress in fulfilling the promise of equal opportunity in housing. Today, our cities and neighborhoods are less segregated, loan underwriting guidelines no longer spell out different policies based on race, and many building codes across the country now require new multifamily housing to be accessible to persons with disabilities.

But discrimination persists. HUD studies show that African Americans, Hispanics, Asian Americans, and Native Americans receive consistently unfavorable treatment at least 20 percent of the time when they seek to purchase or rent a home. In some communities, persons with certain disabilities encounter unfavorable treatment in one out of two transactions. And more than half of the population is unaware that it is illegal to discriminate against families with children in housing.

As the Assistant Secretary for Fair Housing and Equal Opportunity, I oversee the federal government office with the principal responsibility for enforcing the Fair Housing Act. However, we do not do it alone. We are aided by 108 state and local agencies that enforce laws that provide rights and remedies that are substantially equivalent to those provided under the federal law. We also work in close partnership with the Department of Justice, which has the authority to pursue cases against housing providers, lenders, and others who engage in a "pattern and practice" of discrimination. The Department of Justice also files suit in cases charged by HUD, when one of the parties elects to have the case heard in federal court.

HUD's fair housing mission is broader than the investigation, conciliation, and adjudication of individual cases. The Department also conducts significant education and outreach activities in support of its enforcement operation. This includes the release of public service announcements and other material to educate the general population on its fair housing rights and remedies. The Department also conducts regular studies on the level and extent of housing discrimination in American society and public awareness studies of the rights protected under the law.

The Department also manages two major fair housing programs which complement the Department's fair housing activities: the Fair Housing Assistance Program (FHAP), a $25.6 million program in FY 2008, which reimburses the 108 state and local agencies for the investigations they conduct under their substantially-equivalent laws, and the Fair Housing Initiatives Program (FHIP), a $24 million program in FY 2008, which provides grants to non-profit organizations to carry out private education and enforcement activities in support of the federal law. These activities include testing local housing providers to determine whether they treat applicants fairly, filing private fair housing litigation, and holding forums and seminars to educate consumers and housing providers alike.

Then, finally, in addition to the Fair Housing Act, the Department administers several other fair housing laws that guarantee fair access and equal opportunity in housing. These laws include Title VI of the Civil Rights Act of 1964, which prohibits discrimination on the basis or race, color, and national origin in federally-assisted housing; Section 504 of the Rehabilitation Act of 1973, which prohibits discrimination on the basis of disability, in federally-assisted housing; Section 3, which requires recipients of federally-assisted housing funds to create economic opportunities for low-income persons in those communities; as well as several other authorities.

The Department's enforcement of the federal Fair Housing Act, however, comprises its primary fair housing function. The Fair Housing Act, unlike the other authorities the Department administers, applies to virtually all housing transactions, public and private.

HUD enforces the Fair Housing Act through investigation, conciliation, and adjudication of complaints from individuals who believe they have experienced discrimination and complaints the Department initiates on its own based on information that suggests a discriminatory housing practice has occurred. While the Department has increasingly exercised its authority to bring complaints on its own (having brought over 20 such complaints or investigations in the last two years), the Department dedicates most of its resources to the investigation of individual complaints of discrimination. The Department receives these complaints from individuals who write the Department by mail; file a complaint online at www.hud.gov/fairhousing; call HUD's toll-free Housing Discrimination Hotline at 1-800-669-9777 or one of HUD's office's directly; or visit one of HUD's offices in person.

HUD investigates each complaint and, as required under the Fair Housing Act, makes informal attempts to resolve the complaint through conciliation prior to making a formal determination on the merits. If conciliation fails, the Department issues a finding on the merits. The Department will dismiss the complaint if there is insufficient evidence to support the allegation of discrimination. Where the evidence supports a finding of discrimination, HUD will issue a charge—the equivalent of a lawsuit—before an Administrative Law Judge. In the Administrative Law Judge forum, HUD attorneys argue the case at no cost to the individual who faced the discrimination. If the Administrative Law Judge finds in HUD's favor, the judge may compensate the complainant for any injury, enjoin the housing provider or other entity from further discrimination, and impose a civil penalty. The parties, at the time HUD issues the charge, also have the right to elect to have the matter heard in United States District Court. If the parties elect to that forum, the Department of Justice will bring the suit on behalf of the government and at no cost to the individual victim of discrimination.

One cannot comprehensively describe or assess national trends in fair housing enforcement without also examining the complaints handled by HUD's FHAP partners—108 state and local agencies that administer laws substantially equivalent to the Fair Housing Act. Of the 10,150 complaints filed in FY 2007, FHAP agencies investigated approximately 7,700 of those complaints, or 75%, of the complaints filed nationally. This is a 25% increase from five years ago (FY 2003), and a 75% increase from just ten years ago (FY 1998), when HUD and FHAP agencies received just 5,819 housing discrimination complaints.

It is important to note that HUD and the FHAP agencies also receive several thousand complaints about other "unfair" housing practices each year that do not constitute a jurisdictional complaint under the Fair Housing Act. These could be complaints of unfair eviction, poor maintenance, or other disputes, where the individual does not allege discrimination based on race, color, religion, national origin, sex, disability, or familial status. The agencies also receive complaints alleging discrimination because of age, marital status, source of income, or sexual orientation. The Fair Housing Act, however, does not authorize HUD to accept complaints on these bases nor can the Department reimburse FHAP agencies for their investigation of these complaints. Therefore, when HUD reports in FY 2007 that HUD and FHAP agencies received 10,150 complaints, it is counting only those complaints determined to be jurisdictional under the Fair Housing Act.

FHAP agencies, to be certified as a "substantially-equivalent agency," must attempt to resolve all complaints informally prior to issuing a determination on the merits. Congress included this conciliation requirement in the federal Fair Housing Act in order to expeditiously resolve complaints of discrimination and promptly recover for victims of discrimination the housing they sought and other equitable relief for the individual and the public interest. Together, the Department and its state and local partners successfully conciliated or reached informal resolutions in more than 3,100 cases, or in 30% of cases, in FY2007. Collectively, the agencies obtained over $4.76 million in monetary relief through these resolutions. This amount is in addition to other relief complainants may have obtained, such as housing units they desired, accessible parking spaces sought, fair rental price or fair interest rates on loans, or retrofits to make a property accessible to persons with disabilities. Conciliation agreements also include public interest relief, such as changes in the housing provider's policies or practices, fair housing training, or relief funds for other victims of discrimination.

The Fair Housing Act and substantially-equivalent laws require the agencies to attempt to resolve every case through conciliation, regardless of the evidence against the respondent. Even if a housing provider has an explicitly discriminatory policy on its books, which would result in an almost-certain charge against the housing provider, the Department must bring the parties together for conciliation before issuing a charge. In these cases, the housing provider, given the weight of the evidence, more often than not, chooses to conciliate the case. In executing any conciliation agreement, the Department ensures the agreement ameliorates the wrong done to the victim, and that it provides relief for public interest, which includes the elimination of any discriminatory policies and practices and monitoring. Many cases that would lead to charges conciliate instead because the parties decide that conciliation best meets their needs in the given case.

Let me share a few examples of cases which may have resulted in charges but where the parties instead negotiated conciliation agreements providing significant relief for the complainants.

On April 15, 2008, the Department successfully conciliated a complaint on behalf of the Sanchez family, a couple with an autistic child, who lived in an apartment complex outside Portland, Oregon. Two years after Mr. and Mrs. Sanchez moved into the Masters Apartments in Aloha, Oregon, Mrs. Sanchez gave birth to a baby boy. At three years old, the child was diagnosed with autism and, because of his condition, he caused some noise disturbance to the downstairs tenants. The Sanchez family asked the apartment management company to move them to a first-floor unit as an accommodation for their son's disability so they would not disturb any neighbors. The management company refused to move them and also refused to extend their lease when it came up for renewal. The Department conciliated this case, obtaining $40,000 in relief for the Sanchez family plus an additional $10,000 donation to charitable organizations.

Another example of the notable relief HUD obtains through its conciliation agreements are the cases the Department conciliated in December 2007, on behalf of seven families living at Ridge Crest Apartments in St. Louis, Missouri. The families alleged that the property's rules, which included parental supervision of children under 18 whenever they went outdoors (even to go between buildings), discriminated against families with children. The investigation found that many of the families and children lived in fear of the management company, which closely monitored and reported on their children's activities. HUD's conciliation agreement provided: $83,000 in relief for the complainants; $15,000 for a victims" fund; $72,000 in funding for an after school program for two years; and removal of rules pertaining specifically to children.

Conciliation agreements meet the needs of the complainants and the public interest. When complainants are dissatisfied with the relief offered by housing providers, they may reject it and seek determinations on the merits from the agency. If complainants are satisfied with conciliation proposals, but the Department, or the state or local agency, believes the relief proffered does not match what complainants or the agency can obtain in an adjudicative forum, the Department educates the complainants regarding the existing case law and the relief obtained in comparable cases. The complainants may, under those circumstances, decide not to settle the case but pursue the case before an Administrative Law Judge. If, however, complainants insist on accepting settlement proposals that the agency does not believe satisfies the public interest, the agencies will allow the parties to settle privately and open Secretary-initiated complaints.

The Department's case against Summer Place in Las Vegas, Nevada, is one example of a complaint filed by an individual that the Department expanded into a Secretary-initiated complaint. In November 2006, the Department received a complaint from a single mother living in Summer Place Apartments in Las Vegas, NV, who had just obtained custody of her daughter. She alleged that less than a month after her daughter came to live with her, the apartment manager told her to find a new place to live, because the management company did not allow children to live at the property. HUD's investigation found that the management company did refuse to rent to families with children, and encouraged other tenants to leave when they became pregnant or obtained custody of their children. The complainant and the management company wished to settle the case. The Department, however, had to address the broader public interest and filed a Secretary-initiated complaint against the housing provider to obtain relief for others who were discriminated against. The Department identified additional victims of the "no children" policy. The complainant and the management company wished to conciliate rather than await a determination on the merits. The Department successfully negotiated a settlement that provided $35,000 in relief to the complainant. The Department obtained $10,500 in relief for the other victims identified during the investigation, and $29,500 for an escrow fund to compensate other victims of the discriminatory policy who may be identified after the Respondents placed notices in local newspapers.

The Department and FHAP agencies thoroughly investigate all complaints, and reached determinations on the merits in about 54% of the cases completed in FY 2007 (The agencies dismissed 16% of the total cases, where circumstances prevented the agency from proceeding. Such "administrative closures" include cases where some investigation determined the agency lacked jurisdiction over the alleged violation, and cases where the complainant party disappeared, withdrew the complaint, or refused to cooperate with the investigation). If the investigative agency finds no reasonable cause to believe that a housing provider or other entity has violated the Fair Housing Act, it will issue a finding of "no-cause" and close the investigation. The complainant retains the right to pursue the matter through private litigation. The statute of limitations to file in court is tolled while the matter is pending with the agency. If the agency concludes that discrimination has occurred, the agency issues a "determination of reasonable cause." In complaints filed with HUD, at the same time the Department issues the determination, it also files a charge of discrimination with a HUD Administrative Law Judge. The Department seeks through its charges to recover damages for the individual, civil penalties, and other relief for the public interest. As stated earlier, the parties may also elect at this stage to have the matter heard in federal court, where the Department of Justice files suit on behalf of the government and may recover damages for the individual and obtain injunctive relief.

Together, the Department and FHAP agencies found "cause" in 609, or 6%, of the cases the agencies investigated in FY 2007. As a result of HUD charges this past year: six female tenants of a Missouri apartment complex received a $165,000 settlement for the sexual harassment they endured from the owner of the complex; an African-American woman who was physically barred from entering an apartment she had contracted to rent, and the woman who tried to rent her the unit over the owner's wishes, received a $74,000 award from an Administrative Law Judge (the judge also imposed a $22,000 civil penalty); a mentally-disabled man who was wrongly evicted from his home while he was in a coma received, along with his family, $45,000 in a federal consent decree; seven Hispanic families whom owners of an apartment building in Orange Grove, California, evicted so they could move in Vietnamese persons, received $174,000 in a consent order; an African-American school principal denied the opportunity to view a home for sale because of the color of her skin received $30,000 and her agent $5,000, in a federal consent order; and a mother, whose daughter's epileptic seizures worsened after the landlord refused to allow her assistance animal on the property, received $102,000 plus attorney's fees in a Department of Justice consent order.

In addition, whenever the Department learns of discrimination from an independent source, the Department informs victims of discrimination of their rights and takes a complaint. For example, the Department advised an African-American woman of her right to file a complaint when it learned from a television report about the discrimination she experienced. The woman attempted to rent an apartment at Fountainview Apartments near Orlando, Florida. At the rental office, she saw a map on the wall indicating which units at the complex were currently available. The manager, however, told her that nothing was available and that nothing would be available anytime soon. Suspecting she had been discriminated against, the woman, who had seen HUD's public service announcements, asked another woman, who did not have a racially-identifiable voice, to call the property. That person learned that units were, in fact, available and she was invited to come view the units. The woman reported this experience to a local news station, who conducted its own testing, which showed clear evidence of discrimination. Upon watching the televised report of the woman's experience, the Department contacted her on February 8, 2008, to take her complaint. The Department charged this case on April 28, 2008. The parties subsequently elected to move to the case to federal court, and the Department of Justice filed suit on behalf of the government in May 2008.

Moreover, whenever an individual files a complaint that suggests an apartment complex owner/manager or other entity may be engaging in a systemic practice of discrimination, the Department works with the additional victims to assist them in filing complaints and securing compensation for these individuals, as well. For example, in September 2006, residents of an apartment building in Virginia Beach, Virginia, filed complaints with the Department alleging that Mr. Henry, the owner of their apartment building discriminated against them because they were African American. In the course of HUD's investigation, the Department discovered that Mr. Henry subjected African-American tenants to rules and restrictions that he did not place on white tenants. The African-American tenants, for example, had to abide by "quiet hours" and restrictions placed on their guests. The Department sought and received complaints from four additional tenants who had faced discrimination and charged the case in April 2007. Just last month, the Department of Justice entered into a consent decree that requires Mr. Henry to pay $361,000, which includes: $84,000 to two of the tenants; $235,000 for a fund to compensate other victims; and a civil penalty of $42,000. Mr. Henry paid additional compensation to five other complainants in private settlements.

From charges, conciliations, and settlements combined, victims of discrimination receive positive outcomes in more than 36% of complaints investigated by the Department and its state and local partners in FY 2007.

While investigations, settlements, and adjudications of individual complaints comprise the principal means by which the Department enforces the Fair Housing Act, the Department regularly exercises its authority to bring its own action against a person or entity that has violated the Fair Housing Act, where no individual has filed a complaint. In FY 2007 alone, the Department initiated 16 Secretary-initiated complaints or investigations. These included investigations of: a large apartment management company in New York engaged in alleged racial discrimination; several large apartment complexes in Pennsylvania, Nevada, and Colorado, who allegedly refused to rent to families with children, subprime lenders who charged African Americans and Hispanics higher rates and fees, on average, than white borrowers, and real estate associations that limited benefits of association to others of the same religion. In FY 2008, the Department has filed additional Secretary-initiated complaints, including a complaint a large Florida housing provider for refusing to rent to families with children and four additional investigations into the practices of lenders for possible discrimination on the basis of race and national origin.

The Department's Secretary-initiated investigations of possible discrimination in the lending market is particularly critical as applicants for loans often do not understand the reason for their denial nor the complicated metrics that go into pricing their loan. Moreover, borrowers have no information regarding what others pay for the same mortgage product, so they do not know if they have received a fair price. HUD can examine the larger lending and pricing patterns of the lender and uncover discrimination an individual cannot.

Each year since 2005, the Federal Reserve Board (FRB) has provided the Department with a list of independent mortgage companies that the FRB had identified as having disparities in the incidence, denial rate, or rate spread of high-cost loans. Each year the Department analyzes the loan data for each lender flagged on that list, reviews the complaint data on those lenders and selects targets for investigation. Since the lists were first published in 2005, the Department has conducted econometric analyses on more than 350 lenders to select targets for investigation. To date, the Department has initiated six investigations into independent mortgage companies because of disparities in their HMDA data.

To further ensure the best possible handling of all fair housing complaints by the Department, FHEO has made structural changes to the organization. In FY2005, FHEO created the Office of Systemic Investigations, which oversees all of the Department's Secretary-initiated investigations and complaints that involve systemic discrimination. In FY2007, the Department further enhanced its enforcement by adding a Lending Division within the Office of Systemic Investigations. The Division initiates investigations when lending patterns or other information suggests discrimination by a lender, but no individual has come forward to file a complaint. In addition, the Department has reassigned to the Division HUD's fair lending oversight of Fannie Mae and Freddie Mac to ensure their underwriting policies and practices comply with fair lending laws. The Lending Division is currently conducting six nationwide Secretary-initiated investigations of independent mortgage companies for possible discrimination on based on race or national origin in the making and pricing of loans.

Because individual complaints are the primary enforcement mechanism under the Fair Housing Act, the Department has increased efforts in recent years to educate the public and housing providers on their rights and responsibilities under the Act. This has included national public-service campaigns over the last several years, funded through the Fair Housing Initiatives Program (FHIP) and other contracts. Fair housing organizations have used the radio, television, and print materials created by these campaigns to promote fair housing and educate people about housing discrimination. The Ad Council estimates that a quarter of television viewers in 2003 viewed Accents, an award-winning public-service announcement. This included the complainant in Orlando, Florida, who used her knowledge of this PSA to test Fountainview Apartments for discrimination. More recently, in FY 2007, the Department purchased advertisements on movie screens across the nation to inform the public about how to report housing discrimination. More than 1.5 million people saw these advertisements over the two weeks that they were in theaters.

In addition, the Department distributes the Education and Outreach funding to individual organizations under FHIP. This funds education and outreach programs to inform the public about their rights and responsibilities under the Fair Housing Act. This includes presentations before community groups, participation in homeownership fairs, assistance with housing counseling and development of education and outreach materials targeted to the local audience. In FY2007, the Department provided funding to 33 local fair housing groups in 32 states to conduct education and outreach in their respective areas of the country. Through fair housing presentations alone, these groups will educate more than 250,000 people about their fair housing rights this year. Additionally, all organizations who receive private enforcement grants under FHIP devote a percentage of their budget to education and outreach on the services they provide in the community.

Also, to encourage people to report the discrimination they encounter, HUD has widely publicized outcomes in housing discrimination cases. This helps the public recognize that taking action is likely to yield positive results. In February 2007, the CNN program *Open House* aired a segment on housing discrimination. The segment featured an interview with an African American woman who filed a complaint with HUD alleging that Fifth Third Bank denied her application for mortgage loan because of her race. HUD negotiated a $125,000 settlement in this case. *Parade* magazine, in an April 15, 2007 profile of the Department's fair housing mission, advised readers that housing discrimination is illegal and provided several examples of unlawful discrimination, such as charging higher rent to tenants based on race or religion or refusing to accept families with children. *Parade* has a circulation of more than 35.5 million. In addition, on a monthly basis, from June 2006 through June 2007, *Essence* Magazine featured an article on 12 steps of the home buying process. Assistant Secretary Kim Kendrick served as one of 12 members of an advisory board throughout the 12 steps and provided fair housing information for three of the 12 articles.

While more than 10,000 people each year avail themselves of the investigation and complaint process, HUD understands that some persons may not want to file a federal complaint. Among other reasons, persons may not want to invest the time and effort into filing a complaint and going through an investigation. In order to serve such persons, the Department funds dozens of private fair housing groups though Fair Housing Initiatives Program (FHIP). These groups provide immediate assistance to persons who have experienced discrimination. Private enforcement groups are able to provide on-the-spot assistance without going through the administrative and legal requirements involved in a formal complaint and provide the public with a useful alternative to the formal complaint process available through HUD and state and local fair housing agencies.

Finally, the funds the Department administers under FHIP support organizations that provide first-line assistance in many communities. For example, HOPE Fair Housing Center, a FHIP grantee, discovered that a private property management company in DuPage, Illinois, used a rental application that required potential renters to disclose their race, ethnicity and any disability. In June 2007, as part of the conciliation agreement in the case the organization filed, the management company agreed to pay HOPE Fair Housing $30,000, undergo fair housing training, and remove the offending questions from its application. In another case, an individual with HIV, who was denied housing, turned to Project Sentinel for assistance. Project Sentinel, a FHIP recipient in California, conducted testing that substantiated the allegation that the individual was denied housing because of his HIV status. The individual filed a complaint with HUD, and based on the Department's investigation and the testing by Project Sentinel, the Department charged that case in September 2007.

In order to encourage and compensate fair housing group for their work on large resource intensive complaints HUD added multi-year grants to FHIP in 2005. This funding accounted for 73% of FHIP's $13.9 million enforcement budget in FY 2007, providing the top-performing groups with three years of funding. Many fair housing organizations, including the National Fair Housing Alliance, advocated for this funding, arguing that it would promote more comprehensive testing and better strategic planning by the organizations. Any organization that receives a performance-based grant must have exceptional experience and excellent performance reviews. The multiple-year funding encourages these groups to take on larger cases of housing discrimination and allows for better strategic planning by the organizations. Both of the organizations discussed above were recipients of performance-based funding under the FY2007 grant cycle.

HUD's other civil rights responsibilities include the oversight of HUD-funded recipients to ensure that they are providing housing and housing-related services in a nondiscriminatory basis and that they are affirmatively further fair housing. HUD reviews its programs by investigating complaints alleging discrimination by HUD-funded recipients and conducting compliance review of recipients. HUD uses several methods to provide remedies for public interest: voluntary compliance agreements, corrective action orders and debarments. For example, after HUD found the Atlanta Housing Authority in noncompliance with Section 504 of the Rehabilitation Act of 1973, HUD entered into a voluntary compliance agreement with the housing authority in which it agreed to make changes to its housing and other programs to improve accessibility for persons with disabilities. Until the City of Gainesville, Florida Housing Authority agreed to enter into a voluntary compliance agreement, HUD issued a Corrective Action Order to the housing authority. The corrective action order restricted the housing authority's access to all Capital Fund Program funds not already obligated or under contract to expenditures necessary to cure the civil rights noncompliance and to remedy emergency situations. In one instance, HUD debarred an Omaha Section 8 landlord for sexual harassment of women tenants. This landlord is no longer a Section 8 participant.

When HUD has found discrimination in Fair Housing Act cases, HUD has not hesitated to eliminate Section 8 landlords from HUD programs. On June 11, 2007, HUD debarred John Koch, the manager of several Section 8 properties in Omaha, Nebraska, from participation in HUD programs after a jury trial in the U.S. District Court for the District of Nebraska found that Koch had engaged in unwanted verbal and physical sexual advances toward prospective and current female tenants. Further, on September 13, 2007, HUD debarred Bobby and Jewel Veal of Kansas City, Missouri, from participation in federal programs after the U.S. District Court for the Western District of Missouri found that Mr. Veal, a Section 8 landlord, engaged in a pattern of housing discrimination on the basis of sex through unsolicited sexual advances toward female tenants, including rape and fondling. The court found that Mr. Veal entered the homes of these women without notice, destroying their sense of security, and that Mrs. Veal had personal knowledge of his activities and failed to take steps to prevent them. The Department debarred the Veals" participation in HUD programs for five years.

The work of each component of HUD's fair housing program is necessary to fair housing enforcement in the United States. The Department's enforcement system allows an individual to file a formal fair housing complaint, which is investigated by a federal agency. Through the Fair Housing Assistance Program, an individual has the option of similar services but on a state or local level. Finally, the Fair Housing Initiatives Program provides the public with quick resolution to housing discrimination, without the filing of a formal complaint.

But more important than any individual program is the right of every person in the United States to rent an apartment, to buy a home, to obtain a mortgage, to live in their home without prejudice because of their race, color, religion, national origin, sex, familial status or disability. This was the goal of Dr. Martin Luther King, Jr. This is the goal this country reached for when this country passed the Fair Housing Act in 1968, and amended it to protect more people 20 years later. This is the goal that this Department rededicates itself to every fair housing month. We are committed to ensuring that each housing transaction in this country is fair and without discrimination. And when a housing transaction is discriminatory, when someone violates the Fair Housing Act, there is no greater priority for this office than assisting the man or woman whose rights have been violated.

Thank you for this opportunity to appear before the subcommittee today.

Mr. NADLER. The lady's time has expired.

I thank the witnesses.

And I will recognize myself for 5 minutes to begin the questioning.

Ms. Liu, 2 years ago, the Department of Justice launched Operation Home Sweet Home, to which you have referred, to combat more hidden forms of discrimination.

In the last fiscal year, the department conducted 20 percent more housing discrimination investigations. How many pattern-or-practice cases were filed as a result of these investigations?

Ms. LIU. Thank you so much for that question, Mr. Chairman.

In February of 2006, the Attorney General announced Operation Home Sweet Home to beef up our fair housing testing program. And in fiscal year 2007, as you mentioned, we had an extremely successful year, with over 500 paired tests. That was 20 percent more than had been conducted in any prior year.

I can tell you that, since September of 2007, we have filed four cases based on testing evidence.

Mr. NADLER. You have filed four cases in the last, what, 6 months, 7 months?

Ms. LIU. Since September——

Mr. NADLER. Nine months. Four in the country? How many pattern-or-practice investigations have been filed since 2006?

Ms. LIU. Mr. Chairman, I am not sure of the number off the top of my head.

Mr. NADLER. Roughly, roughly.

Ms. LIU. I am not sure of the number——

Mr. NADLER. About how many have you been filing of pattern-or-practice investigations in recent years on an annual basis?

Ms. LIU. Based on testing evidence?

Mr. NADLER. Based on testing.

Ms. LIU. Over the last few years, the number of pattern-or-practice cases has averaged about 21 per year, I believe. But I can get you the more specific numbers.

Mr. NADLER. Well, 21 sounds pretty specific. Roughly 20, 25 pattern-or-practice cases a year.

Three-and-a-half million—I think it says 3.7 million housing discrimination cases, and we are filing 21 or 25 pattern-or-practice cases a year? That is one out of every 200,000 or something like that. Does this sound a little weak, in terms of real enforcement?

Ms. LIU. Mr. Chairman, as I think I said in my written statement, the Civil Rights Division's jurisdiction extends to pattern-or-practice cases as well as cases in which HUD investigates, issues a charge, and one of the parties elects to proceed in Federal court.

The number, 3.5 million or 3.7 million, as I understand it, includes an estimated number of complaints of discrimination. So I just want to emphasize that our jurisdiction is to pursue the large-scale pattern-or-practices cases as well as charges that HUD has issued and in which one of the parties has elected to proceed in

Federal court. So we deal with a much smaller subset than the 3.7 million number that has been referenced.

Mr. NADLER. And how many land-use and zoning cases has the department brought based on race and national origin for the last couple of years?

Ms. LIU. In this Administration, Mr. Chairman, we have brought a number of land-use and zoning cases based on race and national origin. We have also been very successful——

Mr. NADLER. Wait a minute. I know you have brought "a number." Can you be a little more specific than that?

Ms. LIU. Well, over the past 7 years, I know of at least four cases against municipalities in zoning and ordinance cases based on race and national discrimination.

Mr. NADLER. Four cases in 7 years?

Ms. LIU. At least. And I am certainly happy to get you more details on the numbers.

Mr. NADLER. Again, do you think that that is a fair representation, a vigorous policy against land-use and zoning discrimination?

Ms. LIU. I do. I think we have been very successful in bringing those cases. And I——

Mr. NADLER. No, wait a minute. You may have been very successful in those four cases. But do you think four cases over 7 years is a vigorous attempt to enforce the laws, including the laws against land-use and zoning discrimination?

Ms. LIU. I do, because those are at least four cases in the zoning context against municipalities for alleged race and national origin discrimination. We also do many, many other kinds of cases. We had a very recent successful case against General Properties that resulted in $725,000 in relief——

Mr. NADLER. Okay. I am sorry, I am going to have to rush to one other thing.

Ms. Kendrick, approximately 3.7 million fair housing complaints occur annually, but in 2006 HUD processed 11,000 complaints. That is less than half of 1 percent of the estimated fair housing violations that occur in the United States.

Given the large number of violations, can you explain why so few complaints are processed by HUD? Why is it 11,000 and not 110,000, for example?

Ms. KENDRICK. Thank you for that question, sir.

We actively seek out complaints. We don't just sit in our seats and wait for complaints to come to us. The 10,000 complaints that you are talking about are complaints that were brought to us, but we don't sit in our seats and wait. What we have been doing for the last 3 years is we have actively been using the authority that we have to initiate——

Mr. NADLER. I am sorry. Those 11,000 are complaints brought to you?

Ms. KENDRICK. Brought to us by individuals.

Mr. NADLER. They do not count actions initiated by you?

Ms. KENDRICK. Exactly.

Mr. NADLER. And could you give us an estimate of how many that might be?

Ms. KENDRICK. In the last 3 years, we have brought 20 secretary-initiated complaints based on cases that we have observed in the press, actions that we think need to be taken against a discriminatory lender——

Mr. NADLER. So roughly 11,000 complaints brought to you and 20 initiated by you.

Ms. KENDRICK. But the 20, you have to accept, sir, represents more than just one case. For example, if we go against an apartment owner who is renting out 353 units, when we bring a secretary-initiated case against a landlord that has that many units, that is an additional 357 complainants that would have come to us but we went to them.

Mr. NADLER. Thank you.

My time has expired. I will now yield 5 minutes to the Ranking minority Member, Mr. Trent Franks.

Mr. FRANKS. Well, thank you, Mr. Chairman.

And just for the record, Mr. Chairman, I would like to address the comments of one of the minority Members who criticized the citing of the *National Review* magazine.

But let me first say the thing on which I agree with the gentleman very deeply: that, indeed, with low-income families, one of the most important ways that they can stabilize their families economically is homeownership. And it is something that I have supported all of my public life, both through private initiative and public initiative.

But I believe it goes even beyond the economics. I think there is strong evidence that says that if families own a home, that they are also more stable structurally as a family. And I believe it is vitally important. It is something I hold as a very deep conviction, and that any discrimination against anyone on these bases should be prosecuted to the fullest extent of the law.

I think the point of *The New York Times* discovery—that when minorities disproportionately take out the riskiest mortgage, that they also have disproportionate foreclosures as well—is something that we should face as policymakers.

Policymakers should do everything that they can to prevent discrimination, but if they force banks into making loans that are actuarily not sustainable, then we don't do the people that we are trying to help any good. We end up ruining the customer. And that is one of the things that a bank is not supposed to do. And I think that sometimes policymakers need to take responsibility for their actions in that regard.

And I just wanted to make that very clear, that every family I think is improved by homeownership, but I especially think the pressures of low-incomes families are ameliorated to a great degree by homeownership. And it is something that I have supported privately and publicly all of my adult life.

With that said, Ms. Liu, I wanted to ask you, what proactive measures is the Department of Justice taking to protect the rights of all Americans to obtain housing without illegal discrimination?

Ms. LIU. Congressman Franks, thank you for that question.

Operation Home Sweet Home lies at the very center of our effort to act proactively in seeking out discrimination. This is a fantastic initiative that the Attorney General announced in February of 2006. And what we do is we send out testers, both testers from a protected class and testers who are not from a protected class, all over the country to determine whether people are being treated differently on the basis of race, national origin, familial status, sex, et cetera.

And we have been very successful. In fiscal year 2007, we conducted more than 500 paired tests all over the country. That was a record number for us. In fact——

Mr. FRANKS. And how does that paired test work? Explain that for the less educated among us.

Ms. LIU. Sure. We will identify, for example, an apartment complex that we would like to test. And we will quite often make a phone call to find out whether or not they have vacancies.

We will send in, for example, an African-American tester. They will express that they are looking, for example, for a one-bedroom apartment. They will give a little background about themselves and why they want the apartment and so on. And we will track how they are treated—for example, whether they are told that an apartment is available, whether the property manager is polite to them, offers to show them apartments and so forth.

Very shortly afterwards, we may send in a White tester who has the same profile, who is looking for the same kind of apartment, and then we will track how that person is treated. And based on this evidence, we are able to uncover hidden forms of discrimination.

And, as I mentioned a little bit earlier, we have filed a number of cases since last September, including a race discrimination case in Michigan, as well as the first-ever case alleging discrimination against Asian-Americans based on testing evidence, and that was in Lowell, Massachusetts. We settled that a little bit earlier this year. So we are very proud of that.

In addition, we do a substantial amount of outreach. One example is we do do outreach to the construction community. We do multi-family housing access forums twice a year all over the country, where we reach out to developers and architects and emphasize how important it is to everyone in the community that housing be built so that it is accessible to persons with disabilities. And we try to essentially stop the problems before they occur by educating people.

Mr. FRANKS. Ms. Liu, this is more of a subjective question, but do you, in your capacity, sense any sense on the part of the Administration to de-emphasize the effort to prevent housing discrimination in this country? Do you sense that there is any environment in the Administration that has reduced your focus in that regard, as opposed to previous Administrations?

Ms. LIU. Absolutely not. This Administration, this Department of Justice, is completely and totally committed to fair housing. And I think we have a very good record on that.

I should also add that we have the good fortune of working with some very talented and extremely dedicated career professionals in the Housing and Civil Enforcement Section. And I couldn't be prouder to work with them.

Mr. FRANKS. Thank you, Mr. Chairman. My time is up, but where did the yellow light go? Okay. It goes to red from green.

Mr. NADLER. It is probably still somewhere in the vicinity.

I now recognize for 5 minutes the distinguished Chairman of the full Committee.

Mr. CONYERS. Thank you. I would be happy to give the gentleman a minute if he needs some more time.

Mr. FRANKS. No, forgive me, I wasn't asking for more time. I just wondered where the yellow light went. There was no yellow light that time.

Mr. CONYERS. All right.

You know, Ms. Liu, you are the most positive person I have heard all day about this horrendous problem. And your courtesy and style is very charming. I am just caught up with how wonderful this is and the progress we are making.

Now, tell me, where did you ever practice civil rights law?

Ms. LIU. Sir, I began my career at Jenner & Block in both Chicago and here in D.C., a very——

Mr. CONYERS. Right.

Ms. LIU [continuing]. Fine firm. And I had the opportunity to do some housing enforcement work there. You may recall that there was a very large case against the City of Baltimore's housing authority a few years ago involving racial segregation, and I was lucky enough to be a part of that case.

Mr. CONYERS. Okay. Now, who were you representing in that case?

Ms. LIU. We were on the plaintiff's side, sir.

Mr. CONYERS. The plaintiff. And who was the plaintiff?

Ms. LIU. We worked with—and I wish I could—unfortunately, the name of the named plaintiff is escaping my memory right now. But Jenner & Block worked with one of the fair housing groups in Baltimore to bring suit, and I believe it was not only against the housing authority——

Mr. CONYERS. Okay, all right. Thank you.

Ms. LIU [continuing]. But HUD, as well.

Mr. CONYERS. All right. We will find out afterwards.

Now, how long have you been in your position?

Ms. LIU. In my current position——

Mr. CONYERS. Yes.

Ms. LIU [continuing]. Since December of 2007.

Mr. CONYERS. So that is less than a year.

Ms. LIU. That is correct.

Mr. CONYERS. Okay.

What we have here is a tremendous problem. Do you know how long it will take us to ever get this problem of 3.7 million fair housing violations dealt with at the rate that we are going?

Ms. LIU. Sir, I wish I could tell you how long it would take to eradicate housing discrimination in this country. I think——

Mr. CONYERS. I didn't ask you all that. The fact of the matter is that we will never get it accomplished. So I don't need you to admit that you can't project it. I can't either.

The point I am trying to make is that, at the rate we are going, I can't see how you could possibly positively come here to trumpet the accomplishments of either of these departments when the situation is horrendous and getting worse.

Now, let me turn to Attorney Kendrick.

Here we are getting so few cases. You are the ones with subpoena power. They don't even have subpoena power and don't get the cases unless you refer to them in the housing area, right?

Ms. KENDRICK. That is correct.

Mr. CONYERS. So if we have millions of complaints, and we are talking about 31 cases brought and 50 cases brought and 20 cases brought a year, what is the problem? That is why we are holding the hearing, ma'am.

Ms. KENDRICK. I think the problem, sir, is that we have to get out more to the people who have complaints to make sure they understand——

Mr. CONYERS. You mean you are needing millions more than the ones you are already getting.

Ms. KENDRICK. That is correct, sir, because until we are able to make sure that everybody understands what their rights are——

Mr. CONYERS. But you are not processing—you are processing a fraction of the ones in the pile that you are getting. Getting more complaints isn't going to give——

Ms. KENDRICK. No, sir, that is not—sir, I would have to beg to disagree, because the cases that we are getting we are processing. We are conciliating those cases. In 40 percent of the cases that we are processing, we are conciliating and getting——

Mr. CONYERS. All right.

Ms. KENDRICK [continuing]. Substantial results for those——

Mr. CONYERS. I ask for a minute more.

Mr. NADLER. Without objection.

Mr. CONYERS. Well, I won't ask you if you are proud of your record. You can't come before a Committee like this and say you are not.

But we have got a humongous problem here. And both of you are telling us about a case here and a case there and "they had 500 tenants, and so this is a big case." This is a mess that we will never get out of.

And, of course, you are new on the job.

How long have you been on your job?

Ms. KENDRICK. It will be 3 years in October, sir.

Mr. CONYERS. Well, then you ought to have some sense of the frustration that some of us are feeling here today. All this back-and-forth, and we have got a problem that will never end the ghettos in America. We have been talking about this since I came to Congress and probably well before. And these kinds of reports that you are giving us, your successors 20 years from now will be doing the same thing and telling us the same thing.

Thank you.

Mr. NADLER. The gentleman's time has expired. I now recognize for 5 minutes the gentleman from Alabama.

Mr. DAVIS. Thank you, Mr. Chairman.

Ms. Liu, let me begin with you. And let me, frankly, move a little bit beyond what you have talked about today in your testimony. You focused primarily on, frankly, I hate to use the term "garden-variety" fair housing cases or "garden-variety" civil rights cases, but the standard red-lining, the standard obvious, overt kinds of discrimination that we have seen in the housing industry is what you talked about. I want to move beyond that to talk a little bit about, frankly, one of the major factors that is pulling our economy into a recession right now, which is the explosion of the subprime market and all of the issues around that market that are now affecting the economy.

And I want to read you one statistic from a notably non-Democratic, non-liberal source called *The Wall Street Journal*. *The Wall Street Journal* says that, in 2006, 61 percent of subprime borrowers qualified for a better loan based on their credit scores. And I have no idea what number of those were Black, what number of those were White or Hispanic or Asian. But a number of people have, frankly, raised the question of why the Department of Justice has not been more aggressively focused on the whole subprime market.

I want to read you some other quotes that I thought were interesting. Perhaps Mr. Franks might even find them interesting.

This is a story that was written in *The New York Times* last week, June 6, and it outlines in a fairly succinct nature some of the issues around the subprime market's collapse.

"Mortgage brokers were not told the true terms of their loans, homes were overvalued, and investment firms put together mortgage-backed securities packages in ways that inflated their true value."

Your boss, the Attorney General, was asked to respond to that description of the subprime market, and he said, "That has happened over and over again. Someone that I met with characterized it as 'white-collar street crime.'"

So perhaps Mr. Franks might find it interesting that someone of his party in this Administration that I think he supports on a fairly regular basis doesn't view this as a public policy matter in its entirety, but the Attorney General of the United States describes the proliferation of problems around subprime as "white-collar street crime."

Would you agree with the Attorney General, Ms. Liu?

Ms. LIU. Congressman Davis, let me answer the question in two parts, if I could.

Mr. DAVIS. As long as one of them actually answers the question.

Ms. LIU. I will do my best.

The first part of the questions is that the Civil Rights Division's jurisdiction in the fair lending area stems from the Fair Housing Act and the Equal Credit Opportunity Act. And one of the things that we have done in the subprime area is that we have pursued a number of very large red-lining cases in this Administration, notably in the Chicago area, in Detroit——

Mr. DAVIS. Now, you are not suggesting the Justice Department's jurisdiction is limited to red-lining subprime cases. There is no dispute that if there is an obvious instance of someone extending subprime to African-Americans in a disproportionate manner that you have jurisdiction. Let's not waste time arguing about that, given my 5 minutes.

I am talking about, frankly, the nonracial dimensions affecting so many people in this country of all colors. And I am asking why the department has not been more aggressive in tackling that problem.

You wouldn't dispute that the Department of Justice would have jurisdiction if there was evidence that mortgage-holders weren't told the true terms of their loan, that homes were deliberately overvalued, and that some investment firms deliberately put together securities that were inflated—you are not suggesting that any of those things that are proved would not be in the jurisdiction of the department, are you?

Ms. LIU. Those may well fall within the jurisdiction of the department, but not necessarily within the Civil Rights Division, which is the division that I work for.

I will say that there are, as far as I know, a number of other components of the department that may have jurisdiction over those areas. The Criminal Division, for example, I would imagine may have jurisdiction to prosecute instances of out-and-out fraud.

Mr. DAVIS. Now, let me stop you at that point. Has the chief of the Criminal Division talked with you about the feasibility of a combined task force, perhaps, to address these problems? Why not take your expertise, as someone who runs the housing section, Civil Rights, why not match it up with the Criminal Division, which investigates fraud? Has that kind of internal conversation happened within the department?

Ms. LIU. Congressman Davis, we, at the department, have had a tradition of not discussing our internal deliberations for a variety of reasons, most notably so that we can have candid discussions and receive advice from the folks that we work with without chilling them.

Mr. DAVIS. Well, I am not asking you for any privileged, confidential communications. I am not even asking you what the results of those communications would be. From my old days of practicing law, I always thought even the most ill-conceived privileges protected the content of the conversation, not whether or not they have happened.

Have there been conversations with the chief of the Criminal Division about a combined, coordinated task force effort within the department to address not just the racial part of this problem but broader issues?

Ms. LIU. Sir, I believe the Attorney General made a statement about a mortgage fraud task force. And I really don't think it is appropriate for me to go beyond what the Attorney General has said on the matter.

Mr. DAVIS. If I could ask for an additional 15 seconds, just to follow up on that.

Would you have an opinion on that, Ms. Liu? I mean, the Attorney General has made a statement that he is not going to appoint a task force, as a matter of fact. Does that strike you as being an advisable decision?

There was a task force regarding Enron. Frankly, Enron did not cause the kind of ripple effects in this economy that the securities crisis and the subprime crisis has caused. This is worse than Enron, isn't it? From what you read in the paper, isn't this worse than Enron?

Ms. LIU. I appreciate your question, but I really don't think it is appropriate for me to go beyond what the Attorney General has said.

Mr. DAVIS. All right.

Well, thank you, Mr. Chairman.

Mr. NADLER. Thank you.

The time of the gentleman has expired. I now recognize for 5 minutes the gentleman from Minnesota.

Mr. ELLISON. Ms. Liu, do Whites and African-Americans and Hispanics have subprime loans at the same rate?

Ms. LIU. Sir, I don't know the statistics, so I am unwilling to express a view on those statistics. I have seen news reports that indicate that there may be a disparity.

Mr. ELLISON. Yes. So, are you saying you don't want to express a view on whether or not there is a disproportionate impact of the subprime mortgage crisis on people of color than others?

Ms. LIU. I have seen news reports that seem to suggest that there is a disparity.

Mr. ELLISON. Well, you would agree that the subprime mortgage crisis is a housing issue, right?

Ms. LIU. I would agree that, broadly speaking, the subprime crisis is a mortgage issue. But——

Mr. ELLISON. Is it an issue that your department has focused on, the disproportionate numbers that you have heard about in the press of subprime mortgages?

Ms. LIU. If I could, I would like to highlight some of the work that we have done.

Mr. ELLISON. I can read about that.

I am still stuck on this idea that you don't know whether or not there is a disproportionate impact. Why don't you know that?

Ms. LIU. Sir, I can tell you about what I have seen in the news reports. I can tell you what reports that I have read.

Mr. ELLISON. Has your department done any focused research on this issue?

Ms. LIU. I don't know the answer to that question, but I am happy to go back and get back to you with a response.

Mr. ELLISON. Well, let me ask you this. Let's just assume for a minute that there has been a disproportionate—well, Ms. Kendrick, can you speak to this issue?

Ms. KENDRICK. Yes, sir. I think that we can—I certainly think, from our point of view at HUD, I think we have seen studies and we have conducted studies where we have seen that African-Americans and Hispanics have received higher rates in the subprime market than Whites.

Mr. ELLISON. You know, I want to talk about how we arrived there, because I think it is connected to housing discrimination.

Let me ask you this. Do you think that historic housing discrimination patterns made African-American and Hispanic homebuyers more susceptible to getting into predatory loans?

Ms. KENDRICK. I think the lack of education, in terms of lack of history and not being homeowners, not having high rates of homeownership, may have contributed to the situation, yes, sir.

Mr. ELLISON. Well, what about if you are historically barred from the prime market of home mortgages, discriminated against in areas of credit, aren't you sort of ripe for somebody to come along and say, "Hey, this is your chance to buy a piece of the American dream"?

Ms. KENDRICK. I think that one of the things that we have tried to do in this Administration is to make sure that we have increased homeownership dollars, increased dollars for homeownership counseling to make sure that people understand what their responsibilities, what their rights are and obligations are when they are purchasing homes. So I think that we have done that.

Mr. ELLISON. I am glad you mentioned that.

Now, let me ask you this. Now, Chairman Conyers, you know—I assure you, the frustration he expressed is shared by most of us on this side of the aisle. I mean, we are not prosecuting enough cases of housing discrimination. We are not really bringing the cases forward.

So, in many ways, this problem that I think you are sort of agreeing with, the historic housing discrimination patterns, has contributed to this susceptibility of African-American and Hispanic homebuyers to get into predatory mortgages——

Ms. KENDRICK. I think I said lack of education, sir, just so we make sure that—the lack of education or the lack of history in homeownership, owning property——

Mr. ELLISON. Okay, you want to go there? What about education—so education has been equally available for all Americans through the course of our history?

Ms. KENDRICK. That is what I am saying, the lack of education in these areas, sir.

Mr. ELLISON. Which is the result of what, ma'am?

Ms. KENDRICK. Not being——

Mr. ELLISON. Segregation, right? I mean, right, Ms. Kendrick? Right?

Ms. KENDRICK. The lack of opportunities to secure mortgages, the lack of opportunities to own homes——

Mr. ELLISON. Ms. Kendrick, I have only got 5 minutes. That is because of discrimination, yes or no?

Ms. KENDRICK. In some cases, yes.

Mr. ELLISON. Okay, let's talk about the "yes" part, okay? The Justice Department's lack of enforcement of housing discrimination cases, their lack of aggressive enforcement has helped to contribute to the subprime mortgage crisis, wouldn't you agree?

Ms. KENDRICK. I can only speak for the Department of Housing and Urban Development and the tactics that we have been taking to try to address the situation.

Mr. ELLISON. Yes, but I am asking you about your cohort there. I mean, isn't this a causal factor in the situation we have now?

Ms. KENDRICK. I am not willing to say the Department of Justice by itself is the sole cause of the problem.

Mr. ELLISON. But would you agree that they played a role?

Ms. KENDRICK. I would not say that, sir.

Mr. ELLISON. They played no role? Okay.

Ten seconds just so Ms. Kendrick can answer?

Ms. KENDRICK. I can speak to what HUD has been doing in working with the Department of Justice to try to address this issue.

As I said before and I think as we testified last year, we have been trying to take an aggressive approach to taking a look at these lenders, using the HMDA data. And by taking a look at these lenders who have these high pricing disparities and going and investigating these, filing complaints against these lenders, I think jointly the Department of Justice and HUD are trying to do those sorts of things, sir.

Mr. NADLER. The time of the gentleman has expired. And I recognize for 5 minutes the gentleman from Virginia.

Mr. SCOTT. Thank you, Mr. Chairman.

Ms. Liu, you have referred to the 500 testing pairs several times. That is about one per congressional district. There are 435 congressional districts; that is about one per district. What result did you find from those tests?

Ms. LIU. Sir, I have already mentioned that we have brought some cases based on the results of those tests. Since the beginning of the testing program, I believe we have brought about 85 cases. Fifty-three or so of those——

Mr. SCOTT. Wait a minute. Eighty-five cases were brought out of the 500 tests?

Ms. LIU. No, 85 since the beginning of our testing program, which was begun in the early 1990's.

Mr. SCOTT. Out of the 500 tests, what kind of differences did you detect from the protected classes? How were they treated differently?

Ms. LIU. Well, we have one case that we are currently pursuing in the Detroit area, in Roseville, MI, in which we found that the owners and operators of the apartment complex were telling African-American testers that there were no apartments available while telling White testers that there were apartments available.

Mr. SCOTT. Out of the 500 pairs, how often was discrimination detected?

Ms. LIU. I can tell you that since September we have brought four cases. And I also want to add——

Mr. SCOTT. Wait, wait. That is 1 percent experienced discrimination. Ninety-nine percent of the time there was no discrimination detected by the testers?

Ms. LIU. Congressman Scott, whenever we find that the law and the facts justify bringing a case alleging discrimination, we do that.

Mr. SCOTT. I have heard of studies that show that almost routinely when you send out pairs that there is a different in treatment. And you are saying that in about 99 percent of the cases, there is no difference in treatment. Is that your testimony?

Ms. LIU. No, sir. My testimony is that whenever we find that the evidence and the law justifies bringing a case—and remember, we have pattern-or-practice authority and not general authority to bring cases alleging individual instances of discrimination——

Mr. SCOTT. Well, I am not asking authority to bring a case or whether you can even make a case. What kinds of differences did you detect between the pair going into the same apartment? I mean, I assume this is not only apartments but homeownerships? You go into realtors——

Ms. LIU. We do do sales testing, yes.

Mr. SCOTT. Okay. And what kinds of differences—did you find a difference only in about 1 percent of the cases? Or was it routine, like everybody else in the world has seen?

Ms. LIU. I think I have described earlier some of the kinds of differences that we have seen. And I can just state again that when we find that there is evidence to justify—remember, we are looking for pattern or practice——

Mr. SCOTT. I am just asking a simple question. What kinds of differences did you detect from the way people were treated based on your pairs?

Ms. LIU. We have seen members of protected classes being told that there are no apartments available——

Mr. SCOTT. And how often does that occur?

Ms. LIU. We have brought four cases based on——

Mr. SCOTT. How often does it occur that people are given different stories about the availability of apartments? How often? One percent? Twenty percent? Fifty percent?

Ms. LIU. I can't, as I sit here right now, put a number on that. I can tell you what we look for is whether or not we can bring a lawsuit. And where we think that we can based on——

Mr. SCOTT. I am asking you a simple question, not whether you can bring a lawsuit, but what kinds of differences among people occur. And I am not getting an answer. I have got one answer, that 1 percent of the time there is a difference. And I think people would be shocked to hear that number, quite frankly. And you are under oath that 1 percent of the time people go finding an apartment, they are not given a different story.

Now, the question is, how often were people given different stories?

Ms. LIU. Sir, I don't know the answer to that question, because what we are looking for is whether or not we can file a case, whether the facts and the law warrant filing a case under our pattern-or-practice authority.

Mr. SCOTT. Well, let me ask Ms. Kendrick, if you had 500 pairs go out, how often would you expect them to get different stories?

Ms. KENDRICK. Since we don't have a testing program, sir, I really don't know the statistics on that.

Mr. SCOTT. Have you seen studies of pairs going out?

Ms. KENDRICK. I can tell you based on our own cases that we take a look at, there are cases from 2007 where we had 10,000 complaints of discrimination, and of those cases 40 percent we were able to settle. Certainly there was some discrimination that went on in those 40 percent of the cases.

So I can't say specifically on paired testing, but based on our statistics, in about 40 percent of the cases we get, we see discrimination.

Mr. NADLER. The time of the gentleman is expired. I now recognize for 5 minutes the gentleman from North Carolina.

Mr. WATT. I am just going to continue exactly where Mr. Scott left off, because the HUD doesn't have testing in its repertoire of things that it can do, is that correct?

Ms. KENDRICK. That is correct. But I was just passed a note by my trusty colleague that says, under our housing discrimination study in 2000, we showed about 20 percent of the time we see discrimination in paired testing.

Mr. WATT. Okay. The Department of Justice has testing authority, has used that testing authority, pairing authority, in 500 cases, 500 times, it says. I don't know how, even if you found 500, that would be a pattern or practice probably.

There is a bill—Representative Al Green of Texas has introduced bill H.R. 2926 that would give HUD testing authority, this kind of pairing testing authority that is not being used effectively by Justice. Does the Department of Housing and Urban Development have a position on Representative Green's bill?

Ms. KENDRICK. I have not had an opportunity to review the congressman's bill yet.

Mr. WATT. Okay, but will you go back and do that——

Ms. KENDRICK. Yes, I will.

Mr. WATT [continuing]. And report back to us about whether you all have an opinion about it?

Ms. KENDRICK. Yes, I will.

Mr. WATT. Okay. That would give you broader authority to do the kinds of paired testing that is being done.

Ms. Liu, I know you have no interest in second-guessing the statement that the Attorney General made in which he rejected the idea of creating a national task force to combat the country's mortgage fraud crisis and called the situation "regular white-collar crime" even though it has thrown the whole economy into absolute distress, just "regular white-collar crime."

And your response to it is, well, you deal with housing discrimination, you deal with pattern-or-practice, and the Justice Department operates in these different silos where somebody over there can prosecute corporate fraud and you can do housing, you are the Civil Rights Division and—you know.

It seems to me that everything you have said—although you, justifiably so, don't want to say that the Attorney General is out to lunch by refusing to acknowledge this as a multidisciplinary problem—everything you have said suggests that there needs to be a more coordinated approach to dealing with these issues of discrimination: failure to be fair in loan terms, directing people.

Unlike what Mr. Franks says, when people elect to get subprime loans, the great bulk of the evidence is that people were directed by one means or another, quite often through discriminatory means, to subprime loans even though they would have qualified, in 60 percent of the cases, for regular prime loans, and disproportionately more for minorities. All of that evidence is in the record in Financial Services, which I happen to sit on also.

Don't you think there needs to be a more coordinated, multidisciplinary, outside the silos that you all operate approach to dealing with this?

This is the Justice Department, and basically you have just said, "This is localized crime, and we are going to let local people deal with this." That is ridiculous, isn't it, Ms. Liu?

Ms. LIU. Congressman Watt, I appreciate your remarks, but I am not——

Mr. WATT. You appreciate them, and you agree with them, don't you?

Ms. LIU. I didn't say that I appreciate——

Mr. WATT. I mean, but everything you have said suggests that there needs to be some coordination of this effort, which is exactly what we have asked the Attorney General to do.

Ms. LIU. Sir, I am not in a position to go beyond what the Attorney General has said, or I am certainly not in a position to second-guess his excellent judgment.

Mr. WATT. Well, in that case, you may find him to have excellent judgment in some cases. In this case, everything that you have said suggests that his judgment is not so excellent, Ms. Liu.

I yield back.

Mr. NADLER. On that note, I want to thank the witnesses on this panel. And thank you very much.

And we will ask the second panel to come forward. And while they are taking their seats, I will read the biographical information so as to save time.

Our first witness will be Mr. Jim Carr, who is the chief operating officer for the National Community Reinvestment Coalition. He is also a visiting professor at Columbia University in New York and at George Washington University in Washington, DC

Prior to his appointments to NCRC, Mr. Carr was senior vice president for financial innovation, planning and research for the Fannie Mae Foundation and vice president for research at Fannie Mae. He has also held posts as assistant director for tax policy with the U.S. Senate Budget Committee and research associate at the Center for Urban Policy Research at Rutgers University.

He holds a bachelor of architecture degree with honors from Hampton University, a master of urban planning degree from Columbia, and a master of city and regional planning from the University of Pennsylvania.

Shanna Smith has served as president and CEO of the National Fair Housing Alliance since 1990. NFHA has recently released its 2008 Fair Housing Trends report, "Dr. King's Dream Denied: Forty Years of Failed Federal Enforcement."

Prior to joining NFHA, she was executive director of the Toledo Fair Housing Center. Ms. Smith has a B.A. from the University of Toledo.

Suzanne Sangree has been a chief solicitor in the Baltimore City Department of Law since March 2007. She is the counsel in the case *Baltimore v. Wells Fargo*, a Fair Housing Act case alleging racial discriminatory and predatory lending. Her other work includes low-income energy assistance, foreclosure prevention and relief, and issues affecting the homeless.

Previously, Ms. Sangree was director of appellate advocacy at the Public Justice Center and taught at the University of Maryland School of Law, the Washington College of Law at American University, and the West Virginia University College of Law.

Ms. Sangree received her LLM from Harvard Law School.

Professor Stan Liebowitz is the Ashbel Smith professor of economics in the management school at the University of Texas at Dallas and is head of the Center for the Analysis of Property Rights and Innovation.

In addition to five books, he has published over 60 academic articles in journals. Professor Liebowitz's research interests include the economic impact of new technologies, intellectual property, antitrust, and mortgage discrimination.

He holds a Ph.D. in economics from UCLA and a B.A. from Johns Hopkins University.

Audrey Wiggins is the director of the Fair Housing and Environmental Justice Project at the Lawyers' Committee for Civil Rights Under Law.

During her 10 years at the Lawyers' Committee, she has also served as a senior counsel for the Employment Discrimination Project, litigating employment discrimination cases involving racial, national origin, and sexual discrimination in the workplace.

Ms. Wiggins received her undergraduate degree *cum laude* in broadcast journalism from Hampton University and a juris doctorate degree from North Carolina Central University.

Immediately prior to joining the Lawyers' Committee, she was an attorney advisor for the U.S. Commission on Civil Rights.

I am pleased to welcome all of you.

As a reminder, your written statements will be made part of the record in its entirety. I would ask each of you to summarize your testimony in 5 minutes or less. To help you stay within that time, there is a timing light at your table. When 1 minute remains, the light will switch from green to yellow, and then to red when the 5 minutes are up.

It is the custom of the Committee to swear in witnesses. Would the witnesses please stand and raise your right hand?

[Witnesses sworn.]

Mr. NADLER. Let the record reflect that the witnesses answered in the affirmative.

Mr. Carr, you are recognized for 5 minutes. Thank you.

TESTIMONY OF JAMES H. CARR, CHIEF OPERATING OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION

Mr. CARR. Good morning, Mr. Chairman, Ranking Member Franks, and other distinguished Members of the Subcommittee. On behalf of the National Community Reinvestment Coalition, I am honored to share with you today our thoughts on the context for and effectiveness of the Fair Housing Act of 1968.

The National Community Reinvestment Coalition is an association of more than 600 community-based organizations that promote access to banking services and supports sustainable, affordable homeownership, job creation, and vibrant communities for America's working families.

Members of the Subcommittee, we applaud your efforts to ensure equal housing opportunities for all Americans by convening this hearing.

Discrimination is irrational and counterproductive to the common good of the Nation. It stifles human potential, undermines the economic and social well-being of communities, and limits the Nation from reaching its potential as a fully inclusive and competitive society.

Major disparities in economic and social advancement exist for African-Americans, Latinos, Native Americans, and other Asian communities. Lack of economic advancement, it is important to note, is not due to market forces or a lack of personal responsibility by people or communities of color.

Rather, limitations on economic mobility and wealth accumulation are a direct result of more than a century of policies and practices that directly undermined access and opportunity for members of color. I would be pleased to discuss specific policies in the Q&A.

The net result of discriminatory actions is the hypersegregated, isolated and disadvantaged communities that we see today.

The goal of highlighting the historic role that discrimination has played, however, is not to point fingers, assign blame or to live in the past. Rather, it is important that America understand the fundamental underpinnings of public policy that have created the disparities we see today.

Moreover, historically, the issue of discrimination has been argued solely on the basis of equality and justice. There is increasingly another critical reason to level the playing field by race/ethnicity. Globalization represents for America competitive challenges this Nation has never experienced. America cannot afford to stumble into the 21st century; the risks are too great.

Yet we are already stumbling. Consider that by the middle of this century, half the U.S. population will consist of people of color. Yet this fastest-growing share of the Nation's population is disproportionately composed of people who are the least well-housed, the most tenuously connected to labor markets and financial markets, are disproportionately isolated from quality educational opportunities, and achieve relatively low levels of wealth.

The Fair Housing Act was signed into law in 1968. A full 40 years later, millions of instances of discrimination exist on an annual basis. As a result, we have 40 years of experience that the current enforcement system does not work.

In response to this continued failure to enforce the law, we recommend the establishment of a new Cabinet-level agency focused on civil rights enforcement. This agency would report directly to the President of the United States and would be responsible for measuring, monitoring and eliminating all forms of discrimination from our society once and for all.

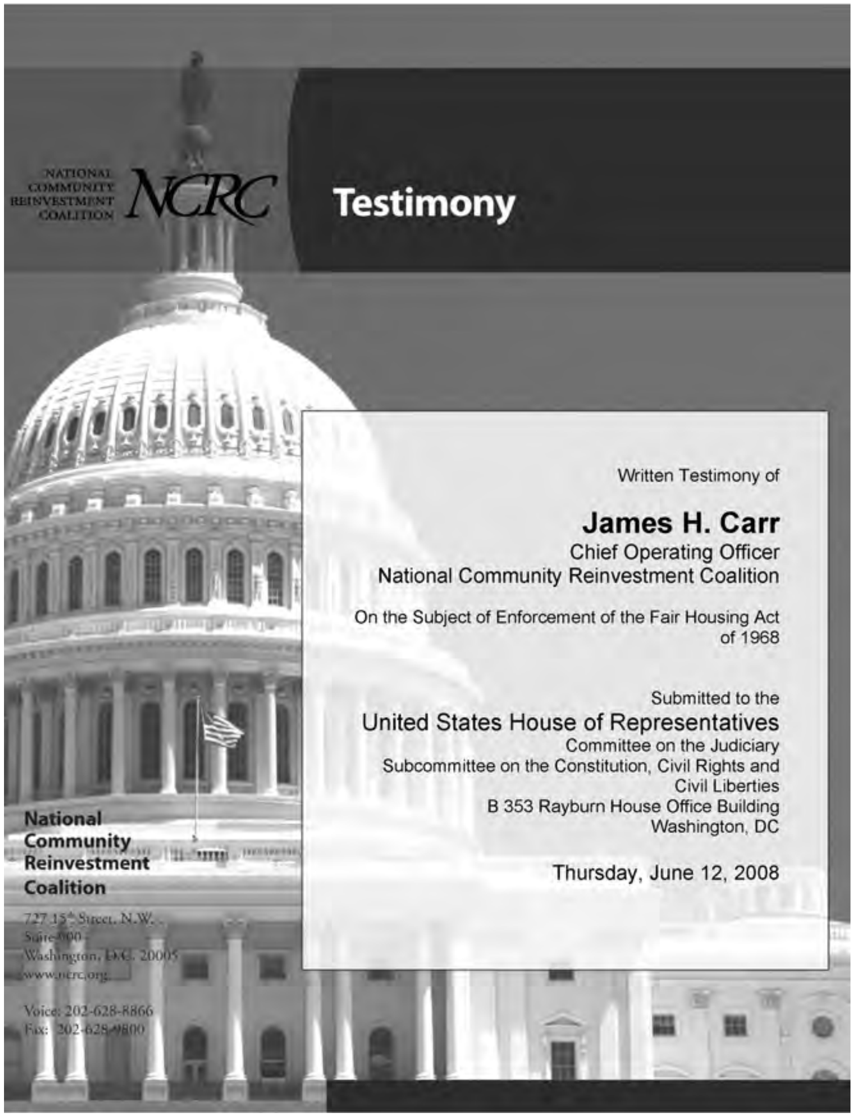
And given the importance of housing to accessing opportunity for social and economic advancement, housing-related laws would be among the agency's highest priorities. This position is essential. And I outline this proposal and others in my written testimony.

Enforcing the law would immediately open the door for millions of households that are prepared to access opportunity today but for whom their only impediment is illegal denial of access. Let's open that door, let equality and justice prevail.

Thank you.

[The prepared statement of Mr. Carr follows:]

PREPARED STATEMENT OF JAMES H. CARR



Introduction

The National Community Reinvestment Coalition (NCRC) is honored to testify today before the United States House of Representatives Committee on the Judiciary, Subcommittee on the Constitution, Civil Rights, and Civil Liberties regarding the enforcement of the Fair Housing Act of 1968.

NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

Along with our members, we are committed to an open housing market free of discrimination. Through our National Neighbors program, NCRC leads fair housing and fair lending best practice initiatives, which promote racial and cultural equality, opportunity and diversity. In particular, National Neighbors efforts are aimed at ensuring that solutions to the current mortgage crisis are fair and equitable and do not place a disproportionate burden on underserved communities, nor restrict access to responsibly underwritten and fairly priced mortgage products for qualified applicant.[1]

Chairman Conyers, and other distinguished members of the Subcommittee, we applaud your efforts to ensure equal housing opportunities for all Americans by convening this hearing.

Title VIII of the Civil Rights Act of 1968, (Fair Housing Act) prohibits discrimination in the sale, rental and financing of dwellings based on race, color, religion, sex, or national origin; designating these as protected classes. In 1988, Title VIII was strengthened to include handicap and familial status as protected classes. This act is one of the strongest pieces of legislation to promote equal access to housing in our nation's history. Unfortunately, a lack of enforcement undermines the effectiveness of this law. In fact, in 2007 the Department of Justice (DOJ) received only 27 fair lending referrals involving potential Equal Credit Opportunity Act claims from the bank regulatory agencies; 15 from the Federal Deposit Insurance Corporation (FDIC); nine from the Federal Reserve Board (FRB); and three from the Office of Thrift Supervision (OTS).[2]

NCRC and many of its members have brought more complaints acting as "private attorney generals" under the Fair Housing Act then individual Federal regulators charged to enforce the law. NCRC and its members have challenged violations, including reverse redlining, discriminatory underwriting, discriminatory pricing, problematic sub-prime mortgage servicing, overt redlining of urban and rural neighborhoods, and even the role of Wall Street and rating agencies in the current market crisis.[3]

The failure to properly enforce Title VIII especially affects communities where there are high concentrations of discriminatory loans, and in turn, high levels of foreclosures. We are witnessing a disproportionate share of unethical, high-cost lending targeted specifically at financially vulnerable African American and Latino households and communities. According to a study by the nonprofit research institution United for a Fair Economy, African American and Latino communities together stand to lose between $140 to more than $200 billion of equity as a result of the foreclosure crisis[4]. Billions more will be drained over the next year and into 2009 unless there is meaningful foreclosure intervention and active enforcement of the Fair Housing Act.

NCRC has consistently called for a greater role to be played by Federal and state regulators in challenging reverse redlining, discriminatory pricing and predatory lending that targets minority communities across the country.

Despite substantial progress that has been made to celebrate compliance and equal treatment under Title VIII – including industry best practice initiatives, neighborhood diversity initiatives and fair housing planning programs – much more work needs to be done until the Fair Housing Act's legislative authors dream of "one America" can become a reality.

NCRC highly recommends the creation of a Cabinet-level civil rights position that reports directly to the President and ultimately to Congress. Additionally, a newly developed National Fair Housing Plan would ensure that all Federal and state agencies work collaboratively with each other and the public and private sectors, to realize our nation's long established and accepted policy of equal housing and employment opportunity, equal professional service and equal treatment under the Americans with Disabilities Act (ADA).

The Road to Equal Housing Opportunity and One America

Historically, minority families have experienced less opportunity to obtain housing at a fair and reasonable cost than their white counterparts. Following passage of the Emancipation Proclamation came the court decision in the matter of *Plessy v. Ferguson* and "Separate but Equal", where the Supreme Court ruled that separate did not necessarily mean a denial of equality – the precise purpose of that policy was to ensure inequality.

The early 1900s Jim Crow practice of restrictive covenants became the major tool to enforce the policy of separate and unequal in the housing market by not allowing homes in white neighborhoods to be sold to African Americans. No longer afforded the opportunity to live among whites, African Americans were increasingly isolated from major areas of employment growth, as well as the best-funded schools and other services.

In the 1930s, the Federal Home Loan Mortgage Corporation (HOLC) institutionalized "redlining", the denial of loans and financial services to specific neighborhoods, which became a practice within the housing market for decades to come. Even after WWII, programs established by the Veteran's Administration continued to discriminate against minorities. After returning home from the war, many African Americans found themselves left out of jobs, training and home ownership opportunities that were available to many of the nations veterans. Urban Renewal policies affected entire communities and relocated African Americans into low-income, and often unsafe, concrete towers – physically isolating them from areas of job growth, affordable housing, quality schools or other opportunities that are essential for economic mobility and success.

The cumulative impact of these and many other practices was that by the 1960s segregation experienced among African Americans in both southern and northern cities had reached levels never before achieved by any other racial or ethnic group in American history.

In 1968, President Lyndon Johnson created the Kerner Commission to examine these and other issues affecting African American communities and provide policy recommendations. Quoting to the report, "All Americans sought both the material assets of the capitalist system and its subsequent psychological benefits of dignity and peace of mind."[5] However, neither of these two American aspirations were attainable for the majority of African American households.[6] The Report warned of an America "moving toward two societies, one African American, one white – separate and unequal."

The Fair Housing Act was intended to outlaw all discriminatory actions within the housing and lending industry. The legislation passed on April 10' 1968, only 6 days after the assassination of Dr. Martin Luther King, Jr. and was signed into law by President Johnson the following day. The Act gave the

United States Department of Housing and Urban Development (HUD) Office of Fair Housing & Equal Opportunity (FHEO) the power to investigate complaints received. In 1988, Title VIII was strengthened to include handicap and familial status as protected classes. HUD was also given the ability to initiate complaint proceedings and impose more meaningful remedies. And in March of 1991, it became unlawful to design nonhandicap-accessible housing.

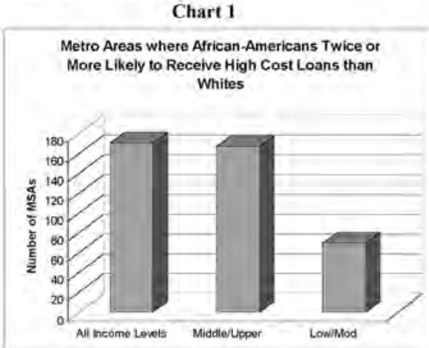
While the primary purpose of the Fair Housing Act was to respond to the immediate need to eradicate housing discrimination, many people also recognized it as a tool to promote integration. Senator Walter F. Mondale is widely quoted as stating that the purpose of the Fair Housing Act was to replace the ghetto with "truly integrated and balanced living patterns."[7] Similarly, Senator Edward Brooke commented that though the legislation was "a giant step in the right direction," is was not a "cure [for] all of the wrongs and the ills in this country."[8]

An inherent tension in the law can be seen between the idea of freedom of housing choice and promoting broader social goals of a racially and economically diverse and sustainable society. This tension has carried over to present day, and throughout the past 40 years the Fair Housing Act's broad policy mandates have forced the courts to play an important role in the Act's interpretation. The Supreme Court has acknowledged that Congress intended the legislation to be construed broadly, so as to root out discrimination within the housing industry.[9] This has led to a series of landmark decisions, ranging from inclusive zoning and supporting a municipality's commitment to neighborhood integration, to affording plaintiffs, who often represent municipalities, homeowners, businesses, and other aggrieved parties, the opportunity to enforce their rights.

High Cost Lending is Unfairly Distributed

The Fair Housing Act includes strong protections for fair lending, including determining unfairly distributed high-cost loans. High-cost first lien loans, as defined by Home Ownership and Equity Protection Act is one in which the annual percentage rate (APR) exceeds by more than eight percentage points the rates on Treasury securities of comparable maturity[10]. Responsible high-cost lending serves legitimate credit needs, including compensating lenders for the added risk of lending to borrowers with credit imperfections. However, wide differences in lending by race, even when accounting for income levels and credit quality, suggests that more minorities are receiving high-cost loans than is justified based on financial criteria.

Chart 1



In 2007, for example, NCRC analyzed the 2005 Home Mortgage Disclosure Act (HMDA) data and observed striking racial disparities in high-cost lending.[11] NCRC's subsequent report, *Income is No Shield Against Racial Differences in Lending*, showed consumers in protected classes, particularly African Americans and Hispanics, are most at risk of receiving a poorly underwritten high-cost loan.

Furthermore, NCRC found that middle-class or upper-class status does not shield minorities from receiving high-cost loans (Chart 1). In fact, NCRC observed that racial differences in lending increase as income levels increase. [12] Hispanics also experienced greater disparities in high-cost lending compared to whites as income levels rose.

NCRC's research has found that even after controlling for creditworthiness and other housing market factors, African Americans are more likely to receive high-cost loans.[13] [14] The Center for Responsible Lending (CRL) also used HMDA data with pricing information to reach the same conclusions - that racial disparities remain, even after controlling for creditworthiness.[15]

Large credit unions, investment banks, rating agencies, insurance providers, and independent mortgage companies do not abide by Community Reinvestment Act (CRA) requirements, but CRA does require banks to serve the credit needs of communities, especially low and moderate-income communities. NCRC and Government Accountability Office (GAO) research concludes that large credit unions lag behind CRA-covered banks in their lending and service to minorities and low- and moderate-income borrowers and communities.[16] The Federal Reserve Board, in its review of HMDA data, found that bank lending exhibited fewer disparities in geographical areas covered by their CRA exams than in areas not covered.[17] These and other unregulated financial institutions have played a major role in the current foreclosure crisis.

National Neighbors Fair Lending Testing Confirms Honsing Discrimination

Mortgage brokers serve as the point of entry for most families seeking to buy a home or refinance a mortgage. Brokers facilitate up to 70 % of the loans made in this country, and many honest brokers serve an important role in the marketplace. However, over the past five years, considered to be the height of subprime lending, unscrupulous brokers set up borrowers for failure. NCRC's National Neighbors program regularly engages in fair lending testing, "mystery shopping," and has consistently uncovered disparate pricing and treatment for minorities with the same or better qualifications than whites. NCRC has reached similar findings regardless of the loan being originated by brokers, mortgage companies or other types of financial institutions.

From 2004 to 2006, with support from the HUD's Fair Housing Initiatives Program Private Enforcement Initiative, NCRC conducted mystery shopping of mortgage brokers of varying asset size. Posing as loan seekers, both white testers (the control group) and African American or Hispanic testers (the protected group) met with and called local brokers to inquire about their loan options. The protected-class testers were actually given more attractive loan profiles in terms of their amount of equity, credit standing and employment tenure, and should have logically received better treatment. Instead, NCRC's fair lending testing of mortgage brokers uncovered a 46 % rate of disparate treatment based on race and national origin.[18]

Our results documented the following patterns:

- African Americans and Latinos were discouraged 25% of the time concerning their efforts to meet with a broker, while white testers were discouraged only 12% of the time.

- African Americans and Latinos were questioned about their credit over 32% of the time, compared to white shoppers who were only questioned about credit 13% of the time. While responsible lenders may ask about credit, this finding highlights differential treatment for African Americans.

- White mortgage seekers had specific products discussed with them 91% of the time, while African Americans and Latinos had specific products discussed with them 76% of the time. Furthermore, white testers received two rate quotes for every one quoted to African American and Latino testers.
- NCRC documented pricing discrimination in 25% of the fair lending tests and noted that fees were discussed 62% of the time with white testers, but only 35% of the time with "protected testers."
- Fixed rate loans were discussed 77% of the time with white testers, but only 50% of the time with African American and Latino testers.

These results clearly document the fact that even when controlling for credit and individual applicant qualification factors, African Americans and Latinos are discriminated against in the marketplace and are paying high rates for loans. The results also affirmed a 2004 NCRC fair lending audit of financial service providers, conducted with support from the HUD Fair Housing Initiatives Program Private Enforcement Initiative, which found that African Americans and Latinos were treated differently than their white counterparts more then 40% of the time when seeking financial services.

The Impact of Fair Housing Violations On Individuals & Commuuities

Failure to purge discrimination from the housing markets has created a self-reinforcing system of disadvantage that feeds on itself and in which discrimination continues -- but often in forms that are much more subtle and difficult to detect and address. One example is the exponential growth in recent years of alternative or non-regulated institutions concentrated in distressed urban minority communities.

Segregation enables the alternative lending industry to target racial and ethnic minorities by creating the scale economies necessary for them to operate. Without the ability to concentrate in areas that lack competition for financial services, many, if not the majority, of these institutions could not exist. Moreover, fringe lenders provide the breeding ground for institutions such as predatory mortgage lenders that specialize in removing the home equity from financially challenged households.

Forty years after the enactment of the Fair Housing Act, many of the metropolitan areas in the United States are still segregated.[19] In analyzing the last three decades of census data, over two dozen metropolitan areas were identified as "hypersegregated", or highly segregated areas. [20] And nearly all—more than 90 percent—of the neighborhoods that were predominantly or exclusively African American in 1990 remained predominantly or exclusively African American a decade later. [21]

The National Fair Housing Alliance (NHFA) approximates that African Americans and Hispanics experience 3.7 million instances of housing discrimination every year.[22] The Federal Reserve estimates that African Americans and Hispanics pay more for home purchases and refinancing than their white counterparts.[23] The effect of housing discrimination disproportionately affects African Americans, since home equity represents a greater share of total assets as compared to whites. [24]

NCRC's National Homeownership Sustainability Fund (NHSF) illustrates how minorities are disproportionately affected by unfair lending terms or conditions that cause financial damage and harm their ability to build wealth. Most NHSF clients are facing foreclosure due to unfair predatory loans. A recent survey of NHSF loans shows that African American borrowers make up 77% of the total program caseload. Nearly half (47%) resided in low- and moderate-income neighborhoods and 83.6% of the borrowers had incomes below $45,000. The study also found that unscrupulous lenders targeted minority and low- and moderate-income borrowers and communities with high-cost mortgages.[25]

NCRC's NHSF is intervening in a number of cases where borrowers who are members of protected classes have experienced appraisal fraud. Inflated appraisals leave borrowers with unaffordable loans that they are then unable to refinance because the loan amounts are higher than the true value of their homes, especially in a cooling housing market. A separate sample of loans revealed that about one-fifth of the homes were over-valued by more than 50% of their true value, and two-thirds of the homes were over-valued by 15-50% more than their true value.[26]

Recent Declining Markets Policies Raise Significant Fair Lending Issues

Facing an ongoing foreclosure crisis, combined with falling house prices, many financial institutions have or are considering pricing decisions that could disfavor communities that have already been disproportionately harmed by unfair and deceptive lending practices. Declining market policies would utilize zip codes to determine down payment requirements for borrowers. Zip code and related local demographic or census tract data have long been used as a proxy for race in lending and insurance discrimination. Using that data could reduce access to credit in communities of color, stifle access to loans provided by responsible lenders, and cause lenders to further steer borrowers toward higher cost alternatives in the sub prime market.

Fair lending requires that mortgage originations must be based on the individual qualifications of a borrower, rather than the location of or type of housing that a consumer is purchasing. To apply any other standard, regardless of any apparent business justification, will reestablish an institutional and historic bias to limit mortgage credit in minority communities. Responsible underwriting, along with meaningful valuation and related underwriting practices, remains a proven methodology in assuring sound underwriting, equal access to credit, and healthy and sustainable communities. The role of securitizers, rating agencies, loan issuers, bundlers, and insurers must be closely monitored from a fair lending perspective due to changes in the financial markets.

The Government Sponsored Enterprises (GSE) Fannie Mae and Freddie Mac have abandoned these declining market policies and replaced them with industry leading best practices. Many institutions have not followed their lead and continue to use potentially discriminating factors.

The State of Fair Housing Enforcement

Currently, our Federal fair housing enforcement efforts are failing to protect the interests of America's working families and minority homebuyers.

In September 2005, the Federal Reserve Board referred about 200 lending institutions to their primary federal regulatory agency for further investigations based upon the Board's identification of significant pricing disparities in HMDA data, accounting for almost 50 percent of loans reported under HMDA.[27] [28] One year later, the Board referred 270 more lenders to their primary regulatory agencies for further investigation.[29] Inconceivably, not a single case of discrimination or civil rights violations has arisen from the roughly 470 Federal Reserve Board referrals. While HMDA data analysis by itself cannot conclude which financial institutions were discriminating, federal investigators have a far greater opportunity then they are currently using in making assessments about possible violations of fair lending laws. In the 1990s, with less detailed HMDA data available than today, the Department of Justice settled nearly a dozen cases alleging discrimination against major lenders, such as Long Beach Mortgage and Huntington.[30] These settlements have had a lasting impact on the entire lending industry and should be resumed today.

Recent reports from GAO and other sources document that the federal government is filing fewer housing discrimination charges despite rising consumer complaints against landlords, real estate agents and mortgage brokers. Many renters and buyers who seek help from HUD are unlikely to get relief for their complaints, which can include alleged discrimination by landlords and sellers based on race, religion, sex or disability. [31] An April 2004 GAO[32] study measured key elements, particularly timeliness and effectiveness, in the fair housing enforcement process. Although the Fair Housing Act mandates HUD to complete its investigation within 100 days, only 41% of FHEO investigators and 33% of Fair Housing Assistance Program investigators complied with the 100 day processing requirement[33]. Additionally, the report noted that between 1996 and 2003, the most frequent outcome of investigations was a "no reasonable cause" finding. The study also showed that of the approximately 7,500 FHEO inquiries filed each year, 39% to 95% of the inquiries are deemed non-jurisdictional, and thus are never filed as formal complaints.

Several high profile cases have highlighted the lack of enforcement on fair housing laws. As a result, local groups and municipalities are taking on the role of enforcement. The City of Baltimore is currently suing Wells Fargo, one of the nation's largest lenders, arguing that their subprime lending rate to African Americans in that city was fully 5 times the rate of lending to non-Hispanic white households. The suit claims that fully 65 percent of loans made by Wells Fargo to African American households were high -cost loans, compared to only 13 percent of loans to non-Hispanic white families[34]. In 2007, a civil rights group filed a suit against Westchester County, claiming the county not only failed to promote fair housing, but they failed to desegregate the county. The Anti-Discrimination Center of New York argued the county should give back $45 million dollars it had received from community development grants from 2000-2005. [35]

NCRC's NHSF and National Neighbors staff assisted over 100 African American and Latino officers of the New York Police and Fire Departments who purchased homes from a dishonest housing developer and mortgage broker. The broker manipulated the origination system by quickly selling the fraudulent loans onto the secondary market. After being passed up by the New York State Human Rights office, HUD and the DOJ, NCRC helped them file a Title VIII claim in Federal Court, which is currently pending. [36]

HUD recently announced that it has implemented several measures to improve the fair housing enforcement process, including revising written material, streamlining inquiry processes and training investigators and attorneys. Additionally, HUD established a Fair Housing Training Academy to teach effective investigation techniques to Fair Housing Assistance Program (FHAP) investigators throughout the country, creating a systemic unit to investigate pattern and practice issues and a greater consistency in fair housing enforcement, while launching a national fair lending education and outreach campaign to educate consumers about their rights as well as available resources. These are all crucial moves forward, but additional steps are necessary. Fair housing goals should be consistent for all federal agencies. Detailed description of the types of fair lending tests conducted and the results of those tests would provide a level of public confidence in fair lending enforcement that is currently lacking.

NCRC Recommendations

1. Create a Cabinet Level Civil Rights Position to Coordinate National Civil Rights Policy

Equal opportunity in housing, employment and public accommodations are the core of our nation's democratic values. NCRC recommends the establishment of a new cabinet level agency focused on Civil Rights Enforcement. This agency would report directly to the President of the United States and would be responsible for measuring, monitoring and eliminating discrimination from our society. Enforcing the law would immediately open the door for millions of households that are prepared to access opportunities today and for whom their only impediment is an illegal denial of access. The creation of a Cabinet level civil rights position will affirm our nation's commitment to an open society while ensuring that we effectively leverage and coordinate all Federal resources to affirmatively further fair housing. Coordinating all federal agencies – from HUD to the United States Department of Commerce – will produce sustainable communities that celebrate our nations diversity.

2. Establish a Federal Interagency Fair Housing Planning Policy For All Federal Programs and Recipients of Federal Funds

Currently, all states and localities that receive funding from the Community Development Block Grant must have Fair Housing Planning activities that are updated every five years. These plans should act as a model for a national plan, be aggressively enforced and be updated every three years to reflect changes in the market. All Federal agencies should ensure that their public and private sector partners are working to affirmatively further fair housing. This plan would be created by the new cabinet level position.

3. Make Fair Housing & Fair Lending Enforcement More Transparent and Effective

Enforcement activity should be coordinated on an interagency basis and focus on issues identified by Federal, state and local fair housing analysis of impediments and plans. Federal agencies should annually report to Congress the number of fair housing and lending investigations, types of investigations, and outcomes of these investigations. Annual reporting should include information on fair lending compliance exams conducted in conjunction with CRA exams and HUD's processing of fair lending complaints.

HUD, the Department of Justice and State Fair Housing Assistance Program agencies must investigate, mediate and charge more complaints, including pattern and practice, architectural accessibility and fair lending matters. Regulatory capacity to investigate national fair lending systemic investigations must be also increased including investing in training, staff resources, and interagency collaboration. Congress should also act to ensure that claims that present ongoing acts of discrimination are permitted. This is particularly important in design and construction and fair lending matters.

4. Support a Fair Housing Agenda

HUD's Fair Housing Assistance Program (FHAP) and the Fair Housing Initiatives Program (FHIP) provide funds for state agencies and nonprofit organizations, respectively, to engage in anti-discrimination enforcement, complaint processing, education, and outreach activities. For fiscal year 2008, HUD requested $55 million for these programs. NCRC believes a more appropriate way of determining funding for fair housing programs would be to allocate a proportional commitment indexed to the percentage to real estate and financial services market.

5. Expand the Number of Groups Who Are Identified as "Protected Classes" under Title VIII

People frequently encounter discrimination on the bases of familial status, disability, gender, marital status, source or amount of income, age, military service and sexual orientation.[37] In fact, many states and localities have expanded the number of groups who are protected under local fair housing ordinances to reflect these issues. NCRC strongly recommends that this subcommittee consider expanding the limited number of groups currently and also consider others as appropriate. protected under the Fair Housing Act.

6. Support Public & Private Partnerships that Celebrate Fair Housing

Many private sector groups have committed to ensuring fair housing through testing and other techniques. Congress should support these innovative programs and partnerships among communities, real estate providers, financial institutions and other market participants while encouraging expanded partnership. Particularly, Congress should focus on partnerships that celebrate neighborhood diversity, smart growth and environmentally significant programs, and those that empower open housing and strong tax bases utilizing a comprehensive fair housing plan. Congress should also consider investment tax benefits or similar public sector incentive support, i.e., community development finds, CDFI, etc. to overcome identified fair housing impediments.

7. Expand The Community Reinvestment Act to Non-Bank Lending Institution

To address the fair lending issues presented in this testimony, NCRC also suggests that the subcommittee enhance the CRA Modernization Act of 2007 (HR 1289), co-sponsored by U.S. Representative Eddie Bernice Johnson and U.S. Representative Luis Gutierrez, and apply and adapt CRA to mortgage companies, insurance companies, securities firms, and non-depository affiliates of banks, as well as mainstream credit unions.

The subcommittee may also wish to consider the number of geographical areas on CRA exams to include areas where banks make loans through brokers and other non-branch channels. CRA's mandate of affirmatively meeting credit needs should include minority communities as well as low- and moderate-income neighborhoods.

8. Enhance the Quality of HMDA Data

Congress and the Federal Reserve Board (which implements the HMDA regulations) should enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending. Data should include information on minorities, the elderly, women, and low- and moderate-income borrowers.

Fee and pricing information should be included for all loans, not just high-cost loans. Specific loan terms such as whether the loan was fixed and/or adjustable rate, information on the length of time in which the initial rate was in effect, age of the borrower, price of the loan, type of financial institution used to receive the loan is needed to make information more precise. HMDA data must contain credit score information[38] loan-to-value and debt-to-income ratios.

Additionally, homeowners' insurance is essential to acquiring and maintaining housing. Currently, there is a limited amount of publicly accessible data available about where homeowners' insurance policies are being written, the types of policies being written, how much coverage is being provided and what is the cost of each individual homeowners' own insurance policy. Creating and applying Federal legislation similar to HMDA to homeowner's insurance would allow government agencies and community groups to understand the overall amount of coverage offered to consumers by homeowner's insurance providers and identify any disparities that may exist among those protected by the Fair Housing Act.

Conclusion

NCRC's 600 member organizations strongly support the creation of a Cabinet level civil rights position to coordinate our nation's historic commitment to open housing. We also respectfully request that this subcommittee act to ensure that all of the Federal regulators that are charged with enforcing the Fair Housing Act do so with transparency and in a coordinated and effective manner to ensure that the United States remains economically competitive and retains a strong tax base.

A renewed commitment to national, state and local fair housing planning is required, coupled with a meaningful policy commitment that recognizes the critical role that an open housing market represents to a viable economy.

Despite the enactment of the Fair Housing Act over forty years ago, the dual lending marketplace continues to flourish and reinforce housing discrimination and segregated housing patterns that preclude racial diversity and inclusiveness. This not only affects our communities, but also affects our entire society. To quote Dr. Martin Luther King Jr., "We may have all come on different ships, but we're in the same boat now."

NCRC firmly believes that effective fair housing policy combined with the enactment of the CRA Modernization Act of 2007 will help to restore our financial markets address the stop the epidemic of discriminatory lending. Every day our member organizations struggle to assist families whose American dream of owning their own homes has been jeopardized by financial distress and discriminatory lending.

Thank you and we look forward to working with you in the future.

[1] National Neighbors, a program of the National Community Reinvestment Coalition, is
dedicated to creating public and private sector partnerships and programs that promote racial and cultural equality, opportunity and diversity. It does this by increasing multi-cultural dialogue and access, influencing public policy, and developing national models that support healthy and sustainable communities through the realization of our nation's civil rights laws. Through the National Neighbors initiative, NCRC convenes, supports and pursues workshops, conferences, investigations of civil rights complaints, systemic "testing," education and outreach, fair

housing planning and "best practice" compliance initiatives. National Neighbors provides technical assistance to NCRC's members in urban, suburban and rural communities to promote economic mobility and ensure fair housing for working families throughout our nation. National Neighbors advances fair lending and fair housing through multifaceted programs, including: private enforcement; education and outreach; fair housing planning; comprehensive voluntary compliance services; and testing and building partnerships among communities, real estate providers, financial institutions and other market players.

[2] The Attorney General's 2007 Annual Report To Congress Pursuant To The Equal Credit Opportunity Act Amendments Of 1976 Submitted By Grace Chung Becker Acting Assistant Attorney General , April 2, 2008

[3] See for example, NCRC v. Southstar, NCRC v. Wilmington Finance, NCRC v. Novastar Financial, NCRC v. Accredited Mortgage, NCRC v. Allied Mortgage, NCRC letter to SEC concerning role of Rating Agencies in sub-prime market failure (2008), and other enforcement actions cited at www.NCRC.org.

[4] Rivera Amaad et al. Foreclosed: State of the Dream 2008, United for a Fair Economy, January 15, 2008.

[5] National Advisory Council on Civil Disorders, Report on of the Commission on Civil Disorders vi at 92. (1968) (hereinafter Kerner Report)

[6] Id.

[7] See Trafficante v. Metro Life Insurance Company, 409 U.S. 205, 211 (1972), quoting Senator Mondale

[8] 114 Cong. Rec. 6000 Statement of Senator Brooke.

[9] Trafficante, at 409-412 (applying generous construction of standing to Fair Housing Claims)

[10] http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea19.shtm

[11] NCRC income is no Shield

[12] The lending disparities for African-Americans were large and increased significantly as income levels increased. In the *Income is No Shield* report, NCRC found that African-Americans of all income levels were twice as likely or more than twice as likely to receive high-cost loans as whites in 171 metropolitan statistical areas (MSAs) during 2005. MUI African-Americans were twice as likely or more than twice as likely to receive high-cost loans as MUI whites in 167 MSAs. In contrast, LMI African-Americans were twice as likely or more than twice as likely to receive high-cost loans as LMI whites in 70 MSAs. Moreover, MUI African-Americans receive a large percentage of high-cost loans. In 159 metropolitan areas, more than 40% of the loans received by MUI African-American were high-cost loans.

[13] 2004 Credit NCRC Study

[14] Paul S. Calem, Kevin Gillen, and Susan Wachter, *The Neighborhood Distribution of Subprime Mortgage Lending*, October 30, 2002. See also Paul S. Calem, Jonathan E. Hershaff, and Susan M. Wachter,*Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities*, in Fannie Mae Foundation's Housing Policy Debate, Volume 15, Issue 3, 2004 pp. 603-622.

[15] Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, see http://www.responsiblelending.org/issues/mortgage/reports/page.jsp?itemID=29371010

[16] NCRC, *Credit Unions: True to their Mission?*, 2005, http://www.ncrc.org; and Government Accountability Office, *Credit Unions: Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements*, November, 2006

[17] Avery, Robert B., Glenn B. Canner, and Robert E. Cook, "New Information Reported under HMDA and Its Application in Fair Lending Enforcement." *Federal Reserve Bulletin*, Summer 2005. Avery, Robert B., Kenneth P. Brevoot, and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data," *Federal Reserve Bulletin*, September 2006.

[18] NCRC's broker testing yielded 106 total complete, matched-pair tests. Individuals located in the metropolitan areas of Atlanta, Baltimore, Chicago, the District of Columbia, Houston, Los Angeles and Saint Louis tested brokers that were local, established businesses. In conducting the broker testing, NCRC found several companies with particularly egregious initial results. In these cases, testers were again dispatched for follow up testing to confirm and further investigate the practices of these companies. Of the 106 total tests, 84 separate companies were tested, the difference being as a result of 22 follow up tests.

[19] See Douglas S. Massey and Nancy A. Denton, American Apartheid: Segregation and the Making of the Underclass 61-78, 221-223 (Harvard U. Press 1993).

[20] Massey and Denton, supra note 3 at 74-75; Nancy A. Denton, "Are African Americans Still Hypersegregated?," in Residential Apartheid: The American Legacy 63 (Robert D. Bullard et al. eds., UCLA Press 1994).

[21] Rawlings, L., et. al., "Race and Residence: Prospects for Stable Neighborhood Integration," in Neighborhood Change in Urban America, n. 3 (March 2004), p. 2.
[22] NFHA 2006. "Unequal Opportunity: Perpetuating Housing Segregation in America, Fair Housing Trends Report." Washington, DC NFHA.
[23] Robert B Avery, Kenneth P. Brevoot and Glenn B. Canner, "Higher-Priced Home Lending and the 2005 HMDA Data." Federal Reserve Bulletin (2006) A 123-166.
[24]NFHA Fair Housing Trends Report, Dr. Kings Dream Denied, National Fair Housing Alliance, April 2008, pg21.
[25] For more detail about the CRF fund, see the report by NCRC and the Woodstock Institute, *Asset Preservation: Trends and Interventions in Asset Stripping Services and Products*, September 2006, at http://www.ncrc.org/policy/analysis/policy/2006/2006-09_LifetimeOfAssets_NCRC-WoodstockPaper.pdf
[26] See NCRC's report, *Predatory Appraisals: Stealing the American Dream*, June 2005, http://www.ncrc.org/responsible-appraisal/pdfs/AppraisalReport.pdf
[27] Robert B. Avery, Glenn B. Canner, and Robert E. Cook, *New Information Reported under HMDA and Its Application in Fair Lending Enforcement*, Federal Reserve Bulletin, Summer 2005, http://www.federalreserve.gov/pubs/bulletin/2005/05summerbulletin.htm
[28] Inside Regulatory Strategies, November 14, 2005, p.2.
[29] Joe Adler, *Big Increase in Lenders with Suspect HMDA Data*, American Banker, September 11, 2006.
[30] There were a couple of cases in 2002 and 2004, but these cases were before the new HMDA pricing information was available. The cases involved the Department of Justice versus Decatur Federal Savings and Loan, September 1992; Shawmut Mortgage Company, December 1993; African AmericanPipe State Bank, December 1993; Chevy Chase, FSB, August 1994; Huntington Mortgage Company, October 1995; Security State Bank of Pecos, October 1995; Northern Trust Company, 1995; First National Bank of Gordon, April 1996; Long Beach Mortgage Company, September 1996; First National Bank of Dona Ana County, January 1997; Albank, August 1997; Deposit Guaranty National Bank, September 1999; Mid America Bank, FSB, 2002; Fidelity Federal Bank, FSB, July 2002; First American Bank, July 2004.
[31] HUD, as the agency responsible for investigating and prosecuting cases under the Fair Housing Act, filed thirty on discrimination charges in 2007 and thrity six in 2006. Charges for the same two year period dropped 65% from the last two years of the previous administration. One hundred and eleven charges were filed in 1999 and eighty two in 2000. Complaints during the same period rose from fewer than 7,100 in both 1999 and 2000 to more than 10,000 in both 2006 and 2007. Notably, settles most of its discrimination complaints out of court, but the agency is settling more cases overall than during the previous administration, while the percentage of settled cases has declined. In 1999, HUD settled 778 cases, 42% of the total investigated. In 2007, it settled 948 cases — 36.5% of the total investigated. HUD dismissed nearly two-thirds of the 2,595 investigated complaints filed last year. The majority of the remaining 7,000 complaints go to HUD-certified and funded local and state agencies. Housing cases at the civil rights division of the Justice Department, which prosecutes cases in which investigators find patterns of discrimination, also have dropped. The department filed 35 civil lawsuits in 2007, marking a steady decrease since 1999.
[32] Fair Housing: Opportunities to Improve HUD's Oversight and Management of the Enforcement Process. Washington, DC: United States General Accounting Office, April 2004.
[33] FHAP are local government agencies who have laws that are substantially equivalent with the Federal law and have been authorized to investigate complaints by HUD FHEO
[34] Mayor and City Council of Baltimore v. Wells Fargo, 2008
[35] See http://www.nytimes.com/2007/02/04/nyregion/nyregionspecial2/04wemain.html?pagewanted=1
[36] See www.consumeraffairs.com/news/housing_scam.html
[37] See U.S. Dept. of Housing and Urban Development, 1995 Annual Report to Congress: The State of Fair Housing in America 5-10 (describing discrimination on the bases of sex, disability, and familial status); id. at 47 (listing numbers of complaints filed). See also Michael H. Schill and Samantha Friedman, The Fair Housing Amendments Act of 1998: The First Decade, 4 Cityscape 57, 61-64 (1999) (providing more recent information about the numbers of complaints on these bases).
[38] For example similar to the data used in NCRC's Broken Credit System report released in the winter of 2003. For each HMDA reportable loan, a financial institution should indicate whether it used a credit score system and if the system was its own or one of the widely used systems such as FICO (a new data field in HMDA could contain 3 to 5 categories with the

names of widely-used systems). The HMDA data should contain one more field indicating which quintile of risk the credit score system placed the borrower. Another option is to attach credit score information in the form of quintiles to each census tract in the nation. That way, enhanced analyses can be done on a census tract level to see if pricing disparities still remain after controlling for creditworthiness. This was the approach adopted in NCRC's Broken Credit System and in studies conducted by Federal Reserve economists.

Mr. NADLER. I thank the gentleman.

I will now recognize for 5 minutes for an opening statement Ms. Sangree.

Let me just explain. Ms. Smith—I normally proceed in order, but she has something, a video thing, that isn't quite ready yet. So we will come back to her.

Ms. Sangree is recognized for 5 minutes.

TESTIMONY OF SUZANNE SANGREE, CHIEF SOLICITOR, CITY OF BALTIMORE LAW DEPARTMENT

Ms. SANGREE. Thank you, Mr. Chairman, Ranking Member Franks, Members of the Committee. I am Suzanne Sangree. I am a Chief Solicitor in the Baltimore City Department of Law, testifying on behalf of the Mayor and City Council of Baltimore.

Baltimore is a case study of the damage that has befallen cities in the absence of aggressive Federal enforcement of our civil rights laws, especially the Fair Housing Act of 1968. In particular, lax enforcement of the Fair Housing Act, combined with Federal relaxation of Federal banking regulations and Federal preemption of States' abilities to regulate lenders, created an environment in which predatory lending flourished. And Baltimore, a majority-African-American city, is now contending with the devastating economic fallout of this petri dish for racially targeted predatory lending.

Baltimore City has turned to the Fair Housing Act as our best weapon for stanching the economic damage and obtaining resources to remedy it. The shapers of that act smartly fashioned it to have very broad standards for standing, and the Supreme Court has long recognized that cities have standing to sue under the act. But the shapers of the act always envisioned that the Federal Government would play a major role in enforcement of the act, and it has not done so.

Like other American cities with large non-White populations and a history of racial segregation, Baltimore was particularly vulnerable to racially targeted predatory lending. And that is because racially targeted predatory lending happens when two conditions are present. This has been pointed out by several of the representatives here today. A history of red-lining, of denying credit to minority communities is the first condition. And the second condition is a history and a present, contemporary racial segregation in housing patterns.

Baltimore has both of those conditions. Initially, our housing patterns were set with racially restricted housing covenants, which were enforced by the courts up until the 1950's and 1960's. However, well into the 1970's, the siting and maintenance of public housing projects were also racially segregated. As late as the 1970's, the secretary for HUD, Romney at the time, admitted that the Federal Government had refused to provide insurance in integrated neighborhoods, promoted the use of racially restrictive covenants, and engaged in other methods of red-lining.

So we have condition number one, minority communities deprived of access to credit, and condition number two, as well, patterns of racial segregation.

Not surprisingly, therefore, beginning in the 1990's, Baltimore was targeted for racially discriminatory predatory lending, and we are now contending with the tsunami of foreclosures that this lending has brought upon us. Since 2000, more than 33,000 homes have been subjected to foreclosure filing. In a city of 650,000 people, we are expected to have over 6,000 foreclosures this year.

January 8 of 2008, the City of Baltimore filed suit against Wells Fargo under the Fair Housing Act, alleging that it had engaged in racially targeted predatory lending. It is also known as "reverse red-lining." We chose to sue Wells Fargo because it is the biggest lender in Baltimore and it is among the lenders with the greatest racial disparity in their lending practices.

And to give you some of the examples which are in our complaint, which is attached as an exhibit to my written remarks, in 2006 Wells Fargo made high-cost loans to 65 percent of its African-American mortgage customers in Baltimore, but high-cost loans were only made to 15 percent of its White customers in Baltimore.

Refinanced loans were even worse. An African-American borrower was two-and-a-half times more likely to have a high-cost loan in a refinance than a White borrower. And we see similar racial disparities in foreclosure rates as well. African-American borrowers have four times the rate of foreclosure in Baltimore than White borrowers.

And it is interesting to note, although we have not had access to borrowers' credit scores yet, because we haven't gotten into discovery, a study that is being done by the Annie E. Casey Foundation in 13 cities including Baltimore concludes that for Baltimore, when one corrects for credit scores—this researcher has access to Experian credit scores—when one corrects for credit scores in Baltimore, there is a very high, meaning over 15 percent, racial disparity in Baltimore neighborhoods for refinances in 2006 and a high to medium, meaning 5 to 15 percent, racial disparity for purchase loans in 2006.

Mr. NADLER. The time is expired. Can you wrap up very rapidly?

Ms. SANGREE. Yes, I can.

The impact of this predatory lending and the foreclosures that it has spawned is quite devastating to municipalities. A study, in 2006 alone, the city lost $41.9 million in tax revenues. And between 2004-2005, a total of $17.8 billion in real estate value was lost.

Thank you.

[The prepared statement of Ms. Sangree follows:]

PREPARED STATEMENT OF SUZANNE SANGREE

Members of the Committee, my name is Suzanne Sangree, and I am a Chief Solicitor in the Baltimore City Department of Law, testifying on behalf of the Mayor and City Council of Baltimore. Thank you for inviting me to speak with you today.

Baltimore is a case study of the damage that has befallen cities in the absence of aggressive federal enforcement of this nation's civil rights laws, especially the Fair Housing Act of 1968. In particular, lax enforcement of the Fair Housing Act, combined with federal relaxation of federal banking regulations and federal preemption of states' ability to regulate lenders, created an environment in which racially discriminatory predatory lending flourished. Baltimore, a majority African-American city, is currently contending with the devastating economic fall out of this petri dish for racially targeted predatory lending. The City has developed and continues to develop a six pronged approach to staunching the resulting economic damage and repairing it. Litigation against the wrong doers is one prong of our plan; act one of this prong being our Fair Housing Act suit against Well Fargo for reverse redlining. In the absence of federal enforcement cities have been left to contend for themselves. Under the leadership of City Solicitor George Nilson, and our co-counsel John Relman and Brad Blower of Relman & Dane, Baltimore City turned to the Fair Housing Act as our best weapon for fending off reverse redlining and obtaining relief to repair the damage it has been inflicted. The shapers of that Act smartly provided a broad capacity for standing to sue and the Supreme Court has long recognized that Cities have standing under the Act. However, it was always envisioned that the federal government would play a leading role in enforcing it. It has not.

Like other American cities with large non-white populations and a history of racial segregation, Baltimore was particularly vulnerable to predatory lending. This vulnerability is caused by two complimentary factors: 1) a history of denying minorities access to credit; and 2) a history of racially segregated living patterns. Communities that for generations had been locked out of credit and housing opportunities, because of redlining are rendered desperate for credit and without the knowledge or experience required to identify loan products and lenders offering better terms. When one's only experience with loan applications has been no—it is common to jump on the first yes without much critical evaluation.

The fact that these vulnerable communities are geographically concentrated and so easily targeted by abusive lenders sets up the second condition. Unfortunately Baltimore suffers from both of these conditions.

Our solid patterns of racial segregation were initially enforced by racially restrictive convenants. In 1954, within months of the Supreme Court's *Brown I* decision, forward looking Baltimore officials decided to desegregate the City's low-income housing units. However, well into the 1970's and later the siting and maintenance of racially segregated public housing continued to reinforce Baltimore's patterns of housing segregation. Importantly, redlining practices by federal and state government authorities—and private entities—mortgage lenders, insurers—also created barriers to desegregation. The Secretary of the United States Department of Housing and Urban Development admitted in 1970 that the federal government had "refused to provide insurance in integrated neighborhoods, promoted the use of racially restricted covenants," and engaged in other methods of redlining. Data from the 1980's, long after the institutionalized government and corporate apparatus of discrimination had been formally dismantled, shows that the more African-American residents in a Baltimore neighborhood, the fewer the mortgage loans and dollars the neighborhood received. And while we are 64% African-American and 32% white, today's map of our neighborhoods shows that many still have very high concentrations of one race or the other.

As the presence of these two conditions would predict, beginning in the late 1990's Baltimore has been targeted for predatory loans, and this fact is reflected in the wave of foreclosures currently wracking the City. Since 2000, more than 33,000 homes have been subjected to foreclosure filings. From the first to the second quarter of 2007 foreclosure activity in the City increased five-fold. Moreover, we expect this year to be even worse than last year as an additional 4,300 ARMs adjust to higher rates in the City, often to rates the borrowers cannot afford. Another 2,000 ARMs readjust in 2009. During the first quarter of 2008 alone 1,447 foreclosure filings were made in Baltimore City.

On January 8, 2008 Baltimore City filed suit against Wells Fargo in the federal district court of Maryland alleging that Wells Fargo engaged in reverse redlining, i.e. that it has targeted Baltimore's African-American neighborhoods for bad loans. We chose Wells Fargo because it is one of the largest mortgage lenders in Baltimore and it has the greatest number of foreclosures in the City. Since 2004 to the present, Wells Fargo has made over a 1,000 mortgage loans per year in Baltimore City. No other lender made more than 1,000 mortgage loans in Baltimore during these years. In addition, the racial disparities in lending practices for Wells Fargo loans were among the greatest of all lenders. But there are certainly other bad actors in the City, and we hold them accountable as well.

Home Mortgage Disclosure Act (HMDA) data reveals the racial disparities in Wells Fargo lending practices in Baltimore. As documented in the attached complaint, in 2006 Wells Fargo made high-cost loans to 65% of its African-American mortgage customers in Baltimore, but to only 15% of its white customers in Baltimore. Wells Fargo's refinance loans were even worse: in 2004, 2005, and 2006, a Wells Fargo refinance loan to an African-American borrower was 2.5 times more likely to be high cost than a refinance loan to a white borrower. In addition, Wells Fargo's **pricing sheets** require that equally credit worthy borrowers in predominantly African-American neighborhoods pay higher interest rates compared to their counterparts in white neighborhoods, imposing thousands of dollars in extra interest payments on African-American borrowers.

Interestingly, research recently conducted by Chris Herbert of Abt Associates Inc. for the Annie E. Casey Foundation confirms that race accounts for lenders' disparate lending practices in Baltimore neighborhoods and not credit scores or other risk factors. He has analyzed HMDA, Census Bureau and credit scores from the credit bureau Experian for selected neighborhoods in 13 cities, including Sandtown/Winchester/East Side Revitalization Area in Baltimore. He concludes that **when one corrects for credit** scores, there is a "Very High" (over 15%) racial disparity in these Baltimore neighborhoods for refinances for 2006, and a "High/Med" (5–15%) racial disparity for purchase loans in 2006. Wells Fargo Bank NA was the most active lender in both categories in Baltimore. In other words, even after taking the credit characteristics of borrowers into consideration, Wells Fargo was ranked first among lenders in Baltimore for having the largest disparity in the prices it charged African Americans versus whites.

As our complaint documents, Wells Fargo also has one of the highest foreclosure rates of any lender in Baltimore and its foreclosure rates in majority African American neighborhood is 4 times the rate in majority white neighborhoods. Two thirds of Wells Fargo foreclosures in Baltimore in 2005 and 2006 were in census tracts more than 60% African American, while only 16% were in tracts that are less than 20% African American. Wells Fargo foreclosure rate for loans in African American neighborhoods is nearly double the overall City average, while the loans in white neighborhoods is less than half of the average.

An interesting fact about Wells Fargo loans in Baltimore is that fixed rate loans constitute the majority of Wells Fargo's foreclosures. With contemporary underwriting methods lenders can reliably predict whether a borrower will be able to repay a fixed rate loan (debt to income ratio/loan to value/FICO/work history etc) the loan payments do not change over the life of the loan. However, even though 70% of Wells Fargo's foreclosures in both the African-American and white neighborhoods are on fixed rate mortgages, African Americans are nearly 4 times more likely to be foreclosed upon by Wells Fargo than whites. This is compelling evidence that Wells Fargo followed a policy of putting African Americans into loans they could not afford.

When people are locked into mortgages that they cannot afford—they will soon fall behind on payments and foreclosure will often result. This pattern of predatory lending and foreclosure is ravaging our City. The TRF/Goldseker Study, "Foreclosures in Baltimore, Maryland" found that Baltimore lost **$41.9 million in tax revenue** in 2006 alone because of foreclosures. Lost property values across Baltimore in 2004 and 2005 total **$17.8 billion.**

Baltimore incurs increased code enforcement, police and fire costs when buildings remain vacant. And the dollars and effort spent to nurture neighborhoods and to spark and maintain the urban renaissance the City had been undergoing, are being washed down the drain, as up and coming neighborhoods are stalled and even reversed in their economic progress.

The City seeks compensatory and punitive damages from Wells Fargo in order to mend the damage that company's predatory lending has inflicted and to deter such conduct in the future. We would welcome federal law enforcement partnership in ensuring that such racially discriminatory practices do not occur in the future.

Mr. NADLER. Thank you.

There are, as some people may have noted, five votes on the floor pending. One vote has 5 minutes left; the others are 5-minute votes. So the Committee will stand in recess pending the end of the votes.

I ask the Members to come back as soon as the last vote is completed. We will reconvene after the last vote. My estimate, but it is only that, is about 12:15. It could be a little earlier, a bit later.

So the Committee will stand in recess. We ask the indulgence of the witnesses. The Committee will stand in recess until after the votes on the floor.

[Recess.]

Mr. CONYERS. [Presiding.] Mr. Liebowitz, are you prepared to give your statement? We have been waiting anxiously for you to begin whenever you choose.

TESTIMONY OF STAN LIEBOWITZ, ASHBEL SMITH PROFESSOR OF MANAGERIAL ECONOMICS, UNIVERSITY OF TEXAS AT DALLAS

Mr. LIEBOWITZ. Thank you.

As we all know, the major economic news for the last year has been the disarray in the mortgage market. Now, the question is, how did we get here?

And it is not like there is necessarily one single answer. But one key component is that the Government in the 1990's began to base its housing policy on several flawed claims. I believe these claims poisoned the working of the mortgage market, and now the economy is suffering.

The poison began with the claim that minorities were being denied mortgages because of racial discrimination. Now, I am sure, as most of the people in this room know, every year after HMDA data were made available, newspapers have run stories reporting on the discrepancies in denial rates between minorities and Whites.

The charges against the mortgage lenders were made based on the difference in denial rates, which were undeniable. There were clearly large differences. But the individuals making the claim, in the newspapers certainly and I think their political backers, I think it is fair to say they were hell-bent on finding discrimination, whether it was there or not.

Now, it was obvious to a more sophisticated audience that the HMDA data were inadequate for testing whether discrimination was actually going on. To solve that problem, an expanded data set was created by the Boston Fed to allow a more complete analysis of the question. The researchers at the Boston Fed performed a study using this data, and they concluded that 40 percent of the higher minority mortgage rejection rate was due to discrimination.

Unfortunately, this data set was created with insufficient care. The data had apparently never been examined for transcription errors. When my coauthor and I actually looked at the numbers contained in the data set, it was clear that the numbers were, in many cases, outrageously unreliable. The data set could not provide a basis for a claim that mortgage lenders in Boston discriminated against minorities.

Full details are available in my 1998 article, published in the economics journal *Economic Inquiry*, which is attached somewhere to your sheet.

Nevertheless, Government officials and regulatory agencies showed no interest in getting to the truth of the matter. In a rush to judgment and before any outside analysis of the Boston Fed study could even take place, the study was described as definitive and conclusive in various quarters. In other words, it appeared that the fix was in.

The Boston Fed study was just a fig leaf for continuing attacks on the mortgage industry. Under the guise of ensuring greater minority participation in the housing markets, traditional lending standards were attacked as a form of discrimination.

It was claimed that mortgage applicants could handle larger obligation ratios than those imposed by traditional standards. It was claimed that mortgage applicants could make their monthly payments without having been consistently at a job. It was claimed that mortgage applicants didn't need to be able to come up with a downpayment. It was suggested that mortgage applicants should be deemed credit-worthy if they watched some sort of educational video about the mortgage process.

This was all nonsense. The old obligation ratios and standards served a purpose. The purpose is to make sure that the people lending the money got their money back and the people borrowing the money would stay in their houses.

When you build the housing market on false claims, it follows you are asking for trouble. The unusually high current defaults would not be occurring in such large numbers if substantial downpayments had been made on the homes that are out there now. We can thank relaxed lending standards for that. The recent price bubble was unlikely to have occurred with such a vengeance if the relaxed lending standards were not in place. It is much easier to speculate on house prices if no money needs to be put down and if income does not need to be verified. Nor is it likely that the secondary market would have purchased so many bad loans without those claims.

The oft-repeated praise of relaxed lending standards provided justification to investors for the belief that secondary market loans were a AAA. If you examine sales pitches that were being made for mortgages in the secondary market, you will see those claims being echoed.

Although there are many other contributing factors, I think the proliferation of relaxed lending standards is at the center. And if we do not learn from the past, we deserve the future.

Thank you.

[The prepared statement of Mr. Liebowitz follows:]

PREPARED STATEMENT OF STAN LIEBOWITZ

Statement of Stan Liebowitz before the House Subcommittee on the Constitution, Civil Rights, and Civil Liberties Hearing on Enforcement of the Fair Housing Act of 1968, June 12, 2008

The major economic news for the last years has been the disarray in the mortgage market. The malaise in the mortgage market has been threatening to drag the rest of the economy down with it.

How did we get here? One key component is that the government in the 1990s began to base its housing policy on a false claim, or lie. The government repeated this claim over and over again. Eventually this lie began to poison the mortgage market, and now the entire economy is at risk.

The poison began with the claim that minorities were being denied mortgages because of racial discrimination. This claim was originally trumpeted in newspapers and television based on HMDA data even though it should have been obvious to those making the charges that the HMDA data were insufficient to examine the issue of discrimination. Every year when the HMDA came out charges of discrimination were made by the legions of individuals hell-bent on finding discrimination, whether it was there or not.

Because it was obvious to a more sophisticated audience that the HMDA data were inadequate to test for discrimination, an expanded HMDA data set was created by the Boston Fed to allow a more complete analysis of the question. The researchers at the Boston Fed performed a study and claimed that one forth of the higher minority mortgage rejection rate was due to discrimination.

Unfortunately, this data set was created with insufficient care. The data had apparently never been examined for transcription errors by its creators at the Boston Fed. When my coauthor and I actually looked at the numbers in the data set it was clear that the data were outrageously unreliable. There was no basis for a claim that minorities were discriminated against by mortgage lenders. Full details are available in my article published in the 1998 issue of the economics journal "Economic Inquiry."[1]

Nevertheless, government officials and regulatory agencies showed no interest in getting to the truth of the matter. In a rush to judgment and before any outside analysis of the Boston Fed study could even take place, the Boston Fed study was claimed to be definitive and conclusive. In other words, the fix was in. The Boston Fed study was just a fig leaf that could be used to continue attacking the mortgage industry as being racist.

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[1] Available at http://www.utdallas.edu/~liebowit/mortgage/mortgages.pdf

This 'finding' of discrimination was then used to argue for weaker lending standards, in the guise of ensuring greater minority participation in the mortgage lending process. Traditional lending standards were attacked as a form of discrimination by regulators and housing advocates. It was claimed that mortgage applicants could handle larger obligation ratios than those imposed by traditional standards; that mortgage applicants could make their monthly payments without having been consistently at a job; that mortgage applicants didn't need to be able to show that they could come up with a downpayment—a gift, say from a phony charity set up by the seller of the home, would do just fine. It was suggested that mortgage applicants should be deemed credit-worthy if the applicants watched some sort of educational video about the housing market and the mortgage process. This was all nonsense, one lie compounding another.

The claim that lending standards could be "relaxed" without increasing the number of defaults was false. When you build a housing market on such false claims, you are asking for trouble.

The recent unusually high defaults are due to an unusually steep decline in home prices. But there would not have had such a large number of defaults if substantial downpayments had been made on the homes. We can thank relaxed lending standards for that.

I even doubt that the recent major price bubble in housing would have occurred if relaxed lending standards were not in place. It is much easier to speculate on house prices if no money needs to be put down and if income does not need to be verified.

Nor would the secondary market have been as likely to step in and fund mortgages backed by relaxed secondary standards if they hadn't have heard all the claims about the safety of relaxed lending standards coming from various government agencies. If you examine sales pitches that were being made for the sale of these mortgages in the secondary market, you will find them repeating the government claims about how relaxed lending standards do not lead to greater defaults.

Although there are many other contributing factors, I think we can probably lay the core of the mortgage debacle at the proliferation of relaxed lending standards, which have been and continue to be supported by many of the people likely to be in this room.[2]

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[2] See Fannie Is Poised to Scrap Policy Over Down Payments By JAMES R. HAGERTY, Wall Street Journal May 16, 2008; Page A3 which reports that affordable housing advocates are among the supporters of attempts to keep Fannie Mae from slightly tightening its lending standards.

NEW YORK POST
24 HOURS A DAY

THE REAL SCANDAL

HOW FEDS INVITED THE MORTGAGE MESS

By STAN LIEBOWITZ

February 5, 2008 -- PERHAPS the greatest scandal of the mort gage crisis is that it is a direct result of an intentional loosening of underwriting standards - done in the name of ending discrimination, despite warnings that it could lead to wide-scale defaults.

At the crisis' core are loans that were made with virtually nonexistent underwriting standards - no verification of income or assets; little consideration of the applicant's ability to make payments; no down payment.

Most people instinctively understand that such loans are likely to be unsound. But how did the heavily-regulated banking industry end up *able* to engage in such foolishness?

From the current hand-wringing, you'd think that the banks came up with the idea of looser underwriting standards on their own, with regulators just asleep on the job. In fact, it was the *regulators* who relaxed these standards - at the behest of community groups and "progressive" political forces.

In the 1980s, groups such as the activists at ACORN began pushing charges of "redlining" - claims that banks discriminated against minorities in mortgage lending. In 1989, sympathetic members of Congress got the Home Mortgage Disclosure Act amended to force banks to collect racial data on mortgage applicants; this allowed various studies to be ginned up that seemed to validate the original accusation.

In fact, minority mortgage applications *were* rejected more frequently than other applications - but the overwhelming reason wasn't racial discrimination, but simply that minorities tend to have weaker finances.

Yet a "landmark" 1992 study from the Boston Fed concluded that mortgage-lending discrimination was systemic.

That study was tremendously flawed - a colleague and I later showed that the data it had used contained thousands of egregious typos, such as loans with negative interest rates. Our study found no evidence of discrimination.

Yet the political agenda triumphed - with the president of the Boston Fed saying no new studies were needed, and the US comptroller of the currency seconding the motion.

No sooner had the ink dried on its discrimination study than the Boston Fed, clearly speaking for the entire Fed, produced a manual for mortgage lenders stating that: "discrimination may be observed when a lender's underwriting policies contain arbitrary or outdated criteria that effectively disqualify many urban or lower-income minority applicants."

Some of these "outdated" criteria included the size of the mortgage payment relative to income, credit history, savings history and income verification. Instead, the Boston Fed ruled that *participation in a credit-counseling program* should be taken as evidence of an applicant's ability to manage debt.

Sound crazy? You bet. Those "outdated" standards existed to limit defaults. But bank regulators *required* the loosened underwriting standards, with approval by politicians and the chattering class. A 1995 strengthening of the Community Reinvestment Act required banks to find ways to provide mortgages to their poorer communities. It also let community activists intervene at yearly bank reviews, shaking the banks down for large pots of money.

Banks that got poor reviews were punished; some saw their merger plans frustrated; others faced direct legal challenges by the Justice Department.

Flexible lending programs expanded even though they had higher default rates than loans with traditional standards. On the Web, you can still find CRA loans available via ACORN with "100 percent financing . . . no credit scores . . . undocumented income . . . even if you don't report it on your tax returns." Credit counseling is required, of course.

Ironically, an enthusiastic Fannie Mae Foundation report singled out one paragon of nondiscriminatory lending, which worked with community activists and followed "the most flexible underwriting criteria permitted." That lender's $1 billion commitment to low-income loans in 1992 had grown to $80 billion by 1999 and $600 billion by early 2003.

Who was that virtuous lender? Why - Countrywide, the nation's largest mortgage lender, recently in the headlines as it hurtled toward bankruptcy.

In an earlier newspaper story extolling the virtues of relaxed underwriting standards, Countrywide's chief executive bragged that, to approve minority applications that would otherwise be rejected "lenders have had to stretch the rules a bit." He's not bragging now.

For years, rising house prices hid the default problems since quick refinances were possible. But now that house prices have stopped rising, we can clearly see the damage caused by relaxed lending standards.

This damage was quite predictable: "After the warm and fuzzy glow of 'flexible underwriting standards' has worn off, we may discover that they are nothing more than standards that lead to bad loans . . . these policies will have done a disservice to their putative beneficiaries if . . . they are dispossessed from their homes." I wrote that, with Ted Day, in a 1998 academic article.

Sadly, we were spitting into the wind.

These days, everyone claims to favor strong lending standards. What about all those self-righteous newspapers, politicians and regulators who were intent on loosening lending standards?

As you might expect, they are now self-righteously blaming those, such as Countrywide, who did what they were told.

Stan Liebowitz is the Ashbel Smith professor of Economics in the Business School at the University of Texas at Dallas.

Mr. CONYERS. Thank you, Mr. Liebowitz.
Good afternoon, Ms. Wiggins.

TESTIMONY OF AUDREY J. WIGGINS, DIRECTOR, FAIR HOUSING AND ENVIRONMENTAL JUSTICE PROJECT, LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW

Ms. WIGGINS. Thank you, Mr. Chairman. Are you ready for me to begin now? Thank you.

I am Audrey Wiggins. I am the director of Fair Housing and Environmental Justice at the Lawyers' Committee for Civil Rights Under Law. Thanks to you, Chairperson Conyers and all the other Members of the Subcommittee, for having this important hearing on the enforcement of the Fair Housing Act at this point in history and inviting the Lawyers' Committee to participate.

I am honored to provide testimony as an advocate for those brave enough to challenge discriminatory practices that the Department of Justice and HUD have left unchecked.

The law correctly empowers individuals to bring fair housing cases, but neither the intent nor the spirit of the law requires that individuals act alone. Both DOJ and HUD have unique authority, resources and obligations to enforce the Fair Housing Act, yet communities have emerged as the private attorneys general in the enforcement of the Fair Housing Act.

I think all of us on both the panels have expressed the belief that housing choice should be free from discrimination and that no one should be denied shelter because of their race. Yet why are we at odds?

Those reasons that I believe are described more in depth in my written testimony. I wanted to briefly talk about two cases of the Lawyers' Committee.

One occurred right after Hurricane Katrina. With the backdrop of the human crisis of people trapped on the roof of their homes and jammed in municipal arenas, St. Bernard Parish in Louisiana, which borders Orleans Parish, issued an ordinance that prevented single-family homeowners from renting to anyone, with one exception: a blood relative.

According to the 2000 census, the parish population was roughly 90 percent White, and 93 percent of all those single-family homeowners who could only rent to their relatives were also White. Thus, the ordinance has a disparate impact on potential renters of color.

Although HUD did investigate some complaints, neither HUD nor DOJ took any enforcement action against this blatantly discriminatory blood-only ordinance. Instead, in cooperation with the Greater New Orleans Fair Housing Action Center and the law firm of Relman & Dane, it was the Lawyers' Committee who filed a Federal complaint against St. Bernard Parish.

You have already heard statistics about FHEO's office. In 2004 and 2005, the General Accounting Office issued reports analyzing the intake and investigation practices of FHEO. At that time, the GAO found that 39 percent of HUD matters were over 100 days old.

Our client, James Perry, who is the executive director of the Greater New Orleans Fair Housing Action Center, soon after Hurricane Katrina saw some Internet ads from individuals who wanted to house certain people to help those that were displaced. Some of the ads he saw stated, "Not racist, but white only;" "Two bedrooms, private bath, use of whole home for a white family up to five;" and, "We would prefer a middle-class white family."

As those ads were printed in a newspaper, they would no doubt be found as violations of the Fair Housing Act. And, with our assistance, Mr. Perry filed several complaints with HUD's FHEO office in December of 2005. To date, more than 2 years after his filing of these complaints, they are still pending with the FHEO office.

To wrap up, either those of us in the fair housing community are right and the Federal Government should apply its authority and full resources to ensure the breadth of the Fair Housing Act is protected and enforced in all aspects, or those from the Federal Government are right and there is no problem with the narrowing of the scope of the Fair Housing Act and the selective enforcement of its provisions. Because the Lawyers' Committee and other advocates in the fair housing community will bring the cases. So the answer is, we cannot both be right.

We urge Members of Congress, and this subcommittee in particular, to use the full force of your authority and influence to make sure that all who are protected under the Fair Housing Act are served by their Government.

We beseech you to require that the staff of the Department of Justice and HUD in this Administration and the next will fulfill their obligations under the act to investigate and litigate cases challenging race discrimination, especially cases that challenge systemic discrimination and pattern-and-practice and impact cases.

Thank you.

[The prepared statement of Ms. Wiggins follows:]

PREPARED STATEMENT OF AUDREY J. WIGGINS

TESTIMONY OF AUDREY J. WIGGINS
DIRECTOR OF FAIR HOUSING & ENVIRONMENTAL JUSTICE
LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW

UNITED STATES HOUSE OF REPRESENTATIVES
JUDICIARY SUBCOMMITTEE ON THE CONSTITUTION, CIVIL RIGHTS, AND CIVIL LIBERTIES
"ENFORCEMENT OF THE FAIR HOUSING ACT OF 1968"

June 12, 2008

I. Introduction

Good morning. I am Audrey Wiggins, Director of Fair Housing and Environmental Justice with the Lawyers' Committee for Civil Rights Under Law ("Lawyers' Committee"). I would first like to thank Chairman Nadler, Ranking Member Franks, and the members of the Subcommittee for holding this important hearing on the enforcement of the Fair Housing Act ("FHA") at this point in history, when the subprime mortgage crisis, unprecedented foreclosure rates, and limited available affordable housing on the Gulf Coast after Hurricanes Katrina and Rita make it all the more critical that housing choice be unfettered by discrimination. In particular, thank you for providing the Lawyers' Committee with the opportunity to participate in this discussion.

The Lawyers' Committee is a nonpartisan, nonprofit civil rights legal organization that has been in existence for over 40 years. It was formed in 1963 at the request of President John F. Kennedy to involve the private bar in providing legal services to address racial discrimination. The mission of the Lawyers' Committee is to secure, through the rule of law, equal justice under the law. For 45 years, the Lawyers' Committee has advanced racial and gender equality through a highly effective and comprehensive program involving educational opportunities, fair employment and business opportunities, community development, fair housing, environmental justice, and meaningful participation in the electoral process.

My testimony today addresses the failures of the U.S. Department of Justice ("DOJ") and the U.S. Department of Housing and Urban Development ("HUD") to enforce the FHA. Communities have been obligated to act as principal prosecutors of the Fair Housing Act, as a result of DOJ's de-emphasis, if not refusal, on bringing disparate impact cases based on race, failures in the complaint process of HUD's Office of Fair Housing and Equal Opportunity ("FHEO"), and a cut in funding to private and local government fair housing agencies, have burdened communities to act as principal enforcers of the Fair Housing Act. Although the law correctly empowers individuals to bring fair housing cases, the intent of the law does not require that individuals act alone. Indeed, DOJ and HUD have unique authority and resources to enforce the Fair Housing Act, particularly in investigating and litigating systemic, pattern and practice, as well as disparate impact cases. It is imperative that DOJ and HUD, in fulfilling their obligations under the FHA, apply their resources to challenge the systemic, widespread practices that contribute to housing discrimination.

The Lawyers' Committee, and its sister organizations in the fair housing community, now bridge the gap left by these government agencies. The docket of the Lawyers' Committee's Fair Housing project reflects the type of impact litigation that DOJ should join us in continuing to champion.

I am honored to provide this testimony as an advocate for those brave enough to challenge the discriminatory practices, particularly those committed by municipalities, which DOJ and HUD have left unchecked. My remarks today will primarily use Lawyers' Committee's litigation lens through which to illustrate how communities have emerged as private attorneys general in the enforcement of the Fair Housing Act. By sharing the experiences of our clients with you, I hope to call DOJ and HUD to action. I believe that these agencies can and should recommit resources to again focus on violations of the FHA that have a systemic and disparate impact on people of color and other protected classes under this law.

I am confident that members of this Subcommittee are already familiar with the statistics of the nature, number, and type of cases filed by the Housing Section of DOJ as well as the number of complaints received by FHEO. This testimony will focus on DOJ and HUD's missed opportunities to engage in disparate impact litigation based on race, findings by GAO on the effectiveness and timeliness of the FHEO complaint process, and how the lack of Fair Housing Initiatives Program ("FHIP) and Fair Housing Assistance Program ("FHAP") funding place private fair housing agencies as well as state and local housing agencies in jeopardy.

II. Deemphasis of Race-Based FHA Violations by DOJ and HUD

The FHA empowers DOJ to bring lawsuits where there is a "pattern or practice" of discrimination as well as cases involving acts of discrimination that raise "an issue of general public importance."[1] In addition, under the 1988 Amendments to the FHA, DOJ must commence a civil action in a United States district court within 30 days of HUD issuing a charge of discrimination on behalf of individual victims of discrimination if the aggrieved person elects to have the claims heard in federal court, rather than in an

[1] 42 U.S.C. § 3614.

administrative proceeding. [2] The 1988 Amendments also require HUD to refer all complaints alleging "the legality of any State or local zoning or other land use law or ordinance" to DOJ for appropriate action.[3]

DOJ is tasked to be the chief prosecutor against violators of the FHA. The agency's mandate to enforce both the letter and the spirit of housing laws is clear. Throughout this Administration, however, DOJ has placed a greater emphasis in disability-based housing discrimination cases and reduced FHA cases alleging discrimination against other protected classes under the FHA. Although combating housing discrimination based on disability is critical, DOJ should seek a more comprehensive and balanced approach to fair housing enforcement. In addition, DOJ's approach must not only focus on matters which arise out of acts of intentional discrimination, but also on those policies and practices which may be facially neutral, but have a disparate impact on the classes of people the FHA seeks to protect.

In 2003, DOJ announced at a HUD HUB Director's meeting that it will no longer pursue disparate impact cases involving housing discrimination.[4] In looking at the number and types of cases filed by DOJ in the past five years, it appears that the agency has kept its promise. Indeed, the Justice Department has filed fewer cases over the past five years than it filed during the period from 1999 to 2002. The DOJ filed 35 race-based pattern or practice cases between 1999 and 2002, but only filed 24 such cases between 2003 and 2007.[5] Similarly, while the Department filed 24 pattern or practice cases between 1999 and 2002 based on its testing program, it only filed 11 such cases between 2003 and 2007.[6] The reduction in enforcement is mirrored at HUD where the number of fair housing complaints has declined dramatically, falling from a peak of more than 6,500 cases in 1995 to less than 2,500 in 2007.[7]

The above numbers are alarming particularly in light of DOJ's well-publicized implementation of its "Operation Home Sweet Home" initiative in 2006. Per DOJ's website, Operation Home Sweet Home would target testing efforts in areas recovering from the effects of Hurricane Katrina and in areas where the disaster's victims have been relocated.[8].According to a press release issued in April 2008, DOJ "conducted more than 500 paired tests, 20 percent more than the number conducted in any other year since [...] 1991."[9]

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[2] 42 U.S.C. § 3612.
[3] 42 U.S.C. § 3610(g)(.2)©3612
[4] National Fair Housing Alliance, Dr. King's Dream Denied;: Forty Years of Failed Federal Enforcement: 58 (Apr. 2008 Fair Housing Trends) ("NFHA Report (2008) (hereinafter "NFHA 2008 Fair Housing Trends Report"), p. 58[4] NFHA's report p.58.").
[5] Id. at 57.
[6] NFHA 2008 Fair Housing Trends Report Id. at 57.
[7] NFHA 2008 Fair Housing Trends Report Id. at 51.
[8] DOJ's Fact Sheet on the Operation Home Sweet Home initiative is available at http://www.usdoj.gov/opa/pr/2006/February/06_opa_079.html
[9] DOJ, *Department of Justice Celebrates 40th Anniversary of the Fair Housing Act* (Apr. 17, 2008), available online at <http://www.usdoj.gov/opa/pr/2008/April/08_crt_314.html>,

As DOJ reduced the number of race-based disparate impact cases it filed, the number of these types of suits increased on the docket of the Lawyers' Committee. Although DOJ should be the primary enforcer of discrimination by municipalities, in the cases I will now describe, neither DOJ nor HUD used its authority or resources to challenge the violations of the FHA discussed below.

Many of us still carry the visions of people trapped on the roofs of their homes and jammed in municipal arenas, as landmarks crumbled, and thousands of homes and the families were devastated after Hurricanes Katrina and Rita hit Louisiana, Mississippi and Alabama. It was with this backdrop of human crisis not seen by our country in over a century that a Louisiana Parish issued an ordinance which prevented single-family homeowners from renting to anyone with one exception -- a blood relative. The parish I described is St. Bernard, which borders Orleans and other Louisiana parishes that were pummeled by Katrina and Rita. Its population is roughly 90 % white. In essence, this "blood only" ordinance effectively limited rentals to whites only, since whites own virtually all single-family homes in the parish. (93 % white according to 2000 census data).Thus the ordinance had a disparate impact on potential renters of color. Although HUD investigated complaints concerning this ordinance, did DOJ challenge this ordinance under its authority to combat acts of discrimination which raise "an issue of general importance? NO. Unfortunately, neither HUD nor DOJ ever took any enforcement action with respect to this blatantly discriminatory ordinance. Based upon the investigation conducted by the Greater New Orleans Fair Housing Action Center, led by James Perry, the Lawyers' Committee filed a federal court complaint against St. Bernard's Parish.[10]

DOJ has the primary authority to challenge exclusionary zoning ordinances. In addition to the St. Bernard Parish case, the Lawyers' Committee bridges the gaps left by the lack of vigorous enforcement in this area by DOJ, by bringing several cases challenging discriminatory zoning. The Lawyers' Committee filed cases against the governments of Garden City and Huntington on Long Island, New York. The Garden City case[11] challenges the city's rezoning of a large parcel of County-owned real estate to prevent the development of affordable multi-family housing disproportionately needed by African-American families in Nassau County. Garden City's rezoning perpetuates segregation in the County and continues the exclusion of virtually all minorities from Garden City by preventing the development of affordable housing which would provide integrated housing opportunities for African Americans.

At issue in the Huntington case[12] is the rezoning of the largest parcel of residential real estate remaining for development in Huntington. The Town's proposed plan would create a new zoning category to develop an upscale residential community designed

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[10] *Greater New Orleans Fair Housing Center v. St. Bernard Parish* (CV No. 06-7185 E.D. LA). A consent decree permanently enjoining an ordinance requiring that rentals only be made to blood relatives, or the "blood-only" ordinance, and requiring reporting by St. Bernard Parish concerning decisions on special use permits for home rentals was entered in resolution of this case,

[11] *ACORN, et al. v. Nassau County, et al* (05-2301 E.D.N.Y)

[12] *Fair Housing in Huntington Committee v. Town of Huntington*, (CV 02-2787 E.D.N.Y).

primarily for senior citizens. Approval of this plan will maintain the segregated housing patterns in the Town by concentrating low- and moderate-income housing in the racially impacted areas of the Town.

Although both HUD and DOJ have for years noted that the Town of Huntington lacked affordable multifamily housing, which may be in violation of federal laws, neither agency filed a complaint against the Town. For example:

- Since at least 1997, HUD has expressed concerns regarding the Town's compliance with fair housing and civil rights laws. Specifically, in 1997, HUD found that the Town still had not addressed the "problem of the lack of multifamily housing for low and moderate income persons outside of the racially-impacted urban renewal area . . ." In fact, HUD found that the Town did not appear to affirmatively further fair housing as indicated by its signed certification for Community Development Block Grant funds.[13]

- In 1998, HUD noted those same problems and directed the Town to address them. Specifically, HUD noted the Town's failure "to facilitate the construction of Matinecock Court, beyond carrying out the rezoning mandated by the Federal Court, or to support an 84 unit mixed-income project proposed by the Huntington Housing Authority, which could expand rental housing opportunities."[14]

- HUD's review of the Town's 1999 Action Plan prompted it to refer the matter to the United States Department of Justice "based upon information reflecting a possible pattern or practice of racial discrimination in violation of the Fair Housing Act."[15]

The "concerns" noted by DOJ and HUD should have turned into action. When the federal government fails to act, the burden falls on the shoulders of the communities that have been adversely impacted by those acts.

The failure to act in either the Garden City or Huntington situations reflect DOJ's restriction of its caseload only to suits where there is evidence of intentional discrimination and leaves policies with large discriminatory impacts, like Garden City and Huntington unchecked. Systemic exclusionary zoning cases, for example, frequently continue and exacerbate widespread residential segregation patterns that the FHA was designed to combat and often can be attacked only through a disparate impact theory of liability. DOJ's refusal to pursue such claims leaves a major gap in efforts to challenge zoning decisions which perpetuate residential segregation.

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[13] HUD Fair Housing and Equal Opportunity Monitoring Review of the Town of Huntington, New York at p. 20 (November 26, 1997)

[14] Letter from Joseph A. D'Agosta (HUD) to Frank P. Petrone (Huntington Town Supervisor) regarding the Town's 1998 Consolidated Plan (August 7, 1998).

[15] Letter from Joseph A. D'Agosta (HUD) to Frank P. Petrone (Huntington Town Supervisor) regarding the Town's 1999 Consolidated Plan (August 5, 1999).

HUD has demonstrated its lack of focus on allegations of racial discrimination under the FHA, and the agency has also failed to enforce nondiscrimination provisions in its programs which impact the availability of housing units to persons of color. Complainants for whom HUD has issued a charge of discrimination may elect an administrative proceeding, and have their cases heard by an Administrative Law Judge ("ALJ").[16] A development that reflects the federal government's de-emphasis on race-based fair housing cases is the absence of an ALJ to hear discrimination matters at HUD. In February 2008, HUD informed NFHA staff that it has NO ALJs to hear fair housing cases, so ALJs at other agencies must hear these matters.[17]

The Town of Smithtown, New York has a Section 8 program with enough applicants to require a waiting list. The Lawyers' Committee challenge to the Town's use of a residency preference exemplifies HUD's failure to enforce its nondiscrimination regulations.[18] For example, HUD regulation 24 C.F.R. § 982.207(b) requires that public housing authorities (PHAs) certify in their annual plans that their policies governing the eligibility, selection, admissions, and preferences for Section 8 vouchers will be carried out in conformity with civil rights laws such as the Fair Housing Act and Title VI of the Civil Rights Act of 1964. However, HUD has not taken action against the numerous PHAs whose use of residency preferences in their waitlist selection policies discriminate against minorities. In the *Vargas* case, it is alleged that Smithtown's residency preference is applied n a manner that intentionally prevents anyone who does not live or work in Smithtown from receiving a Section 8 housing voucher through Smithtown's Section 8 program, until *every* person on the waitlist who lives or works in Smithtown has received a voucher. Since Smithtown is more than 93% white, the result of Smithtown's residency preference is that Section 8 housing vouchers are effectively unavailable to minorities. It is incumbent upon HUD to enforce its nondiscrimination regulations and to ensure that HUD money is not provided to PHAs that promote segregation and exclude minorities from receiving federal government benefits.

Like the Section 8 program, HUD has also exhibited a lack of enforcement of the nondiscrimination provision of its CDBG program regulations. HUD should ensure that PHAs receiving federal CDBG dollars fulfill their obligations to affirmatively further fair housing with those funds. A lack of vigilance has required nongovernmental entities like the Lawyers' Committee and other nonprofit or public interest firms to act as private attorneys generals. A recent example of this phenomenon is the lawsuit brought by Relman and Dane, a civil rights boutique firm, against Westchester County, New York, challenging the County's practice of certifying compliance with fair housing laws without conducting any analysis of impediments to fair housing based on race. Relman was forced to bring a qui tam action on behalf of the United States for the County's false certifications to the federal government.

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[16] 42 U.S.C. § 3612.

[17] NFHA 2008 Fair Housing Trends Report ,, p.54

[18] *Vargas et al. v. Town of Smithtown.* (CV 07 5202 E.D.N.Y. Dec. 13, 2007).

Worse than HUD's lackluster enforcement of its certification requirements is its waiver of certain certification requirements following the destruction of Hurricane Katrina. One such egregious incident is HUD's approval of the Mississippi Development Authority's (MDA) proposed Port of Gulfport Restoration Program (Port proposal) that would divert $600 million dollars of the CDBG money previously allocated to housing assistance to restoration of the Port. The Port proposal is the most recent and most troubling example of several requests from MDA to HUD to waive the CDBG program's requirement that funds benefit low- and moderate-income persons seeking to recover from Hurricane Katrina. The Lawyers' Committee, in conjunction with its affiliate, the Mississippi Center for Justice, has filed comments in opposition to waivers sought from this requirement and to the diversion of CDBG funds desperately needed for provision of affordable rental housing that allowed revitalization of the port. Oddly, former HUD secretary Alphonso Jackson testified in a Congressional hearing on March 11, 2008, that he felt that he had no choice but to approve the waiver. He went on to state that if he had a choice he would not have approved the waiver. Surely the Housing and Community Development Act of 1974 does not require HUD to be a rubber stamp to states who want to use its dollars for something other than the development of fair housing units.

Under the special appropriation after Hurricanes Katrina and Rita, "the aggregate use of CDBG disaster recovery funds shall principally benefit low- and moderate-income families in a manner that ensures that at least 50 percent of the amount is expended for activities that benefit such persons."[19] The 50% requirement can only be waived if there is a "finding of compelling need."[20] HUD has already approved several requests by Mississippi to waive this requirement, claiming three prior waivers in other redevelopment plans based on State commitments that the needs of the low- and moderate-income population would be addressed in the future, and assertions that, when all the CDBG-funded programs have been offered, low- and moderate-income participation will have been significant. Indeed each HUD waiver includes almost identical language about these commitments. Yet, as each waiver was granted, Mississippi strayed further from its promise and from the primary purpose of the CDBG grant program. Now, after all these proposals have been submitted, 80% of the Mississippi CDBG allocation has been granted waivers from the 50% requirement.

In the Port proposal, the State strays even further from the primary purpose of the CDBG appropriation by seeking approval of the *diversion* of funds allocated to housing recovery to a non-housing project that will do nothing to address the housing crisis, and little to benefit low- and moderate-income persons.[21]

Under the Housing and Community Development Act of 1974, that recipients of Community Development Block Grants must prepare an Analysis of Impediments (AI) to

[19] 71 Fed. Reg. 7666, 7671 at ¶ 20(i) (2).
[20] Pub. L. No. 109-148, 119 Stat. 2780 (Dec. 31, 2005).
[21] Only about 11% of the Port's employees are low or moderate income persons. Mississippi claims that it will be able to hire new employees who will be 50% low and moderate income but does not explain how they will do this.

Fair Housing within their respective jurisdictions. However, estimates indicate that fewer than 10% of the CDBG entitlement jurisdictions have programs to address fair housing concerns. In addition, many jurisdictions fail to update their AIs when conditions in their communities change, to initially submit adequate AIs, or to address the issues that their AIs highlight. This gross lack of compliance with the Housing and Community Development Act's statutory requirement continues to exist because thirty-four years after its passage, HUD has yet to promulgate regulations to enforce compliance with this provision of the law.[22]

II. Inadequacies of FHEO's Complaint Process

In 2004 and 2005, the General Accounting Office issued reports analyzing the intake and investigation practices of HUD's FHEO office.[23] These reports were prompted by continued concerns about the timeliness and effectiveness of HUD's enforcement process, particularly in the 100-day investigation window mandated by the FHA. Analyzing data from 1996 to 2003, the GAO found that 39% of HUD's open investigations were over 100 days old.[24] HUD has taken an average of over 470 days to close cases.[25]

FHEO uses an automated tracking system to record contacts dealing with fair housing inquiries or intakes. FHEO analysts are supposed to interview each complainant to obtain any additional information necessary to perfect the claim and then determine if the office has jurisdiction over the complaint.

In its 2004 report, of the six recommendations GAO made to improve the management and oversight of the fair housing enforcement process,[26] GAO made only one primary request for inclusion in HUD's five-year Departmental Workforce Plan. Specifically, GAO recommended that in creating the plan "HUD fully consider a wide range of strategies to make certain that FHEO obtains and maximizes the necessary skills and competencies needed to achieve its current and emerging mission and strategic goals with the resources it can reasonably expect to be available."[27]

In its 2005 report, GAO again made several recommendations. Specifically, GAO recommended that "the HUD Secretary direct the Assistant Secretary of FHEO

[22] NFHA 2008 Fair Housing Trends Report, Id. at 36.
[23] U.S. Gov't. Accountability Office, Publ'n No. GAO-04-463, Opportunities to Improve HUD's Oversight and Management of the Enforcement Process (April 2004), *available at* http://www.gao.gov/cgi-bin/getrpt?GAO-04-463 ("GAO Report 1"); U.S. Gov't. Accountability Office, Publ'n No. GAO-06-79, HUD Needs Better Assurance That Intake and Investigative Processes Are Consistently Thorough (October 2005), *available at* http://www.gao.gov/cgi-bin/getrpt?GAO-06-79[hereinafter "GAO (Report 2")..
[24] GAO Report 1, *supra*, note 23 at 1.
[25] Residential Segregation and Housing Discrimination in the United States, Violations of the International Convention on the Elimination of All Forms of Racial Discrimination; A Response to the 2007 Periodic Report of the United States of America, Report to the Committee on the Elimination of Racial Discrimination (2008) ("Report to CERD") p., 20.
[26] GAO Report 1, *supra*, note 23 at 57.
[27] GAO Report 1, *supra*, note 23 at 58.

to...[establish] documentation standards and appropriate controls to ensure that required notifications...are made and received, and that the 100-day letters are sent before an investigation has reached 100 days," and "[work] with FHAP agencies and others to develop best practices for offering conciliation throughout the complaint process, including at its outset...[and ensure] that investigators comply with requirements to document conciliation attempts, and complainants' or respondents' declination of conciliation assistance."[28] Even with these recommendations, problems with the FHEO complaint process are ongoing.

To illustrate this point, I want to share the story of one of our clients who filed a complaint with HUD shortly after Hurricanes Katrina and Rita. James Perry, executive director of Greater New Orleans Fair Housing Action Coalition, found what he believed to be discriminatory advertising of housing on an internet site where individuals offered space to people displaced by the hurricanes. The ads he saw agreed to house only certain people. For instance: "not racist but white only," "2 bedrooms, pvt bath, use of whole home, for white family of up to 5" and "[w]e would prefer a middle class white family."

If those words were printed in a newspaper, they would be a clear violation of Section 804(c) of the Fair Housing Act which prohibits notices, statements or advertising with respect to the sale or rental of housing "which indicates any preference, limitation or discrimination based on race, color, religion, sex, handicap, familial status, or national origin. . . ."[29] Mr. Perry, with the assistance of the Lawyers' Committee, filed several complaints with HUD about these ads in December, 2005. To date, more than two years later, Mr. Perry's complaint is still pending with FHEO.

IV. Lack of Funding Equals Lack of Enforcement

Declining budgets, a shrinking enforcement capacity and an increasingly narrow scope of enforcement are especially alarming in light of the increased need for a watchdog in the Gulf Coast as communities recover from Hurricane Katrina, as well as in other parts of the country where the biases implicit in racial hostilities reveal themselves through the exclusion of multi-family housing in municipal zoning, steering practices, and the apparent disparate impact of the policies and practices of certain lenders. For example, although the budget for FHEO has increased since 2000, these increases have not kept pace with inflation.[30]

HUD's FHIP Funding for the grant program which funds private fair housing entities, has remained relatively stagnant in nominal terms and consequently, has declined in real dollars over recent years after declining substantially from a height of

[28] GAO Report 2, *supra*, note 23 at 73.

[29] 42 U.S.C. § 3604.

[30] The Report to Cerd, 22.

$26 million in 1995.[31] As a result, nearly a quarter of Fair Housing organizations have either been forced to scale back their enforcement activities or to close altogether.[32]

In this year's budget, a cut of $1 million is proposed for state and local housing agencies funded through the Fair Housing Assistance Program, which is incredibly severe, given that agencies funded by FHIP and FHAP filed 91% of all fair housing complaints in 2007.[33] As DOJ and HUD focus their resources away from race based impact litigation, the worst thing that could happen is for communities to have the advocates they know and trust stripped of any ability to wage war against discrimination. Alarmingly, while the amount of race-based systemic litigation filed by DOJ is decreasing and the number of race-based cases processed by HUD is falling, one quarter of all fair housing centers throughout the country have either closed or are at risk.[34]

V. Implications of Ledbetter

The Lawyers' Committee has been on the forefront of advocating for a fix to the U.S. Supreme Court decision in *Ledbetter v. Goodyear Tire & Rubber Co., Inc.*[35] Although *Ledbetter* is a case examining the statute of limitations period for an employment discrimination case, the application of the Court's holding is now impacting how the statute of limitations periods in fair housing and fair lending matters is interpreted. The question facing the Court was whether each discriminatory paycheck received by Lilly Ledbetter from Goodyear constituted an unlawful employment practice, thus triggering the 180-day EEOC charging period, or if Ms. Ledbetter was limited to filing her Title VII sex discrimination claim within 180 days of Goodyear's initial discriminatory conduct. In a 5-4 decision, the Supreme Court found in favor of Goodyear, holding that the EEOC charging period for Title VII claims is triggered when a discrete, discriminatory act takes place.[36] The charging period does not reset after every subsequent act that results from the past discrimination.[37]

As Justice Ruth Bader Ginsburg pointed out in dissent, the *Ledbetter* decision nearly foreclosed pay discrimination challenges under Title VII because employees will rarely be able to detect pay-based discrimination within 180 days of an initial, discriminatory decision.[38] In response to *Ledbetter*, Representative George Miller (D-CA) introduced the Lilly Ledbetter Fair Pay Act,[39] to reverse the Supreme Court's severe interpretation. The Act would unambiguously allow plaintiffs to file Title VII claims with

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[31] This discussion is based on annual dollar amounts equaling the total annual FHIP appropriations less any earmarks within said appropriations that are designated for non-enforcement activities such as research. Id. at 60.
[32] NFHA 2008 Fair Housing Trends Report, p.61.
[33] National Urban League Policy Institute Housing Discrimination Fact Sheet, p. 2. Available at www.nul.org/policyinstitute.html.
[34] NFHA 2008 Fair Housing Trends Report, p.61
[35] 127 S.Ct. 2162 (2007).
[36] *Ledbetter*, 127 S.Ct. at 2169.
[37] *Id.*
[38] *Ledbetter*, 127 S.Ct. at 2178-79, 2181-82 (Ginsburg, J., dissenting).
[39] H.R. 2831.

the EEOC within 180 days of a discriminatory paycheck. The bill was passed by the House of Representatives in July 2007, but has not passed in the Senate. Without further legislative action, there is a threat that *Ledbetter* could be further perverted to reach fair housing and lending cases, severely limiting the ability of plaintiffs to challenge discriminatory conduct in the housing context.

The application of the *Ledbetter* rule to fair housing and fair lending cases would frustrate existing precedent that allows plaintiffs to challenge "continuing violations" of the FHA. For over 25 years, the U.S. Supreme Court has recognized that some housing practices involve a pattern, rather than specific incidents, of discrimination. For these continuing violations, the limitation period begins fresh with each wrong.[40]

In an en banc Ninth Circuit Court of Appeals decision issued just last month, the court applied the *Ledbetter* doctrine in the area of design and construction. In *Garcia v. Brockway*, the Ninth Circuit held that the FHA statute of limitations starts to run upon completion of design and construction of a non-complying building, rather than at the time the disabled individuals rent the inaccessible unit.[41] The Ninth Circuit's opinion demonstrates the confusion that lower courts are likely to face if they feel compelled to consider *Ledbetter* in fair housing disputes that have typically been governed under the continuing violation doctrine. Citing *Ledbetter*, the Ninth Circuit unconvincingly attempted to explain why the failure to design and construct accessible dwellings was a discrete, rather than continuous violation. The Court reasoned that "[p]laintiffs and HUD confuse a continuing violation with the continuing effects of a past violation ... Here, the practice is "a failure to design and construct," which is not an indefinitely continuing practice, but a discrete instance of discrimination ...."[42]

As Judge Pregerson pointed out in the dissent, holding that these design and construction violations represent continuing violations of the law and rejecting *Ledbetter* would be more aligned with the breadth and purpose of the FHA, which is to ensure that disabled individuals have equal access to multifamily housing.[43] In short, this case is illustrative of the challenges that lower courts are likely to face, unless Congress takes action to prevent *Ledbetter* from being used to limit the rights of fair housing plaintiffs.

The continuing violation doctrine has been applied to fair lending challenges.[44] The *Ledbetter* decision, along with subsequent rulings like the *Garcia* decision described above, might endanger the standing of those who fell prey to predatory lenders.

Like pay discrimination, fair housing and fair lending violations are often incredibly difficult to detect,[45] which would make the *Ledbetter* rule of a short challenging period very destructive. In the fair lending area, given that most mortgage

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[40] *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 102 S.Ct. 1114 (1982).
[41] *Garcia v. Brockway*, 2008 U.S. APP. LEXIS 10258 (9th Cir. 2008).
[42] Id. at *12.
[43] Id. at *27 (Pregerson, J., dissenting).
[44] *Ramirez v. GreenPoint Mortgage Funding, Inc.*, 2008 WL 2051018 (N.D. Cal. 2008).
[45] See, for example, Kathleen C. Engel, *Moving Up the Residential Hierarchy: A New Remedy for an Old Injury Arising from Housing Discrimination*, 77 Wash. U. L. Q. 1153, 1191-95 (1999).

loans run for fifteen- or thirty-year terms, it would be illogical to allow any further narrowing of a complainant's window of opportunity to challenge discriminatory treatment.

V. Why are we at odds?

I am sure that each witness you hear from today will tell you that they believe housing choice free from discrimination is fundamental to equal opportunity and a fair society. I am sure we would all tell you that whether you are Asian American in Gulfport, Mississippi, African American in Detroit, Michigan, Hispanic in Gary, Indiana or any other person of color, no one should deny you a housing unit because of your race. Then why are housing advocates and the government agencies empowered to enforce the FHA at odds?

Why is it that housing advocates want to safeguard the broad protections afforded by the FHA, while DOJ and HUD do not oppose measures and interpretations of the FHA that would narrow its scope? A growing trend, in certain district courts and two Circuit Courts of Appeals, is to reject allegations of FHA violations which occur after the completion of the rental contract or sales contract of a housing unit.[46] These rulings contravene 30 years of court precedent and HUD regulations, but it has been the Lawyers' Committee and other members of the fair housing community that have been at the forefront of challenging these attacks on the fair housing act with no participation by the federal government in defending the reach of its own regulations

Why are housing advocates sounding the alarm as to the extension of the *Ledbetter* ruling to fair housing and fair lending cases? As the enforcers of the FHA, DOJ and HUD should be participating in cases like *Garcia v. Brockway* to advocate that fair housing complainants not be stripped of their right to file a claim under a continuing violation theory. Yet, again the government played no role in this important fair housing case.

If we all agree that race should not be a barrier to fair housing, then DOJ and HUD should be a partner with the fair housing community, not an adversary.

VI. Conclusion

Either those of us in the fair housing community are right and the federal government should apply its authority and resources to ensure that the breadth of the FHA is protected and enforced in all its aspects or, DOJ and HUD are right and there is no problem with narrowing the scope of the FHA, and selectively enforcing certain provisions of the Act, because the Lawyers' Committee and other advocates will bring these cases. We cannot both be right.

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[46] *Cox v. City of Dallas,* 430 F.3d 734 (5th Cir. 2005), *cert. den.* 126 S. Ct 2037 (2007); *Halprin v. Prairie Single Family Homes,* 388 F.3d 327 (7th Cir. 2004).

We urge you, members of Congress and this Subcommittee in particular, to use the full force of your authority and influence to ensure that all who are protected under the FHA are served by their government. We beseech you to require that the staff of DOJ and HUD in this administration and the next fulfill their obligations under the FHA to investigate and litigate cases challenging race discrimination in housing – especially cases under a disparate impact theory.

Thank you for your demonstration of wisdom in passing the *Ledbetter Fair Pay Act,* and I hope your colleagues in the Senate will follow suit. Please continue the good work you began by ensuring that the U.S. Supreme Court's analysis is not applied to fair housing and fair lending cases.

It is imperative that all of us do what is within our control and influence to dismantle patterns, practices and policies that discriminate against communities of color. This methodology of challenging discrimination is the critical path to eliminating systemic forms of racism. The failure of DOJ and HUD to engage in this battle adversely impacts neighborhoods, schools, and employers. Tragically, the absence of DOJ and HUD from these battles embolden those allow many engaging in a pattern or practice of discrimination because they have the luxury to do so with impunity.

Mr. Chairman and members of the Committee, thank you again for the opportunity to testify on this important subject. I look forward to answering any questions from the Committee.

Mr. CONYERS. Thank you very much, Attorney Wiggins.
Ms. Smith, are you ready to roll?

TESTIMONY OF SHANNA L. SMITH, PRESIDENT AND CEO, NATIONAL FAIR HOUSING ALLIANCE

Ms. SMITH. Yes, Mr. Chairman. I am going to reserve 1 minute at the end to show a public service announcement. Thank you for the invitation to come here.

Listening to the questions that arose—we were talking about the 3.7 million and what are we going to do about it—I want to announce that the National Fair Housing Alliance, the Leadership Conference on Civil Rights, the NAACP Legal Defense Fund, and the Lawyers' Committee for Civil Rights Under Law has formed the commission; it is called the National Commission on Fair Housing and Equal Opportunity.

It is being chaired by former secretaries Jack Kemp and Henry Cisneros. We will be having four hearings across the country to talk about what are the problems, what are the issues, what can we do to make the enforcement of the Fair Housing Act an actual reality. And we will be presenting that report in December to your Committee and to the new Administration.

The purpose of my testimony is to talk about the failure of enforcement at HUD and the Department of Justice. As we all know, the Fair Housing Act had two purposes. The first was to eliminate housing discrimination; the second, to promote residential integration throughout the country.

And 10 years ago I testified before this Committee, and I implored the Committee to give the Department of Justice money for its testimony program, because testing is so critical to uncovering not just the individual cases of discrimination, but the pattern and practice, the large, systemic, institutionalized practices in this country.

The department has been doing a good job when it comes to sexual harassment in housing cases. I applaud them for that. They have done some pretty good design and construction cases.

The failure is in the rental market, the sales market, the lending market, and the insurance market. While they have been doing rental cases, they have not focused on the major, large rental management companies in the United States.

In fact, after Katrina, we were able to do testing and identified the largest rental management company in the Southeast that engaged in discrimination. We filed complaints with HUD, and that one complaint that we filed in December of 2005 has been conciliated. All the other Katrina complaints we filed with HUD remain open.

In the Department of Justice, when I think of their testing program, I would suggest to the Committee to talk to present and former employees of the Department of Justice, because I have heard that the testing is moving forward, that they have produced pretty good evidence, but they have not received authorization to file those cases.

The testing program is incredibly valuable, but it must be used in mortgage lending. The Department of Justice could actually test through the whole mortgage-lending process and get to where the discrimination, particularly in the subprime and predatory market occurs, and that is at closing. I can't do that testing, because if we fill it out, it says it is a felony if we do this on the mortgage loan application.

So at Justice we need to get them to do testing that is totally focused on the systemic issues. They should be testing the largest real estate companies in this country. They should be testing the largest mortgage lenders and subprime lenders. And they should be looking at the homeowners' insurance issue.

Now, to HUD. On the age of cases, for me, it is just ridiculous that any of HUD's cases should be aged. The majority of their cases are rental cases, and, with all due respect, a rental case is not, you know, brain surgery. It is going in to see if an apartment was available or it wasn't available at the time that the person applied for it.

One of the problems is that we have 10 little HUDs all over the country. We have a court decision in the 2nd Circuit saying, you know, how can one HUD say this, sub-office, and how can the other division of HUD say something else?

And, finally, we were talking about why the number is so low. Two big reasons: HUD did its own survey that said people have no confidence in filing a complaint with the Federal Government of housing discrimination. The second is the failure to do media campaigns, appropriate media campaigns.

And the commercial you are going to see now is something we produced in 2003. HUD failed to fund its national media campaign in 2005 and 2006. And what you saw that Assistant Secretary Kendrick showed you is their current ad campaign. And I just want you to compare the ad campaigns, because the ad campaigns are supposed to have a call to action and motivate people to file complaints.

(Video played.)

Ms. SMITH. My time is up, but I wanted you to see that, because HUD tried to block us issuing this, even though they paid for the campaign. They ordered us to remove their name from the spot.

When we had a meeting with Kim Kendrick when she was assistant to Secretary Jackson in the Office of Public Affairs—the FHEO office had supported this commercial, and the Ad Council helped us develop it. The Office of Public Affairs said, "This commercial will offend lenders."

And Kim Kendrick said she didn't think her grandmother would understand it, and required us to do more focus group testing and required us—we already had 5,000 of it ready to go out to all the TV stations and radio stations and print ads all across the U.S.—made us remove their name and their phone number from the print campaign.

And then, subsequent to that, they didn't continue the national media campaign that should have been the follow-up to this and help people avoid predatory lending.

[The prepared statement of Ms. Smith follows:]

PREPARED STATEMENT OF SHANNA L. SMITH

Testimony of
Shanna L. Smith, President and CEO
National Fair Housing Alliance

Before the United States House Judiciary Committee
Subcommittee on the Constitution, Civil Rights and Civil Liberties
Hearing on the Enforcement of the Fair Housing Act of 1968
June 12, 2008

Members of the Committee, my name is Shanna Smith, and I am the President and CEO of the National Fair Housing Alliance (NFHA) located in Washington, DC. I have been NFHA since its founding in 1988. Previously, I was the Executive Director of the Toledo Fair Housing Center for fifteen years. Thank you for inviting me to speak with you today.

Founded in 1988 and headquartered in Washington, DC, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Through comprehensive education, advocacy and enforcement programs, NFHA protects and promotes equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

The members of the Alliance are dedicated to working to develop and implement strategies to reduce, and eventually eliminate, racially, ethnically and economically segregated housing patterns and to make all housing accessible regardless of race, color, religion, sex, familial status, disability or national origin. Since 1990, the Alliance has focused on developing investigative tools in the areas of discriminatory sales, lending and homeowners insurance practices. NFHA has shared with its membership as well as staff of federal, state and local governmental enforcement bodies the techniques used to investigate and test complaints in these areas. Additionally, the Alliance remains committed to providing programs that focus on prevention of discriminatory conduct and will continue to work with members of the housing, lending and insurance industry to provide education and outreach, guidance and self-testing programs.

The purpose of this testimony is to comment on the implementation of the fair housing enforcement programs of the U.S. Departments of Justice and Housing and Urban Development (HUD) and make recommendations that will help further fair housing compliance and promote residential integration in the United States.

Lack of enforcement of fair housing laws is the main cause of the mismatch between the high incidence of housing discrimination and the low incidence of complaints of housing discrimination. Landlords, real estate agents, lenders, insurance agents and others have limited fear of getting caught in the act of discriminating simply because neither the federal, state nor local governments have made fair housing enforcement a priority. Even those who are prosecuted often pay such a small penalty that discrimination becomes just another cost of doing business. As a result, housing providers continue to discriminate and our country remains highly segregated.

The Fair Housing Act, passed by Congress 40 years ago, stated that "It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the country."

The Fair Housing Act has two purposes as outlined in the law, legislative history and discussed by the U.S. Supreme Court in its decision in the 1972 case *Trafficante v Metropolitan Life*.

1. to eliminate housing discrimination in the United States, and
2. to promote residential integration.

We are not yet there as a nation – and we need real changes in fair housing enforcement to ever get there. This is why the National Fair Housing Alliance, the Leadership Conference on Civil Rights Education Fund (LCCREF), Lawyers' Committee for Civil Rights Under Law (LCCRUL) and the NAACP Legal Defense Fund have created the National Commission on Fair Housing and Equal Opportunity to conduct four regional hearings across the country this year that will gather testimony, research, data and information on fair housing enforcement and the persistence of residential segregation forty years after the passage of the Fair Housing Act. The Commission will be chaired by former HUD Secretaries Jack Kemp and Henry Cisneros. The Commission will culminate in a report at the end of the year that outlines the recommendations on how we can move forward together to meet the goals of the Fair Housing Act.

JUSTICE DEPARTMENT'S DWINDLING INVOLVEMENT IN FAIR HOUSING ENFORCEMENT

Ten years ago on July 17, 1998, I testified before this subcommittee about ways in which the Justice Department could increase its fair housing enforcement. I had excellent examples of the work that Justice was doing to litigate mortgage lending and real estate sales and bring sexual harassment cases against landlords. While the Reagan Justice Department refused to accept that sexual harassment in housing was a violation of the Fair Housing Act, beginning in 1993 Justice not only investigated these complaints, but secured relief for victims and insured that these landlords would never come into contact with female tenants or their children. Justice continues to work to protect women and children against sexual harassment by landlords. We can also credit Justice for bringing some rental discrimination cases, doing a pretty good job of investigating and resolving through consent decrees design and construction cases and the Department does very good work on sexual harassment in housing cases. By it has failed to address race and national origin issues in sales, lending and insurance.

DOJ Filed Only 35 Cases in 2007

The Department of Justice has filed fewer fair housing cases in the past two years than in previous years. DOJ filed 35 fair housing cases in 2007 and 31 cases in 2006, compared to 42 in 2005, and down from 53 in 2001. The number of cases filed each year since 2003 is significantly lower than the number of cases filed from 1999-2002.

Total DOJ Cases Filed by Year								
FY99	**FY00**	**FY01**	**FY02**	**FY03**	**FY04**	**FY05**	**FY06**	**FY07**
48	45	53	49	29	38	42	31	35

DOJ's Fair Housing Authority and Mandate

Segregation and discrimination in America are so systematic and so widespread that nothing short of major institutional solutions will do. Indeed, this was the perspective of the Fair Housing Act and its 1988 Amendments, and these pieces of legislation place much authority and responsibility in the hands of the Department of Justice. DOJ is the principal legal authority tasked with enforcing federal fair housing laws, and it has both a clear mandate and wide discretion with respect to fair housing enforcement.

The 1968 Fair Housing Act gave DOJ the authority to prosecute cases involving a "pattern or practice" of housing discrimination, as well as cases involving acts of discrimination that raise "an issue of general public importance." As LCCREF's report *Long Road to Justice* documents, the Civil Rights Division of DOJ used this authority successfully to secure negotiated consent decrees and to challenge discriminatory zoning ordinances in court. One such zoning case involving the city of Black Jack, Missouri, resulted in the court's ruling that an ordinance needn't be intentionally discriminatory to violate the Fair Housing Act. According to the court, "Effect, and not motivation, is the touchstone, in part because clever men may easily conceal their motivation, but more importantly, because...whatever our law was once,...we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme."[1] The authority to prosecute such cases involving "disparate impact" is an important and powerful tool, one that ought to be used vigorously to combat the discrimination that exists today in the housing and lending markets.

In addition to these tools, the Fair Housing Amendments Act of 1988 added to DOJ's fair housing authority and responsibilities. When, after investigation, HUD issues a Charge of Discrimination in response to a fair housing complaint, the complainant or respondent may elect to have the claims asserted either in an administrative proceeding *or* in federal court. If the latter is elected, DOJ "shall commence and maintain, a civil action on behalf of the aggrieved person in a United States district court" on behalf of the aggrieved person within 30 days.[2] The 1988 Amendments also require HUD to refer to DOJ all matters involving alleged fair housing violations by any state or local zoning or land-use laws, and the Attorney General now has authority to initiate civil lawsuits in response to these referrals.[3] DOJ is also permitted to seek monetary relief in "pattern or practice" cases ($50,000 for a first violation and up to $100,000 for subsequent violations).[4]

Finally, the Civil Rights Division of DOJ has the authority to establish fair housing testing programs, which it first did in 1991. The division also subsequently established a fair lending

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[1] *United States v. City of Black Jack*, 508 F2nd 1179, 1184-86 (8th Cir. 1975). See the discussion in *Long Road to Justice*, The Leadership Conference on Civil Rights Education Fund, Sept. 2007. Available at reclaimcivilrights.org.

[2] 42 U.S.C. 3612.

[3] See Bill Lann Lee, "An Issue of Public Importance," in *Cityscape: A Journal of Policy Development and Research*, v. 4, n. 3 (1999), pp. 35-56, p. 47n17.

[4] Ibid., p. 37.

program designed to challenge discriminatory lending mortgage practices and to educate lenders of their obligations under the Fair Housing Act and Amendments.

DOJ's Recent Record

As documented above, the Department of Justice has filed fewer fair housing cases during the past two years than in previous years. DOJ filed 35 fair housing cases in 2007 and 31 fair housing cases in 2006, compared to 42 in 2005, and down from 53 in 2001. While we do not dispute that DOJ has filed several cases with important outcomes, the decline in the number of cases and the failure to focus on patterns that contribute to segregated living in this nation merit serious concern.

The Department provided to NFHA data for Fiscal Years 1999-2007. The data reveal some disturbing trends:

- In the four years 1999-2002, DOJ brought 195 cases; in the five years 2003-2007, DOJ brought 175 cases.
- In the four years 1999-2002, DOJ brought 35 pattern and practice cases based on race; in the five years 2003-2007, DOJ brought 24 pattern and practice cases based on race.
- In the four years 1999-2002, DOJ filed 24 pattern and practice cases based on its testing program; in the five years 2003-2007, DOJ filed 11 pattern and practice cases based on its testing program.
- In the four years 1999-2002, DOJ filed 15 *amicus curiae* briefs; in the five years 2003-2007, DOJ filed 3 *amicus* briefs.

One reason for the decline in filed cases may be that DOJ has recently taken the stance that it is not required to file "election" cases from HUD, insisting that it may instead perform additional investigations, thereby duplicating HUD's activities and prolonging the process. One example occurred in Chicago where DOJ refused to file a federal suit after HUD referred an election case, even in spite of intervention by a Congressional representative. The case eventually settled – but the DOJ's actions served to undercut the relief provided to the complainants in the case.

Another significant problem is DOJ's refusal to prosecute disparate impact cases. In 2003, DOJ announced that it would no longer file disparate impact cases involving housing discrimination.[5] The federal government is often the only entity with the capacity to investigate and litigate such fair housing complaints. Disparate impact cases are crucial in the fight against housing discrimination. As the courts emphasized in permitting disparate impact cases in the first place, many rental, sales, insurance, and related policies are not discriminatory on their face, but have a disparate impact that is at odds with the purpose of fair housing legislation. Recent examples of proposed ordinances and laws that have prima facie disparate impact include (1) placing a limit on the number of persons per bedroom, which has a disparate impact against families with children, and (2) imposing a minimum loan or insurance amount, which has a disparate impact against properties in minority neighborhoods.

[5] HUD HUB Directors' meeting (Rhode Island, 2003).

In the realm of mortgage lending, the Civil Rights Division failed to recognize and combat the deleterious and discriminatory effects of practices within the subprime market. It also did little to induce or require conventional lenders to operate within minority communities. Although it brought a series of successful, high-profile lawsuits against mortgage lenders engaged in "pattern or practice" discrimination in the 1990s, DOJ has prosecuted only a handful of new lending discrimination cases since 2000, despite the significant discriminatory predatory lending that has been going on throughout the past several years.

Moreover, despite continuing indications of redlining in the homeowners insurance industry, the Division has missed several opportunities to confront the discrimination directly and to correct underlying practices. Aside from two cases in the mid 1990s against the insurance companies Nationwide and American Family, the Division has missed the opportunity to take enforcement efforts in this area, leaving it to the private fair housing groups and their lawyers. One suit brought against Nationwide by Housing Opportunities Made Equal in Richmond, Virginia, was instigated by the housing group's dissatisfaction at the Housing Division's settlement with Nationwide. The subsequent suit resulted in the largest jury verdict ever in a Fair Housing Act case – over $100 million dollars.

Mortgage Lending Investigation at the Justice Department

When I testified in 1998, I applauded the ground breaking work of the Justice Department in mortgage lending:

- 1992 consent decree with Decatur Federal Savings Loan brought to light redlining on a massive scale and exposed how subprime lenders provided the only loan option for African American borrowers. Justice created maps showing that mortgage loans were indeed being made in Atlanta's moderate, middle and high income African-American neighborhoods, illustrating there was a market for conventional or prime loans.
- 1994 settlement with Chevy Chase Bank/B.Saul Mortgage illustrated that redlining was a serious problem in the nation's capital. The consent decree included important affirmative marketing programs and a commitment to make loans and open branches in Black neighborhoods. While fair housing and community groups applauded the consent decree, members of the banking industry strongly criticized the Department saying it had overstepped its bounds.
- 1996 Long Beach Bank was Justice's first official predatory lending settlement which put the subprime industry on notice that charging higher rates and fees to women and people of color was illegal. This case made it clear that whether or not the bank engaged in such practices or purchased loans from brokers that included predatory schemes, the bank would be liable.

In the late 1980s and early 1990s, Justice assumed its leadership role by taking on the complex lending cases that previously were pioneered by fair housing centers in Cincinnati and Toledo, Ohio. The Toledo Fair Housing Center, where I was executive director before coming to Washington, brought the first fair lending case in 1988 against a private mortgage insurance company for denying insurance based on the age and value of the home. We had been prepared for protracted litigation when the Justice Department weighed in 1989 by telling the parties that it was preparing an amicus brief in support of the plaintiffs, affirming that the Fair Housing Act did cover private mortgage insurance. Just the inquiry by Justice into the case bought the defendants to the table and resulted in a settlement that required the company to eliminate its discriminatory lending practices.

Yet today, in the face of countless studies demonstrating the targeting of minority homebuyers by unscrupulous lenders, Department of Justice reported resolving four fair lending cases in 2007, three of which involved auto financing. Compare this to the 1,245 complaints processed by private fair housing groups in 2007. This is a very sad commentary –historically the Department did excellent work in mortgage lending. In 1995, when Justice brought the Long Beach Bank case, it learned about the practices within the subprime market. And the complaints resolved in Grand Rapids, Chicago, and Gary between 2002 and 2006 are especially important because they included appropriate affirmative relief. (Please note that these investigations were initiated in the 1990s.) We have to wonder why the Department did not investigate Countrywide Financial or New Century or Argent—the largest subprime lenders.

Questions for Justice on Mortgage Lending: When we examine the foreclosure crisis in America, we can identify policies and practices by many lenders, appraisers, and real estate agents and Wall Street that assured people would lose their homes. So the question is "Where was the Justice Department when civil rights advocates and consumer advocates identified the institutional players?"

Testing Program at the Justice Department

In 1998, I asked this subcommittee for more money for Justice to expand its testing program into real estate sales practices and homeowners insurance companies underwriting issues. I noted the very important role Justice played in an important sales case against the largest real estate broker in Alabama (*Debra Byrd and Patricia Humes v. First Real Estate Corporation of Alabama et al.*).

I was certain in 1998 that more resources for testing and staff for the Department's Housing and Civil Enforcement Section would result in important investigations and litigation that challenge the systems of discrimination blocking equal access to apartments, homes, loans and insurance.

The private fair housing movement has historically been in the forefront of identifying, testing, and litigating fair housing complaints; however, in 1990 several pattern and practice complaints alleging discriminatory rental procedures were referred to the Justice Department. The referral of cases to the Department is significant because between 1980 and 1989 there was virtually no cooperation between the Department and private, non-profit fair housing organizations on matters under investigation or litigation by fair housing organizations. There are several reasons the fair housing groups began to cooperate with the Department and to provide information and case referrals. The first reason was a commitment from the Assistant Attorney General for Civil Rights and the Chief of the Housing and Civil Enforcement Section of the Civil Rights Division to become fully engaged in fair housing litigation as authorized under the Fair Housing

Amendments Act of 1988. The most important reasons, however, were the way Justice handled the initial cases referred to it and its commitment to seek funding for a testing program.

However, for the past seven years we have seen little or no evidence that the testing program has resulted in investigations and litigation involving discriminatory polices or practices by real estate sales companies, mortgage lenders, mortgage brokers, appraisers, or homeowners insurance companies. In fact, the Department's website says that over the thirteen years, the testing program resulted in 79 cases. According to the website's numbers and other Justice documents, 60 out of the 79 cases were brought before 2001.

This Committee should ask the Justice Department how many tests have been conducted and in what area: rental, sales, lending and/or insurance. The career staff at the Department's Housing and Civil Enforcement Section are dedicated to fair housing enforcement; however, after finding out how many tests have been completed since 2000, the follow up question is "Has the Department failed to authorize the filing of fair housing complaints?"

Questions for Justice on Its Testing Program: Did the Department stifle testing in mortgage lending to combat predatory practices? Wall Street investors paid a premium to lenders/brokers for ARMs. Everyone knows that ARMs were originally created for niche market: people with incomes that rise rapidly living in neighborhoods where homes have steady appreciation. The option ARM, 2/28 and 3/27 ARMS, and interest only loans were not designed for the average homebuyer or homeowner. When these loans first appeared, the underwriting required proof of earning potential and appreciation of homes. Did the Department have a plan to investigate Wall Street for providing the incentive to lenders to push exotic loans in the markets? Did the Department look at the low doc and no doc loan products to evaluate its abuse and the impact these loans products would have on people color, women and minority neighborhoods?

What was its plan to investigate and test appraisal companies using automated systems that perpetuated inflated appraisals in neighborhoods of color? If the Department had identified and stopped the churning of the artificially constructed housing bubble, would America have averted this foreclosure crisis? Where are the investigations and testing of mortgage brokers who changed loans terms and conditions at closing from 30 year fixed to exploding ARMs? Where are the insurance complaints? Did the Department test insurers to see if credit scoring was applied equally to all homeowner applicants? Did the department examine if the insurers paid claims based on policies or the race or national origin of the policy holder following the hurricanes in 2005? Where are real estate sales steering complaints?

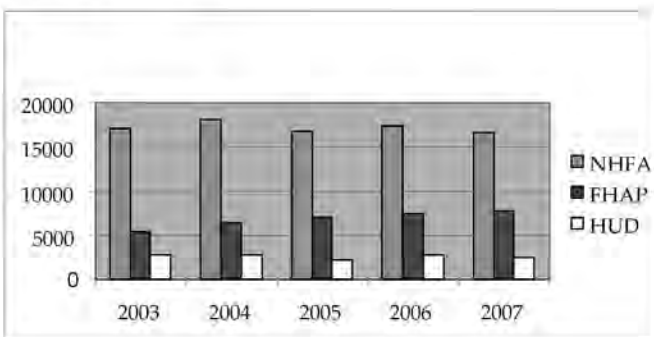
HUD'S MEAGER FAIR HOUSING ENFORCEMENT EFFORT

Each year NFHA collects data from both private fair housing groups and government entities in order to present an annual snapshot of fair housing enforcement in America. And each year these numbers paint the same picture: even compared to an extremely conservative estimate of the gross number of annual fair housing violations, the aggregate number of complaints documented and investigated by all polled entities is miniscule. The following chart reports on complaint filings and (in the case of DOJ) case filings reported by private and governmental fair housing agencies and organizations since 2003. Fair Housing Assistance Program (FHAP) organizations are state and local government organizations that receive HUD funding to investigate and process fair housing complaints. Under the Fair Housing Act, HUD is required to refer cases to these agencies if the agencies are "substantially equivalent" under the law, i.e that the state or local law is substantially equivalent to the federal law.

TOTAL FAIR HOUSING COMPLAINTS FILED						
Agency	**Claims/ Complaints**	**2003**	**2004**	**2005**	**2006**	**2007**
NFHA	Complaints	17,022	18,094	16,789	17,347	16,834
FHAP *	Claims and Complaints	5,352	6,370	7,034	7,498	7,705
HUD *	Claims and Complaints	2,745	2,817	2,227	2,830	2,449
DOJ *	Case Filings	29	38	42	31	35
Totals		**25,148**	**27,319**	**26,092**	**27,706**	**27,023**

* HUD, FHAP and DOJ data are for Fiscal Year 2007. DOJ data represent case filings of HUD Election and Enforcement cases, and Pattern or Practice cases. DOJ's jurisdiction under the Fair Housing Act is limited to pattern or practice cases and cases referred by HUD. HUD, FHAP and NFHA data represent fair housing complaints received and/or processed.

Or shown in another way:



While there are at least 4 million fair housing violations annually, only 27,023 complaints were filed in 2007. Private fair housing groups processed 16,834 of the 27,023 complaints and cases filed in 2007 – a total of 62 percent of all complaints. (This number does not account for double counting of complaints that are referred to HUD and FHAP, and for which fair housing groups are often not given credit for filing.) HUD processed only 2,449 complaints and state and local agencies (FHAPs) processed 7,705. This is a decrease for HUD from last year and modest increase for FHAP agencies from last year. As shown in the chart that follows, the number of cases HUD is processing has drastically declined since the 1992 high of 6,578 complaints. (NOTE: Private fair housing organizations continue to process more than 60 percent of the complaints, despite the fact that over the past five years more than 25 organizations have closed or been on the brink of closing.)

Number of HUD Administrative Complaints by Year	
1990	4286
1991	5836
1992	6578
1993	6214
1994	5006
1995	3134
1996	2054
1997	1808
1998	1973
1999	2198
2000	1988
2001	1902
2002	2511
2003	2745
2004	2817
2005	2227
2006	2830
2007	2449

Aged Cases

Although the Fair Housing Act regulations require that HUD process a case in 100 days or less (except for complex or systemic cases), HUD routinely has a significant "aged" case load, and many cases are open for months and even years and never investigated. In its annual report to Congress released April 1, 2008, *HUD reported that 1,353 cases passed the 100 day mark in FY07, 181 more than in FY06.*[6] This does not include the number of cases that were aged prior to the start of FY07. NFHA has several cases filed at HUD, none of which has been investigated within 100 days. Although many of these cases represent complex or systemic issues, only one case has been referred to HUD's systemic case unit. Some of this may reflect the fact that the

[6] *The State of Fair Housing – FY2007 Annual Report on Fair Housing,* US Department of Housing and Urban Development, the Office of Fair Housing and Equal Opportunity (March 31, 2008), p. 30.

Office of Fair Housing and Equal Opportunity is understaffed, and some of it reflects a breakdown of investigatory practices and systems. We also note that there are 4,081 ongoing investigations by Fair Housing Assistance Program Agencies (HUD's counterparts at the state/local levels) that have passed the 100 day mark, an increase of 141 over FY06.[7]

One NFHA member has several design and construction complaints that have been pending with HUD for almost 4 years. Several of NFHA's cases are three years old. Given HUD non-performance on these complaints, NFHA filed its design and construction cases in federal court.

HUD Charged Only 31 Complaints in 2007

After an investigation, HUD makes a determination as to whether or not there is reasonable cause to believe that illegal discrimination has occurred. If HUD finds reasonable cause, the agency must prepare a final investigative report, make a written determination of its cause finding, and issue a charge. Issuance of a charge is the standard way that government enforcement of fair housing laws is initiated. Following issuance of a charge, the parties to a case – the complainant(s) and the respondent(s) – may elect to have the case heard in federal district court in a case filed by DOJ. If no election is made, a HUD Administrative Law Judge hears the case.

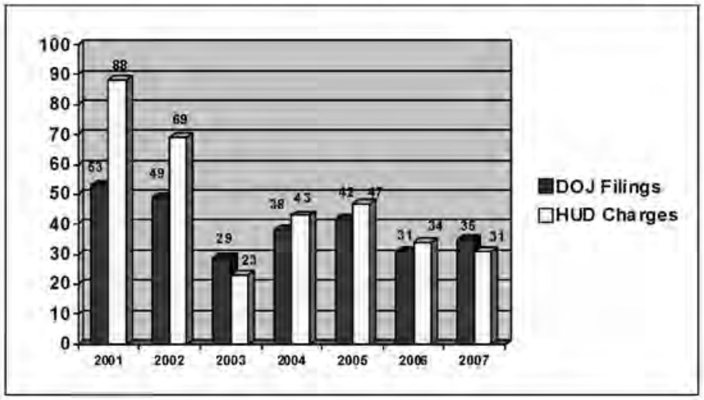
HUD issued only 31 charges following a determination that there was reasonable cause to believe that unlawful discrimination occurred in fiscal year 2007. The number of charges issued by HUD in 2007 dropped from even the small number of 34 issued in FY 2006. Even the recent high of 88 charges in FY 2001 is much too low in light of the level of housing discrimination in America. HUD has consistently set the bar for issuance of a charge too high; issuance of a charge should mean only that there is reasonable cause to believe that there has been a violation – not proof beyond a reasonable doubt.

Fair Housing Act Cases in which HUD Issued a Charge Fiscal Years 2001-2007

2001	2002	2003	2004	2005	2006	2007	TOTAL
88	**69**	**23**	**43**	**47**	**34**	**31**	**335**

[7] Ibid., p. 56.

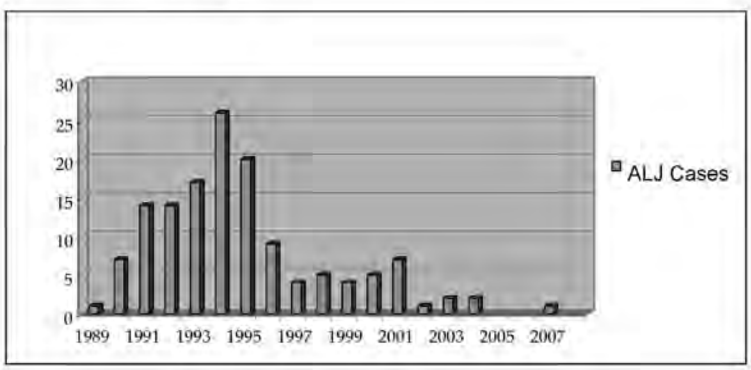
Complaints charged by HUD and consent decrees/lawsuits filed by DOJ



Administrative Law Judge Function is Essentially Defunct

While Administrative Law Judge case processing was considered a positive feature of the Fair Housing Amendments Act of 1988, HUD's failure to properly process, cause, and charge cases, particularly in recent years, has made a farce of the system. The following chart illustrates the number of HUD ALJ proceedings since 1989. **There were no cases in 2005 and 2006 and only two cases in 2007.**

Administrative Law Judge Cases



In February, NFHA was told that HUD currently has no Administrative Law Judges for fair housing cases. Fair housing proceedings must be heard by an ALJ in another department, such as the Environmental Protection Agency.

Inconsistent Standards and Inadequate Investigations

HUD enforcement efforts operate largely through ten "HUB" regional offices. HUD allows these offices in many cases to create their own policies and practices. NFHA has provided information to HUD and met with HUD officials on many occasions to object to the fact that fair housing case processing and legal standards differ from region to region. Many investigators lack information related to basic fair housing case law and many are unable to properly investigate a case. In a recent appellate decision in the Second Circuit (*Boykin v. KeyCorp,* C.A.2 (N.Y.), 2008), the Court identified HUD's practice of allowing inconsistent policies between HUBs as a significant problem. In this particular case, HUD's inconsistent policy related to when an administrative case was considered closed and whether or not a regional HUB sent a closure letter to a complainant, even when the matter had been referred to a Fair Housing Assistance Program agency. The court provided the following assessment of HUDs reasoning in the matter: ". . .we note that HUD's own characterization of this interpretation as 'a matter of practice' does not suggest that it was thoroughly considered. Nor can we conclude, on the record before us, that HUD's practice is validly reasoned. "

Case Study: Crestbrook Apartments

Beginning in 2005, NFHA conducted an investigation of the rental practices of Crestbrook Apartments in Burleson, TX. After revealing multiple instances of housing discrimination, NFHA filed a complaint with HUD on December 28, 2006. Through its own subsequent investigation, HUD verified that Crestbrook agents discouraged Black potential applicants by providing false information about the application process and by providing Black potential applicants with less favorable service and information about available units than was provided to White potential applicants. Additionally, HUD uncovered evidence of a practice of discrimination against Black applicants in application procedures.

Despite these discoveries, HUD did not attempt to conciliate or move forward with a charge of discrimination based on the evidence collected. HUD then erroneously and without appropriate process issued a "no reasonable cause" determination in the matter. Yet the evidence clearly meets the standards for housing discrimination set out in HUD's own regulations.[8] Moreover, in its Determination of No Reasonable Cause, HUD distorted facts by ignoring and suppressing evidence of Fair Housing Act violations. Further, HUD neglected to provide NFHA with standard information about the investigation as it progressed and failed to follow procedures established in the federal regulations.

NFHA has since requested that HUD reopen and complete this investigation, issue a finding of reasonable cause, and evaluate the investigative procedures that led to the unwarranted "no reasonable cause" determination. NFHA's request for reconsideration was granted, and the case

[8] See 24 CFR Part 14.

was reopened. Fortunately, NFHA has the resources and knowledge with which to make such a request; most housing discrimination complainants would be unable to identify and counteract HUD's failures in a similar manner.

HUD Is Handling Less Than 1% of the Cases of Housing Discrimination in America

HUD will claim that conciliations are as important as charges. I support the use of conciliation to resolve housing discrimination claims. When conducted properly and in a timely manner, conciliation can resolve the complaint, secure a unit for the complainant, provide immediate relief for the victim and provide training and self-testing to help the respondent learn how to follow the law and evaluate his/her own compliance with the law.

However, conciliation must be attempted early and it works best after some initial investigation by HUD is conducted. Why? Because then the HUD has evidence available to either support or dismiss a complaint. If there is no case, then the complaint should be dismissed. This cannot be determined without some initial investigation. Secondly, the initial investigation can indicate if the discriminatory conduct was isolated or pervasive. The answer to this question drives the remedy.

Questions for HUD on Case Investigation: How many cases were conciliated at HUD? When was the case filed and when was conciliation reached? Was the case thoroughly investigated or did the investigator simply ask the parties what would it take to resolve the matter? Paying to make something go away when you did not violate the Fair Housing Act leaves a bitter taste in the mouth and certainly does not promote the cause of fair housing. Does HUD require apartment complexes to report on applications, vacancies, rental deposits, rental rates on a quarterly basis? Does HUD conciliation include funds to pay for someone to examine if the monitoring reports are accurate? Do large apartment complexes use self-testing to guarantee that mangers follow the law? With the high turnover in apartment managers this is absolutely necessary to insure compliance.

The Committee should also compare the relief secured by HUD and state and local government agencies (FHAPs) to the relief secured by private fair housing agencies. The Committee will find that the relief by fair housing agencies is more comprehensive and designed to insure that no further violations occur.

Why Are the Numbers So Low?

One major reason that the numbers are so low is HUD's failure to fund national media campaigns as required by the statute that funds the Fair Housing Initiatives Program. (This is the only federal funding stream designated for private fair housing efforts and it is approximately $23.5 million.) In 2001, HUD funded its first anti-predatory lending campaign through my organization. NFHA partnered with the Ad Council and secured matching funds from Fannie, Freddie Mac, Ford Foundation and several lenders to create TV and radio public services announcements, print advertisements for news papers, magazines, outdoor advertising (billboards and bus stops) and a fulfillment kit with vital information for consumers including HUD 1 form and other information to help them spot and reject predatory loan terms.

HUD failed to fund a national media in 2005 and 2006—crisis years for fair lending – despite letters from me and meetings with NFHA explaining the Department's violation of the statute. Then in 2007 HUD advertised in the FHIP NOFA for a national media, but precluded fair housing organizations from applying for the funds. NFHA was the first media grant recipient in 1990. When NFHA conducted this campaign, HUD received 110,000 calls to its Fair Housing HOTLINE in six months; the previous year, HUD had received only 13,000. HUD did not fund another campaign until 1994. Rather than seeking more funding to handle the massive increase in complaints, HUD shut down the pipeline.

HUD's current campaign was developed by an ad agency with no experience in fair housing. So far, we have only seen one TV spot about lending and the tag line is "One call, many answers." In the past the tag line has been "Fair Housing: It's not an Option, It's the law." There is a big difference. The latter promotes an enforcement message and encourages people to report violations. Who needs to be told "One call, many answers?" Are you really going to call a government agencies that says – Well, when you call you will get many answers?

The Committee should ask HUD for copies of all the media materials and sort between those created by NFHA and the Leadership Conference on Civil Rights Education fund over the years and those created by groups that are not experts in fair housing. You will see that when either Democrat or Republican administrations used groups without expertise in fair housing that the message was confused and the complaint numbers reduced.

If there is a commitment to fair hosing enforcement, there must be a commitment to producing a coherent, consistent national message. Changing the tag line and failing to build upon successful campaigns simply undermines the message to consumers and industry. HUD must have an enforcement message that drives people to action, both for consumers to report problems and the housing, lending and insurance industries to comply with the law because they know the government and private fair housing agencies are watching, monitoring and enforcing.

RECOMMENDATIONS

This testimony documents a problem too costly for our country to ignore. We can no longer tolerate housing discrimination and the persistence of segregated neighborhoods. Many of the recommendations that follow require additional funding, but these funds represent a small fraction of the cost of failing to address what are comprehensive social and economic ills. Some of these recommendations require only a change in policy. All are necessary to achieve our nation's goal and the benefits of balanced and integrated living patterns.

HUD and DOJ Must Use Their Full Authority to Enforce the Fair Housing Act

HUD Must Enforce the CDBG Requirement to Affirmatively Further Fair Housing

HUD's Community Development Block Grant (CDBG) funding is the only other federal funding source available for fair housing activities. With the level of housing discrimination that NFHA has documented in its annual *Fair Housing Trends Reports*, NFHA urges HUD to promulgate enforceable and meaningful regulations requiring local jurisdictions to include fair housing in their comprehensive plans and their funding decisions. Those regulations should require that Analyses of Impediments to Fair Housing Choice (AIs): are prepared; accurately reflect the community's needs; describe strategies to improve fair housing compliance; are followed; and are updated at least every five years. If a state or local government fails to comply with these obligations, the regulations should require that HUD reduce or terminate CDBG funding. HUD's Office of Community Planning and Development (CPD) should require recipients to set aside adequate funding for fair housing education and enforcement staff and associated costs.

HUD and DOJ Must Improve Their Processing of Cases

With the annual number of complaints approaching 27,000, and the estimated number of violations more than four million, it is insufficient that last year HUD issued only 31 charges of discrimination and DOJ filed only 35 cases, 16 of which were HUD election cases, and therefore duplicate some of the HUD charges. These numbers speak for themselves. HUD must have consistent and quality standards for investigations, ensure its investigators are well versed in legal standards and case law, and improve its case processing so that cases are investigated in a timely manner. In addition, HUD has spent millions of dollars in the past twenty years educating builders about design and construction requirements. No builder can fail to be acquainted with these requirements. HUD should move these resources to systemic enforcement of the law.

DOJ Must Follow the Statute and Pursue Cases Charged by HUD

The Fair Housing Act as Amended (1988) clearly states that DOJ must pursue cases charged by HUD. DOJ took the position in 2005 that it is not required to file these cases but that it may instead perform additional investigations, thereby prolonging and duplicating the process.

In addition, there are two areas of enforcement at DOJ that have been underutilized in recent years: cases brought under their testing program and mortgage and predatory lending cases. Cases in those two areas have dropped precipitously in the past few years. With this underutilization, DOJ is neglecting its opportunity and obligation to fight housing discrimination.

DOJ Must File Disparate Impact Cases

DOJ has publicly stated its position that it will not litigate disparate impact cases involving housing discrimination.[9] Disparate impact cases are crucial in the fight against housing discrimination. Many rental, sales, lending, insurance, and related policies are not discriminatory on their face, but have a disparate impact on members of protected classes. Even though there may not be any intent in the policy, it can have just as detrimental an effect on individuals and families trying to find housing.

[9] HUD HUB Directors' meeting Rhode Island 2003.

Address Unfair and Predatory Lending Practices

Fair housing centers are at the forefront of the foreclosure crisis – working to counsel people who have been victims of housing discrimination and predatory lending practices and finding ways to enforce the laws intended to protect them. Today, too many individuals and families are targeted for abusive home loans that strip away their hard-earned home equity and put their homes at a high risk of foreclosure. People of color are at greater risk of losing their homes – and their hard-earned wealth – as a result of high-cost, risky lending and abusive servicing.

Congress must enact comprehensive predatory lending legislation that includes: effective rights and remedies; prohibitions against steering; a designation of "high-cost" that includes all loan fees; a ban on yield spread premiums; a ban on pre-payment penalties; no federal preemption; and advanced disclosure of costs and fees. NFHA supports S.2452, the Home Ownership Preservation and Protection Act.

The Federal Reserve and other regulators should expand their fair lending examinations to substantially include the actions of the affiliates and third party vendors of their member lending institutions. The Federal Reserve must enact a strong rule under the Truth in Lending Act. The proposed rule states only that creditors would be prohibited from engaging in a pattern or practice of extending credit without considering borrowers' ability to repay the loan; it does not allow for individual or group complaints. This is too burdensome and would probably make it impossible for an individual to do anything to remedy his or her situation. The final rule must, among other things, do the following: ban pre-payment penalties and yield spread premiums; restrict bait-and-switch tactics, especially at the closing table; cover all loans, not only subprime loans; require the verification of income on all home mortgages; and require escrowing of taxes and insurance.

To assist those currently in bad loans and at risk of foreclosure, Congress must enact strong legislation that permits bankruptcy courts to restructure mortgages on a family's home. NFHA supports S.2636, the Foreclosure Prevention Act and H.R.3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007.

In the face of countless studies demonstrating the targeting of minority homebuyers by unscrupulous lenders, HUD has initiated only 3 fair lending investigations since FY2006 and has processed only 137 fair lending complaints; Justice filed only 4 cases in FY2007. Combined, this amounts to only 10 percent of the cases that private groups have filed. Since federal financial regulatory agencies refer fair housing cases to the Department of Justice, it is clear that these agencies have failed in their responsibility to identify and counteract discriminatory and predatory lending practices. They need to improve training on these issues and increase the attention and importance assigned to fair housing requirements.

Increase Fair Housing Funding and Focus Resources on Investigations

Enact the Housing Fairness Act

Introduced in 2007, the Housing Fairness Act (H.R. 2926/S.1733) represents a significant rededication to fair housing funding by the Congress. The legislation authorizes funds to root out housing discrimination through a $20 million nationwide testing program, a doubling of the funding authorization for the Fair Housing Initiatives Program to $52 million, and the creation of a $5 million competitive matching grant program for private nonprofit organizations to examine the causes of housing discrimination and segregation and their effects on education, poverty, and economic development. The nationwide testing program alone would allow for 5,000 paired tests, amounting to an average of fifty paired tests in each of the nation's one hundred largest metropolitan statistical areas (which contain 69 percent of the nation's population). NFHA urges the Congress to pass this important legislation.

Increase Appropriations for the Fair Housing Initiatives Program

NFHA calls on HUD and Congress to increase appropriations for the Fair Housing Initiatives Program to at least $52 million in fiscal year 2009 to meet the demand. In FY2006, for example, 269 organizations applied for FHIP funding – *a total of $51.75 million in requests* – but only 102 groups received grants totaling $18.1 million. In FY 2007, only 87 groups received grants: 55 organizations received Private Enforcement Initiative (PEI) grants ($14 million) and 32 groups received Education and Outreach Initiative (EOI) grants (3.1 million) for a total of $17.1 million. (HUD has not publicly released the number of organizations that applied in FY2007.)

An appropriation of $52 million would enable FHIP recipients to address thousands of additional complaints. This increase also has the potential to accomplish two important goals:

1. encourage those encountering housing discrimination to come forward to file their complaints with greater hope of resolution; and
2. provide fair housing groups with the capacity to address larger systemic issues, including sales practices, predatory lending practices and insurance policies that are discriminatory.

Restructure the Fair Housing Initiatives Program

We applaud HUD for following NFHA's suggestion of creating a three-year grant cycle for qualified full-service private nonprofit fair housing organizations beginning in 2005. Currently, 39 organizations are funded at that level. While this longer-term funding provides some stability, it also constrains the funds available to other qualified organizations because the funding level is so low. A total of only 55 organizations received enforcement grants ranging from $70,000 to $275,000.

As outlined in NFHA's proposal entitled *A Reformed Fair Housing Initiatives Program: the Private Enforcement Initiative*,[10] FHIP should include funding to provide training to agency

[10] See *A Reformed Fair Housing Initiative Program: the Private Enforcement Initiative*, NFHA (2005).

personnel and to implement programs to improve and enhance agency performance. The minimum grant award should be $300,000 annually and increase to $1 million annually depending upon the service area's population size, number of investigations handled, demographics and other performance measures.

Fund an Annual National Media Campaign

NFHA calls on HUD to abide by the FHIP authorizing statute to fund an annual national media campaign rather than violating the statute as it has for the past three years. As mentioned above, HUD failed to fund a media campaign in accordance with the statute in 2005, 2006 and 2007.

Thank you again for the opportunity to testify before the subcommittee today. I wish that I would have had better news to report today, ten years after coming before this subcommittee in 2008. But we have a long way to go to achieve the dream of fair housing. I hope that I can count on you to work with us to see that we achieve it together.

Submitted as an attachment: ***Dr. King's Dream Denied: Forty Years of Failed Federal Enforcement,*** **the National Fair Housing Alliance's 2008 Fair Housing Trends Report**

Mr. CONYERS. Did anybody ever see it?

Ms. SMITH. Actually, we released it anyway, and it appeared on CNN. And we have documentation to show that our members' complaints in mortgage lending increased significantly because these ads were out.

Now, her current campaign, they spent a million dollars on it. All you heard her say is you are getting one television spot, you are getting some public forum and a tool kit. For a million dollars, we got television spots, radio spots, we have this in English and Spanish, radio spots, print materials that went on billboards, buses, posters that went all over the United States, and we set up an 800 number so people could see these ads, read the print thing, hear things on radio, and give us a call.

And I can tell you, television public service announcements rarely get aired. You have to have a massive radio campaign. And I have these ads up here because State Farm Insurance joined us to start promoting the benefits of multicultural, multiracial neighborhoods.

And, you know, we look at the corporations, everybody—many, many corporations have a very diverse workplace but people go home to segregated neighborhoods. So how are we going to make change in this country?

So we met with some of the corporations, and State Farm has given us $800,000 to do a campaign directed to White, suburban communities to say, "Here is the benefit of multicultural, multiracial associations. Open up your neighborhoods."

But we will never get there if we are not investigating the real estate sales companies who stop African-Americans from moving into neighborhoods, as they did in Detroit. We have a lawsuit pending against this real estate company in Detroit. Well, they are not in Detroit. They have 16 offices outside of the city of Detroit. And they——

Mr. CONYERS. I wonder who "they" are.

Ms. SMITH. I am sorry?

Mr. CONYERS. I wonder who "they" are.

Ms. SMITH. Century 21 Town and Country. And we filed a Federal lawsuit after—and at the same time, the Michigan Department of Civil Rights charged our case against them.

We found that they were steering Whites into Grosse Pointe, and even when African-Americans asked to see Grosse Pointe, they were steered into the beautiful area of East English Village. And Whites were denied the opportunity to see East English Village. I drove through there, took pictures. Beautiful neighborhood, great brick and stone homes. But these real estate agents engaged in steering.

We tested 14 of the agents. We found nine of the agents, in our opinion, that they were violating the Fair Housing Act. We shared that information with the Department of Justice. They said it is not a pattern and practice.

Mr. CONYERS. Well, when do you determine to go to HUD first to file a complaint, as opposed to going to Department of Justice?

Ms. SMITH. Well, we have a number of cases pending before HUD. We often immediately file with HUD because it stops the statute of limitations from ticking. And then we meet with the Department of Justice. We don't always get a chance to—I mean, the staff is very open to talking to us about our cases.

And the issue is that we did the follow-up testing of HUD's housing discrimination study, and we conducted 145 paired tests. We found an 87 percent rate of racial steering in sales properties in the United States in 12 metropolitan areas.

HUD has all of our evidence. The Department of Justice has access to all of that evidence. HUD, on Monday, finally charged one of the cases. These complaints started to be filed in 2005. On Monday, they filed a case that is in suburban Chicago. All the other complaints are just sitting at HUD.

We have a number of lawsuits that we have filed now. We have stopped taking our design and construction complaints to either HUD or Justice. We are just going directly into Federal court, because we want to see immediate change and not just something negotiated. And we want to see stronger implementation of the law.

I mean, you know, I only have one attorney on my staff, so I rely on the Lawyers' Committee and Relman and Dane and the good works of Fried Frank and other law firms to help us.

But we take them to HUD for two reasons. I want to see how the process is working. I have been doing this for 33 years. So I have seen it in the first 20 years of the law and this last 20 years of the law. I am a cynical optimist. I keep wanting to use the process to make it work.

Because you passed a law, it is supposed to work. We have the greatest civil rights law in fair housing than any of the other ones, but there is no will in the enforcement agencies at the Administration level to get it done. So we need the Housing Fairness Act to be passed, so that we can do the systemic investigations.

I have met with the Office of Management and Budget, and they agreed with me a couple years ago when I said, "We can't continue to do this case by case by individual case. We have to deal with the systemic and institutionalized nature of the problem." And they even said, "Well, then your fair housing groups ought to have a systemic unit," and we said, "Yes, they should." Now we need the money to do that.

Mr. CONYERS. I recognize the gentleman who is the Chair of the Crime Subcommittee of the House Judiciary Committee, Bobby Scott of Virginia.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Chairman, we only have 5 minutes, and when I used my 5 minutes at the last panel I just asked the question, what did they find with the 500 pairs, and we got evasion and confusion and failure to answer.

Ms. Smith, if the representative from the Department of Justice had testified truthfully and candidly, what kinds of schemes and tricks would she have described as a result of the 500 testing pairs?

Ms. SMITH. If I look back at HUD's previous testing in the 1990's, she would have been able to describe cases of rental discrimination all over the country, where African-Americans, Latinos or Asian-Americans inquired about the availability of apartments and were either, with a smile and a handshake, told, "You know, they are already all rented," or, "We have three people on the waiting list, and I will get back to you," and then when the White tester went out they would have been given an apartment immediately.

Mr. SCOTT. And how often does this occur?

Ms. SMITH. Well, my members do audit testing, which means they send testers out. When we have created the new fair housing groups in Boston and New Orleans and Fresno, California, we find a rate of discrimination anywhere from 47 to 75 percent of discrimination against African-Americans, Latinos or Asian-Americans when they are looking for rental housing.

Mr. SCOTT. Mr. Carr, if she had testified truthfully, what do you think she would have said?

Mr. CARR. Congressman, the paired testing by national neighbors of the National Community Reinvestment Coalition reinforces the same findings that Ms. Smith has just indicated. We routinely find disparate treatment in at least 40 percent of instances, sometimes close to 50. And other research has shown it to be as high as more than 60 percent of the time.

The range of disparities in information is really across the spectrum, in terms of units available, in terms of explaining financial terminology, in terms of call-backs. There are just huge disparities found in paired testing studies.

So it would be just hard to believe that if someone developed a competent paired testing study, out of 500 cases, you wouldn't have at a very minimum somewhere around 200 of those cases showing some forms of important disparities that could have potentially limited housing opportunities.

Mr. SCOTT. And that would be for each contact? I mean, that is, when you go to a rental unit, you would expect discrimination 40, 50, 60 percent of the time. So if you are looking for an apartment and have checked out five or six different units, and you experienced discrimination 40, 50 percent of the time, it is virtually hard to believe that a person looking for a house wouldn't have run into some discrimination every time they have looked for a house, is that right?

Mr. CARR. That is correct, yes.

Mr. SCOTT. You mentioned apartments. What about steering for homeownership, for purchases, how often does that occur?

Mr. CARR. We find the same general findings for homeownership and rental housing.

Mr. SCOTT. And so, with 500 testers, you would think it would be incredulous that someone could not have found widespread discrimination in their testing?

Mr. CARR. It is just simply hard to believe from any evidence and information that is available widely in the industry.

Mr. SCOTT. And what about—we have heard testimony about subprime loans. How often would someone have discrimination in terms of mortgages?

Mr. CARR. The subprime lending market is an area—one of the things that we said in our testimony is that we need better information. And the reason we need better information is because we continue, year after year after year, to have debates whereby, for example, the groups that represent consumers and minority households point out these severe disparities and the only defense is, "Well, but you haven't looked at all the variables. And, therefore, it makes sense."

And what we say is, "Well, stop hiding the variables. Give us the information. Make publicly available credit scores information, LTV, other product information. Remove from that information individual attributes, so that you don't know specifically whose loan you are looking at, but that you have a good, clear understanding of the industry."

We have found repeatedly, when there is good industry data provided on credit scores and others, that severe disparities continue to exist in the loan process.

And I might say that the idea that a study by the Federal Reserve Board is somehow responsible for excessive subprime lending to communities is novel, to say the least. The fact of the matter is that the lending industry changed pretty dramatically. And people were writing about subprime loans, including me, as early as the late 1990's, early 2000.

I published a study in 2001 called, "Financial Services in Distressed Communities," and that study was not about trying to promote subprime lending. In fact, it was cautioning about the fact that consumers were being steered into the subprime market and, as well, predatory lending. These were just policy papers.

We also did a review of the Boston Fed paper that was academically reviewed. And we found that the Boston Fed did contain a number of methodological errors, but our work found that those methodological errors were not determinative.

And, in fact, the power of the Boston Fed study wasn't to suggest that consumers should get into the housing market using alternative credit scores and alternative data. The real power of that was to say that, when individuals had blemishes in their credit record, they weren't treated the same.

To the extent that Black and Latino households had perfect credit records and credit scores, they were treated pretty well. But, unfortunately, that occurred in only 20 percent of instances; that 80 percent of the market, everyone has some type of blemish, and that is where the disparities arose.

And if I had known we were going to talk about this, I would have reread the study; it was 16 years ago. But——

Mr. SCOTT. Well, let me ask you this. When you talk about the variables, what kind of variables would you be looking for?

Mr. CARR. In terms of—oh, we would look for things like the credit score. Because when people say, "Income is not determinative of whether you should receive a loan," they are absolutely correct. And no one has ever argued that. It is just that when you see the severe disparities, for example, when you see five times the loan-denial rates, you know that just tells you right off-hand, there are not five times the level of credit problems. But the problem is that we don't make that data available, the credit score, so that we can stop arguing about what is missing and start having rational discussions on what data is available to us.

Mr. SCOTT. Let me ask just one, kind of, concluding question. If someone where to testify that, in terms of seeking housing, you sent out 500 pairs of testers, that they didn't find widespread discrimination in the United States, would you find that testimony credible?

Mr. CARR. I would find it curious. It might be that the testimony is correct and the tests were conducted in an insufficient manner, in an inappropriate manner.

Mr. SCOTT. But is there any way that it could have been conducted in an appropriate manner where you would not have found widespread discrimination?

Mr. CARR. Not based on any evidence or information that I have seen about standard paired testing conducted by a range of institutions, from public bodies to private nonprofit agencies.

Mr. SCOTT. Thank you.

Thank you, Mr. Chairman.

Mr. CONYERS. Would you submit those studies you referenced?

And I am sure Professor Liebowitz has written on this subject, on these related subjects, right?

Mr. LIEBOWITZ. I am not sure what you mean by "related subjects."

Mr. CONYERS. Well, have you written at all?

Mr. LIEBOWITZ. Yes, I referenced a paper that I wrote in 1998. I am working on something now that will talk about the subprime type of problems. But the reality is that is not my main specialty. Most of the papers that I write are not on mortgage discrimination.

Mr. CONYERS. Well, I am fascinated by them, I am sure, if I read them. But we are on the other subject. You write about it sometimes as well.

Mr. LIEBOWITZ. The other subject being? I mean, I have written about mortgage discrimination.

Mr. CONYERS. Well——

Mr. LIEBOWITZ. And——

Mr. CONYERS [continuing]. Don't you think that would excite our imaginations, if we read it?

Mr. LIEBOWITZ. Oh, yes, I recommend you read it.

Mr. CONYERS. Well, why don't you submit it?

Mr. LIEBOWITZ. I did submit it.

Mr. CONYERS. Well, okay. Have you got any other written works that we might enter and put in the record, as well?

Mr. LIEBOWITZ. On that topic, just an op-ed or two, which I think are also submitted.

Mr. CONYERS. Well, let's make sure they are.

You know, you fascinate me as a modest writer who keeps secret some of his best writing, and we have to make sure we have to get it out.

When is this study you are writing now, currently, coming out?

Mr. LIEBOWITZ. I am supposed to have it done by the end of August.

Mr. CONYERS. Does it relate to the subject matter that brings us all here this afternoon?

Mr. LIEBOWITZ. Yes and no. It is——

Mr. CONYERS. I will take the "yes" part. That is all I need. [Laughter.]

That is good.

Mr. LIEBOWITZ. Okay. That is fine.

Mr. CONYERS. Would you send that to us too?

Mr. LIEBOWITZ. Yes, I will.

Mr. CONYERS. I thank you very much.

We turn now to Mel Watt, who not only is a distinguished Member of this Committee but Chairman of the Oversight Subcommittee of the Finance Committee, on which he sits.

Mr. WATT. Thank you, Mr. Chairman. I am glad you started with Mr. Liebowitz, because I was going to give him an opportunity to clarify what he was saying in his statement.

I happen to agree that the study that was done by the Boston Fed was probably unreliable. I don't know whether it was outrageously unreliable. Unreliable is unreliable.

Mr. LIEBOWITZ. I said——

Mr. WATT. What I have trouble with is the next sentence of your testimony, which says, "There was no basis for a claim that minorities were discriminated against by mortgage lenders." And I am hoping that you will clarify that you mean no basis in the Boston Fed study.

You can't possibly be sitting here representing to this Committee that you believe that there is no basis for claiming that minorities are discriminated against by mortgage lenders. Or can you?

Mr. LIEBOWITZ. I certainly wouldn't say that there are no individual members of minority groups who are not discriminated against. I would not say that.

Mr. WATT. Well, I am asking you, is your testimony that there is no discrimination by mortgage lenders against minorities? That is the question that is—and that, I believe, could probably be answered with a "yes" or "no." Either that is your testimony or it is not your testimony. Is it your testimony?

Mr. LIEBOWITZ. My testimony is that, in aggregate, for the United States in the early 1990's, which is the time period I am referring to in the study, that there was no evidence that there was overall mortgage discrimination against minorities in the United States.

Mr. WATT. And what period of time was that?

Mr. LIEBOWITZ. Early 1990's.

Mr. WATT. What period of time is the early 1990's?

Mr. LIEBOWITZ. In particular, I think we are talking about 1992.

Mr. WATT. So you surveyed the whole industry, you are not just talking about the Boston Fed study, you are talking about the whole industry you surveyed. And your testimony to this Committee is that, in the early 1990's, 1990 to, what, 1993, that there was no discrimination by mortgage lenders against minorities?

Mr. LIEBOWITZ. No, I am saying that there was no evidence that there was aggregate discrimination. By that, I mean——

Mr. WATT. Okay. All right.

Mr. LIEBOWITZ [continuing]. A statistical analysis, where you take a look at mortgages and you carefully examine whether or not they appear to be turned down at a greater rate for minorities than for non-minorities after you have controlled for enough variables. The one thing——

Mr. WATT. Okay. You have answered my question. I think your testimony has gotten to the point that it is so incredible that I am not going to waste any more time with it. I mean, I was trying to give you an opportunity to clarify what you were saying, but let me just go on to somebody who makes some sense here.

What are you finding—what is everybody else in the real world finding in your experience about whether there is discrimination in mortgage lending, rental, homeownership? Is there anybody else who joins in this opinion? Steering? Anybody else who wants to opine on this, that aligns themselves with Mr. Liebowitz's opinion, first of all? And then, if not, maybe you all could tell me what your opinion is on the same issue.

Mr. Carr, I will start with you and just come down. I won't ask any more questions. But I don't want to leave, as you noticed in the first—even before the witnesses started, I don't want to leave any indication in a hearing record that goes unrefuted or uncontradicted, as the case may be.

Mr. Carr?

Mr. CARR. Thank you very much, Congressman.

I just want to reiterate that we did publish a significantly refereed article on the Boston Fed study, and we found it to be a credible study. And so I will submit that for the record.

Second of all, we have found in our paired testing studies significant levels of disparity in rental and homeownership whenever any studies that I have seen that are credible studies include that.

We also operate a Homeownership Sustainability Fund, in which we help consumers who are dealing with problem loans as a result of subprime, predatory and/or loans that contain otherwise unfair and deceptive terms and practices. And we find routinely in those files all sort and manner of deceptive practices in those loans.

Again, those would not be considered statistically significant in terms of being, you know, something you could report on nationally as a national study, but they are good anecdotal evidence that reinforces the best information that we have that is unfortunately the HMDA data, which we report on.

And we have a study that we are very proud of called, "Income is No Shield," where we show that income really doesn't protect consumers of color in the housing market. In fact, that we find even greater disparities as income increases for minority households.

And what we would encourage and urge is that Congress consider expanding the data variables that we have available, so that, again, we don't debate——

Mr. WATT. As you know, Mr. Carr, I am on your side of that. We are strong advocates of that. And perhaps we can give Mr. Liebowitz some more statistically verifiable information; then he can perhaps reach a different conclusion.

Ms. Smith? And then I will get Ms. Sangree and Ms. Wiggins.

Ms. SMITH. Undersecretary Jack Kemp, he authorized——

Mr. WATT. He was a Republican, wasn't he?

Ms. SMITH. Yes, yes.

Mr. WATT. Okay. Just trying to be bipartisan here.

Ms. SMITH. Me, too. We received a grant through HUD to do testing, mortgage lending testing, in eight cities in the early 1990's. And we found high rates of discrimination against African-Americans and Latinos in those eight cities.

If you look at from the mid-1990's to just 2 years ago, the Department of Justice brought red-lining lawsuits against some incredibly large lenders in Grand Rapids, Detroit, Chicago, and Gary, Indiana.

And last November and December, when we realized the credit crunch was coming in and the underwriting guidelines were tightening up, I thought back to my days in 1975 forward in fair housing and I saw, whenever there was a credit crunch, as there was in the early 1980's, who was squeezed. And that was women and people of color.

So we did some testing of banks in several States. And we found that, while the Latino, African-American and White testers were all given information about loan products, the Latino and African-American testers were referred to the highest-cost loan product, the highest interest rate, the highest downpayment.

And in some instances when the African-American homebuyer went in, the banks said, "The person who deals with mortgage loans is not here today. She is on vacation, and no one can help you." When the White tester came in the next day, she was still on vacation, but they made sure someone helped that White tester get information.

Mr. WATT. Not statistically reliable, according to Mr. Liebowitz, I am sure.

Ms. Sangree?

Ms. SANGREE. I would just add that, in the field of the subprime lending that the Baltimore City lawsuit is concerned with, although there isn't publicly acceptable data, as Mr. Carr is urging should be made more available, we have several snapshots that are provided principally through litigation.

And if you look at page 30 of the Wells Fargo complaint that is attached to my written testimony, you will see a citation to a case from Philadelphia where, through discovery, they had access to the loan documents of borrowers. So they were able to look at credit scores and all of the other risk factors. And the conclusion in that case was that borrowers residing in African-American neighborhoods pay more than comparable non-African-Americans and residents of communities in which White people predominate.

We see similar patterns in Baltimore City. We have not had access yet to the discovery in our lawsuit, but we will be having that.

And in the meantime, as I mentioned in my oral remarks, the Annie E. Casey Foundation, based in Baltimore, is doing research in 13 cities across the country, including Baltimore. In Baltimore they are focusing on a cluster of neighborhoods encompassing 20,000 people. They have a contract with Experian, and their researcher is looking at not just income data but also credit scores and other risk factors. And the conclusion he has made in these Baltimore neighborhoods is that there is an over 15 percent racial disparity for refinances in 2006 and a slightly lower disparity in home-purchase loans.

So we are getting these snapshots of the statistics that show that, you know, the HMDA data that shows vast racial disparities in lending practices can't be explained away by differences in credit scores or other risk factors. And if HMDA data included more of that data, we could see it on a nationwide scale as well.

Mr. WATT. I can tell Mr. Liebowitz is not convinced yet.

Ms. Wiggins, perhaps you can help.

Ms. WIGGINS. You have great faith in me, Congressman. I don't know that I will be the one to——

Mr. WATT. He is turning red, though. [Laughter.]

So his body language is changing a little bit.

Ms. WIGGINS. The Lawyers' Committee generally does not engage in this kind of testing, but I would agree with what has been said so far. I always quote and cite the NCRC study that Mr. Carr referred to. The Center for Responsible Lending has also done good studies on this as well. And I would be happy to talk with the staff about how they could get copies of those studies.

Mr. WATT. And Mr. Liebowitz, make sure you send them to him too.

Ms. WIGGINS. Yes, I will make sure I CC him on that. [Laughter.]

I also just wanted to underscore the point, the need to have funding through the FHIP and FHAP programs, so that the statistical data would be available.

One of the things that I highlighted in my written testimony on pages nine and 10 is that, when the funding for that kind of testing is unavailable, that disparate impact cases aren't able to be filed.

And as NFHA pointed out in their Fair Housing Trends Report, about a quarter of those centers have had to either go down or shut off some of their enforcement activities or just close their doors all together, one of which was a powerful center in North Carolina, where I know you are from.

Also, the FHIP and FHAP agencies accounted for 91 percent of all fair-housing complaints that were filed in 2007. So I wanted to use this opportunity to just underscore those.

Mr. WATT. Thank you.

Mr. Liebowitz, we are working to try to get the data set expanded on the HMDA. We vigorously believe that it should be expanded so that verifiable statistical studies of the kind that you say don't exist can exist. Although a number of people have jumped across that threshold substantially. I am sure that in your heart of hearts you don't believe that discrimination doesn't exist.

Mr. Chairman, with the earlier witnesses, I alluded to the fact that Representative Al Green has a bill that he has introduced that would enable HUD to do paired testing using other agencies beyond what the Department of Justice is doing. And I wonder if it would be appropriate to perhaps allow him, since he came and has a very strong interest in this area, a couple of minutes to question the witnesses.

Mr. CONYERS. Yes, I am interested to know how it would help us deal with the issue that is in front of us.

Mr. WATT. I ask unanimous consent that he be allowed to ask questions of this witness panel.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank Member Watts for his kind assistance. He is the chairperson, of course, of our Oversight Subcommittee, and he does a stellar job.

And, Mr. Chairman, your reputation is far and wide, and it is always good. And I am honored to sit with you today.

If I may, I will move right to what I consider the bottom line, which is the testing. Is it agreed upon by all present—and to respond, I would beg that you kindly extend a hand into the air. This is comparable to what we call voir dire, or "voir dire," in a court, depending on where you are from. [Laughter.]

I am from Texas. We say "voir dire." Which is a French term that means "to speak the truth." So mendacity would not be appropriate.

If you agree that testing is the best methodology by which to ascertain the empirical evidence necessary to prove discrimination, would you kindly extend a hand into the air if you think it is?

Okay. We have two people, three people——

Ms. SANGREE. I am agnostic.

Mr. GREEN. Okay. Well, permit me to ask, because I am looking for something better than testing. If you have a methodology that is better than testing to acquire the empirical evidence, would you kindly help me to understand that methodology?

Ms. SANGREE. Well, I am just not an expert in rental discrimination. I think for rental discrimination that certainly testing would be the best, and probably for home purchases. In the lending environment, I think access to the data would probably be enough. You wouldn't even need to do the testing.

Mr. GREEN. One of the reasons why, as I understand it, we don't have more testing in the area of lending is because we have laws that prohibit one from fabricating a story so as to perfect testing. If I am incorrect, would you kindly help me?

Ms. SMITH. No, you are correct.

Ms. SANGREE. Yes.

Mr. GREEN. Okay. So we really have not had a fair opportunity to apply testing to the lending environment. Is that a fair statement?

Ms. SMITH. We have had the opportunity just at the inquiry but not through the application process.

Mr. GREEN. Exactly, because of the application itself——

Ms. SMITH. Yes.

Mr. GREEN [continuing]. You cannot fabricate.

Ms. SANGREE. I want to amend my vote and say, yes, testing.

Mr. GREEN. Ah, thank you. [Laughter.]

So now I have—for clarity purposes and because Watts is a great lawyer and he will remind me that I did not properly address the record, so would you kindly raise your hands into the air one more time if you agree?

Okay. Let the record reflect that all but Mr. Liebowitz—is that correct? You did not raise your hand.

Okay. You may lower your hands.

Mr. Liebowitz, if you would, kindly explain to me a methodology that is better than testing in the area of home purchasing, for example, or leasing—we will just take these—that is better than testing in acquiring the empirical evidence.

Mr. LIEBOWITZ. If you want to talk about rental or home purchasing, it might very well be the case that that is the best method for one-on-one, individual, in every instance finding out whether——

Mr. GREEN. Thank you. Let me reclaim my time quickly and ask this question, Mr. Liebowitz.

Mr. LIEBOWITZ. I thought you were talking about——

Mr. GREEN. No, no, I have one more question. I accept your answer. One more question, please, sir.

In the area of testing, with reference to purchasing a home, have you had any experience in this area in terms of acquiring intelligence, meaning information, and synthesizing additional thoughts from the data acquired? Have you had any experience with this?

Mr. LIEBOWITZ. I have not had any direct experience with testing, but——

Mr. GREEN. Well, it is testing we are talking about.

Mr. LIEBOWITZ. But if you let me——

Mr. GREEN. No, no, no. It is testing we are talking about.

Mr. LIEBOWITZ. Can I answer the——

Mr. GREEN. I will, but only if we finish this. I only have 5 minutes.

So you have not had experience with testing in this area. Would you conclude that the methodology that you have utilized could have benefited from testing, to some extent?

Mr. LIEBOWITZ. It is conceivable it could have. But the problem with testing is you test some particular location, and the advantage of a database is it covers everyone, or at least what you are hoping is a large, representative area. And——

Mr. GREEN. So would you agree, sir—if I may, if I may, if I may. Would you agree that—are you a lawyer?

Mr. LIEBOWITZ. No.

Mr. GREEN. Okay. Would you agree that in court the empirical evidence that we seek probably will be derived from testing as opposed to the statistical analysis that you performed?

Mr. LIEBOWITZ. I can't talk about what would be——

Mr. GREEN. All right. All right. I appreciate your answer.

Finally, let me say this. This bill, H.R. 2926, for those who are unfamiliar, provides about $260 million over 5 years for FHIP, for the Fair Housing Initiative kind of testing that you have been talking about.

And for those who would say $260 million is a lot of money, I agree; it is almost what we spend on 1 day in Iraq. So it is a lot. But it is needed. And my hope is that we would be able to acquire that type of assistance from our Congress.

A final question before I again thank the Chairman and yield back is this: In performing the testing—I think you have answered the question—but in performing the testing, if you don't have someone who is willing to take the evidence and use the evidence, perhaps even in court, how much value is the evidence—or how do you find value with the evidence?

What do you do with it when you cannot take it to court or you find that you have an agency that is not cooperating to the extent that it deems it necessary to pursue and prosecute? What are you doing with the evidence?

I will just start with the gentleman, Mr.—and I am sorry, I can't see your name from here, but I can look here and find it. This is Mr. Carr?

Mr. CARR. Yes.

Mr. GREEN. Okay, Mr. Carr.

Mr. CARR. With the evidence that we find, we bring actions against a range of mortgage market participants, and we have, ranging all the way from investment banking institutions to the credit rating agencies, all the way to individual lenders.

So we act as expeditiously and as forcefully as we can. But, again, the level of funding that is available, the paucity of information, really limits our ability to perform.

Which is why we have argued that what we really need is a new institutional structure, a Cabinet-level appointment for civil rights enforcement that will talk directly to the President and provide leadership in order to finally and once and for all break the back of discrimination in housing, in education, in health care, insurance, the credit markets and others. And until we have something that is broader and more powerful than that, we simply will be working around the margins.

Mr. GREEN. Thank you.

And, Mr. Chairman, I will yield back. I will just comment and make—someone mentioned that the way has been shown to us. I think that what we are doing with the Fair Housing Act is a part of the way, but the will still has to be there to enforce it.

Thank you, Mr. Chairman. I yield back.

Mr. CONYERS. Thank you all very much.

Professor Liebowitz, what are you thinking about now? Have you been slightly moved by the discussion that has taken place?

Mr. LIEBOWITZ. No, I can't really necessarily say I have, even though some of the earlier discussion with some of the people on this panel moved me somewhat.

The thing that I am picking up, however, which confirms something that was in my statement, was that people are convinced they know the answer before the analysis is done. And when you know the answer in advance, you are not really open to finding out what the truth might be.

And I am picking up people saying they know what the answer is, and they just wait for some study to confirm what they already know. If that is the case, that is fine, but there is not much point in trying to, sort of, conduct studies to actually see what the story is.

Mr. WATT. Would the gentleman yield for just a second?

Mr. CONYERS. Yes.

Mr. WATT. And I am sure the Chairman can attest to this from a vantage point of years that exceeds my 62, 63 come August. But when you are Black and you live in a world for 63 years, I don't need empirical evidence to tell me that discrimination exists.

Now, do we need to verify that to a court? Do we need to test for it? Do we need statistical analysis? Do we need databases for that purpose? Absolutely. Do we need that kind of verification to make good public policy? Absolutely.

But if you are detecting that I know that discrimination exists in the housing market, in the education market, in the criminal justice system, I would have to plead guilty to that, because it is based on years and years of personal experience. And so that I don't apologize for.

We have to get good information and have it verified in every way that we can to convince, quite often, people like you who are reluctant to acknowledge that these things happen in our world and have happened in our world and continue to happen in our world. And I acknowledge that that is part of our responsibility in setting public policy and in winning cases or in operating in this world. I suppose you came here with some predispositions too based on your life experiences.

So that is it. I just thought he needed to hear another perspective on that.

Mr. CONYERS. Well, Stan Liebowitz, you have become the focus of so much attention. I can't understand why. Learned, a writer, prolific, I suspect.

Let me refer you to a book edited by James Carr. It is called, "Segregation: The Rising Costs for America." And I recommend it to the whole panel.

Listen to this. HUD's enforcement powers have, for various reasons, largely remained underutilized. In 2003, HUD brought only four racial discrimination cases, although it had received more than 2,700 complaints that year. Nearly 40 years after the passage of the Fair Housing Act, at least 3.7 million fair housing violations still occur each year.

And it seems to me that it isn't—we don't have to base it on our individual experiences in America. It is there for everybody to see. We live in an essentially segregated housing pattern system in the United States of America.

Is that a reasonable question to put to all of us here?

Mr. LIEBOWITZ. Are you asking me specifically?

Mr. CONYERS. Well, we always point to you to kick off the discussion.

Mr. LIEBOWITZ. I am not trying to deny that there is no discrimination. I am talking about one specific area, which is mortgage discrimination and particularly whether or not one gets a "yes" or a "no." And at the time period when I was looking at it, there was no issue, there were no numbers on what the rate was.

At that time period, the arguments that you could make for why somebody would discriminate, if you were going to be discriminatory in the mortgage business, would you do it, you certainly hurt yourself if you don't make a sale because you want to not allow somebody based on their skin color to get a mortgage.

But we are talking about generally large institutions that were making mortgages that had been taking a terrible beating publicly from the yearly HMDA data coming out. They, I am sure, were concerned about their general track record and the publicity and, I would have thought, would have tried very hard to make sure that they weren't engaged in discrimination, even to the point of bending over backwards the other way to avoid any possible bad publicity.

You also didn't have what you will find in a lot of rental situations, where it may be, because there is still a certain amount of racism that exists in the country, I am sure, of tenants who might not want other tenants to live there of a different color. And, therefore, somebody who is in charge wants to take that into account, or maybe they are racist themselves.

But for the mortgage process, that doesn't really exist, because the person who is giving the mortgage doesn't live anywhere, doesn't have to worry about what any of the other mortgagees out there think, because nobody knows. The neighbors may not like it if somebody moves in, but they don't know necessarily who gave the mortgage.

So the arguments for why you would see people engaging in racism occur much less so in this particular transaction with making the mortgages.

And then, given all the negative publicity, I am willing to accept the proposition that there may not have been any mortgage discrimination going on in the early 1990's, and, therefore, I would like to see a test. And I don't see any evidence that there was.

And unfortunately—I am in agreement with you when you say you want to get more data. More data would be good. More data is always better than less. And any time you can get more data, I think it is good. In the case of the mortgage discrimination, the data from HMDA is insufficient, as almost everyone understands.

There was this one attempt by the Boston Fed to increase it, and we don't have other attempts where we could take a look, for instance, how this thing was done. And it was done—the mortgage lawsuits that did it in a flawed way. And it was unclear that you could ever clean those numbers up properly.

When I used the term "egregiously bad," I wasn't talking about their study so much as the numbers. Somebody put those numbers in that database and didn't look at what they were doing, and there were all sorts of crazy things going on that couldn't possibly be correct: negative interest rates, mortgages that were sold in the secondary market but that were disapproved—and you can't sell a mortgage that hasn't been approved—and those types of things. And there were hundreds and hundreds of those problems.

That was the basis of the problems. And that is the only thing we have to hang this whole big question on.

Mr. CARR. Mr. Congressman, if I could just comment really quickly on two quick statements that were made.

One was the idea that somehow if you are selling these loans into the secondary market into investors who don't live next-door, the likelihood of discrimination is less, one could argue completely the opposite. The fact that you don't have to personally endure what happens when you provide that person with a predatory loan could, in fact, potentially enhance discriminatory practices. And one of the reasons that many argue that the subprime crisis got to the magnitude it is today is because those loans were shipped off to unknown investors and the result happened concentrated in minority neighborhoods.

The second argument about the HMDA data, I don't want to make it sound as if the HMDA data is to be dismissed. There is no publicly available credit-related data that reinforces or supports the levels of disparity in lending by race and ethnicity in the HMDA data. The question is, to what extent, and can you put a specific statistic on it, et cetera, et cetera. But, in fact, the HMDA data do show wide disparity of treatments that cannot be explained by publicly available credit data.

Mr. CONYERS. Ms. Smith?

Ms. SMITH. Thank you.

Mr. Liebowitz implied that people don't act against their own economic interest, that, you know, if you are selling a home, you are going to sell it to anybody because you want that commission. If you are doing a loan origination, you are going to give it to anybody because you want that commission.

The fact of the matter is, that is simply not true. And I will send him the report that the Urban Institute did based on our eight-city testing investigation of hundreds of lending tests in these eight metropolitan areas.

People think and economists often say to me, you know, it is irrational for people to act against their economic interest. And I have to remind them that discrimination is irrational, and they act that way anyway.

Mr. CONYERS. Well, I have to submit that people also act against their political interests. I have noted that in the course of my career. And so I am not shocked to hear you say that they act against, sometimes, some, against their economic self-interests.

Mr. CARR. Congressman, if I could, just one comment very quickly. When I say there is no publicly available credit data, it is not that there aren't studies that have shown that minority households have higher credit challenges than do non-Hispanic, White households. It is that the disparities in their credit profiles don't in any way relate to the extreme disparities in the HMDA data. So there is data; you can actually compare it, and they don't make sense.

Ms. WIGGINS. May I add just a few more points?

I wanted to just speak as the advocate for the folks who are left to bridge the gap when Government agencies underutilize their authority and the obligations under the act. That there is a chipping away of the breadth, of the complete range of what is possible under the Fair Housing Act.

When HUD and DOJ doesn't file disparate impact cases, what happens is what we are seeing now in the court system. Just last month, the Supreme Court ruling from *Ledbetter v. Goodyear Tire* was applied to a design and construction case. This was the 9th Circuit. And they said that the discrimination would have occurred when the design and construction of the noncomplying building was completed, not when the individuals with disabilities learned that the building was out of compliance. The Department of Justice was silent on that issue.

Also, we are seeing a chipping away of the act as to discriminatory acts that occur after the sale contract, or rental contract of housing units. There is a trend among two circuit courts of appeal and some district courts to outrightly reject any allegation of discrimination that takes place after those instances, saying that it is not within the Fair Housing Act.

So I just want to reiterate that, as I was the one who was asked to testify about the burden on the community when Federal agencies don't fully enforce the Fair Housing Act, that this is part of what happens.

Ms. Smith was modest in part of her earlier testimony. She was talking about how her organization has filed a suit against a real estate agency in Detroit. What she got in exchange for that is a suit that we are representing her in. She is now facing court action because of statements she has made about that case. And the Lawyers' Committee, along with some brilliant people at Fried Frank, are representing her and the National Fair Housing Alliance in that. And I just wanted to say that is another deficit when the Federal agencies do not do what they are supposed to do.

I just wanted to briefly address Mr. Liebowitz's comments. What I hear is a different orientation, certainly, from where I come from. That discrimination occurs when only it can be proved as intentional, when someone uses a racial slur, when someone says, "We don't want those people here," or, "Sell to everybody but them," and we draw a red line around a certain neighborhood.

But the disparate impact, pattern-or-practice cases are out there. We are bringing those cases. Other advocates in the fair housing community are bringing those cases. And DOJ and HUD should be bringing those cases too.

Mr. CONYERS. Well, let me, before I recognize the Ranking Member, let me read this passage again.

"In 2003, HUD brought only four racial discrimination cases, although it received more than 2,700 complaints that year. Now, 40 years later after the passage of the Fair Housing Act, at least 3.7 million fair housing violations still occur each year."

Now, those all don't have to be racial; there could be other reasons for them.

And so, Professor Stan Liebowitz, we come back to the original question that we started off with. Isn't it apparent to you that there are serious violations of the act that we celebrate, that was passed 40 years ago, in the millions? And this is annually.

So might we reach some agreement on the seriousness of the problem based on these statistics?

Mr. LIEBOWITZ. I have no idea of the provenance of those statistics. I have been talking about discrimination in the origination of mortgages. And I don't think that is what those statistics are related to. My guess is they are related to renting and other activities.

But I have no idea where that number comes from; I am unfamiliar with it. So I don't know what to make out of that number.

My expertise is more narrow. It is really just with the mortgage origination. And I am not aware of any number that indicates there is a great deal of discrimination going on in that market. So I don't think we are getting any closer right now.

Mr. CONYERS. Well, let's set my statistics aside for a moment. Does your visual knowledge, from what you have seen of the way communities in America are laid out in every part of the United States of America lead you to suspect that the geography of this country, we somehow always seem to be ending up in communities that are distinguishable by race?

Mr. LIEBOWITZ. I certainly agree with that. The exact reasons are not completely clear, because you find that, to some extent, on college campuses as well. And on college campuses, the students are choosing on their own to live and act segregatedly. I think that is very unfortunate, but that is what you see there.

So there is no doubt—I am certainly not going to argue against history, that, you know, there has been a great deal of discrimination in the past. And it was a terrible thing. I don't doubt that discrimination still goes on in terms of activity. In the origination mortgages, I don't see any evidence to that.

And I think there are other parts of society where there may not be as much discrimination going on. I think the country has undergone a great change in my lifetime. And, thus, I have no idea about the 3 million number that you keep bringing up.

So I am not going to deny that discrimination is going on and that racism exists. I would say it is, in my mind, really quite small, that most Americans are very open-minded, much more than they used to be. And there are people who try to go out of their way to, sort of, be open-minded and give everyone a fair chance. And I think that largely describes a great deal of the country right now.

Mr. CONYERS. Well, I hear you implying that it may be the kind of self-segregation on university campuses is somewhat the same as what is going on in housing patterns in the United States. Is that a fair assumption?

Mr. LIEBOWITZ. No, because there is one other difference, and that is there is going to be segregation by income levels, because different parts of cities have different style of houses. So that is going to occur.

Within income levels, segregation still occurs. And that would seem to be something that you wouldn't expect to necessarily happen.

And there I have no doubt that, in the past, it was largely due to racial discrimination. But I am not sure now that that is really all that much of it. I think it may be that it is what we are seeing that people can move and they want to be with people with whom they feel more comfortable.

Mr. CONYERS. What about school patterns, which frequently follow housing patterns? I don't claim you to be an expert here, but it is fairly observable that, as a result of housing segregation, you end up with the resegregation of the school system in America. Does that comport with what you have seen and heard and read about this subject?

Mr. LIEBOWITZ. It is certainly my understanding. I sent my kids through public school. There were attempts to try to integrate by creating magnets and whatnot, not all that terribly successfully. That is a very difficult problem.

Mr. CONYERS. Could I recognize the Ranking Member now, Mr. Franks of Arizona?

Mr. FRANKS. Well, thank you, Mr. Chairman.

My remarks here are more contemporaneous than anything else, because I have to apologize that I couldn't be here for all of your testimony. And I was out trying to save the world, and that is the truth. But this is a challenging situation here, and if I could just kind of lay the premise from my own perspective.

I think with all of my heart that everywhere we find discrimination, whether it be systemic or personal, individual discrimination, we as a society have a responsibility to crush it. I think it is an evil that goes against the dignity of humanity of every individual.

I do associate myself with Mr. Liebowitz's comments, however, in that I believe that the whole mortgage crisis is not predicated on discrimination. There may be elements there that are hard to divine in all of the challenges that we have, but I think there is a great point that he made that related to some of the income levels here.

And this is going to hard, and I will probably say something controversial, and I don't mean to, but I am going to go ahead. I think that the tragedy in this country where we had racial discrimination was such a mark on our hearts and on our history that there is just no way for us to adequately address that and, you know, to really be able to express how tragic that was. Because discrimination, at its very core, is saying that because someone is different that somehow they are not a child of God.

And if there is anything that this country is fundamentally founded on, it is that we hold these truths to be self-evident, that all men, all human beings, are created equal. That is who we are as Americans. And where we step from that, it is a great tragedy. And I believe we continue to step from it in many areas of society today.

But in this particular situation, I believe that we are aiming at the wrong cause, in this particular Committee. And I say that with great respect for the people who disagree with me.

But I also believe something else happened. And maybe this is not the right forum to present it. But I think in the Great Society programs, that however sincere they may have been, with a lot of these sectors of our society, in many cases the minority sectors of our society, brought a dependence upon Government that did not accomplish the ultimate goal, which was to see all sectors of society come to be equal in every way.

And I think, unfortunately, that it has created such a dependency that it was depressed the income levels. And I think that somehow it is hard for us to face those things, because, you know, we don't want to look at something like that directly. But I think, unfortunately, that has been the case.

And we have to have equal opportunity and do everything we can to be color-blind. And I will say this. It was mentioned about schools. The most integrated institutions in America are faith-based institutions, and certainly that applies to schools. There are probably no more integrated schools in America than the local faith-based private schools, because they see everyone there as a child of God and equal in his sight and equal in the sight of all human beings.

And until we as a society, I believe, embrace that and say we are going to see each other equally and we are going to act as brothers and sisters, but we are not going to institute failed policies of a socialistic nature that have proven throughout history to hurt the very people that it purports to help.

Now, again, this is a hard place to bring a subject like this, and I know that I am so outnumbered in this room. But I still say it with absolutely all the respect and love in my heart for everybody in this room. And I hope that somehow we could delineate the difference between discrimination and bad policy.

And the mortgage crisis was caused by greed. It was caused by mortgage brokers that told lenders things that weren't true. It was caused by people who looked at houses and thought, well, I can make money by appraising this house for more than it was. And these are things that we should be going after, because that is what caused the problem.

And, in the meantime, we should go after discrimination wherever it presents itself but not tie the two together unless they deserve to be tied together.

With that, Mr. Chairman, I yield back. I think I am going to take a run for it, okay?

Mr. CONYERS. I think we appreciate your comments, and I am glad that you were able to return.

Attorney Wiggins, you left us with a choice to be made in your presentation. You said there were two strategies, and you were hoping that the right one would be chosen. Would you redescribe what choices were before us and which one of them you might prefer yourself?

Ms. WIGGINS. Thank you. What I was saying was that we are at odds, the advocates, those of us in the fair housing community, we are at odds with the Federal agencies who are supposed to be enforcing this broad act. And we both can't be right.

I was saying that either those of us in the fair housing community are right and that we should safeguard the protections, the full range of arsenals that are afforded to us under the act. Or the Federal agencies are right, and as the lack of using their authority chips away at the breadth of the act is okay because there are folks like me and the other folks on this panel who will pick up the slack.

My request is that the Members of this subcommittee, in particular, as well as other Members of Congress would use the full force of their authority and influence to ensure that we all have the ball picked up, that it is not just the people in the communities who have to bridge this gap, but that those agencies who have obligations and resources under the Fair Housing Act to do everything they are supposed to do within the full force of their authority and influence to ensure that all of us who are protected under that act are served by their Government.

Mr. CONYERS. The Attorney General recently declined to form a task force that deals with parts of this subject. Does anyone want to make any comments about that?

Ms. Smith?

Ms. SMITH. I have been investigating mortgage lending discrimination since 1977. And when the subprime market came about and grew exponentially from 1992 to 2002, we saw the inflated appraisals happening.

I actually met with the largest company at the time who was selling all of the appraisals to the lender. And I said to him, do you understand that you are churning these inflated appraisals, that when an unscrupulous lender and appraiser push it into the system in a neighborhood, then other lenders don't understand that it is just artificially increasing the value of the property and that you need to do a better job about this?

And his response to me was, "I am just taking public records. So I am not discriminating." And I said, "I understand you are taking public records, but you have some responsibility to do due diligence to see that those appraisals are accurate." Then Fidelity bought them, and it kept the churning.

But I was looking at this from the 1970's forward, because I saw this happening first in the African-American community. The lenders who saw the high equity that, particularly, senior citizens had in their homes and ways to strip that equity. And North Carolina passed the first anti-predatory lending law to address this.

The Attorney General should look at not just loan origination but underwriting guidelines that were directed to have higher costs for people of color in neighborhoods.

For example, we filed a lawsuit against United Guaranty, the fourth-largest mortgage insurer in the United States, in 1988 because they have limits. If your home—I am from Toledo, Ohio, originally, so when I say to you that you had—and you know this, Congressman, because you are from Detroit. You can have beautiful homes that are under $40,000, three-bedroom frame homes with a garage, well-maintained homes.

And we uncovered that the mortgage insurance companies had a minimum insurance amount, so that if you were putting less than 20 percent down on your property, they were denying mortgage insurance on the house, which then made the lender reject that loan, which made them then go to a hard-money lender to get a loan.

Now, this was in the 1970's. We saw it replicated in the 1980's, the 1990's, and now today, that the lenders just kind of twist how they are making these loans and what kind of activities they are going to engage in to make it a higher-priced loan in a neighborhood of color or a higher-priced loan to a senior citizen regardless of their race, a higher-priced loan to women.

The Justice Department did a great job with the Long Beach case back in the mid-1990's. They were first to understand with that case, in Decatur Federal, that there was a subprime market and how it was acting.

And I think if the Attorney General would look back at those cases in the early 1990's and the mid-1990's and start looking at all the players in the mortgage lending market and see what their role was—and then we have to jump to Wall Street, because Wall Street paid a premium to lenders to push the exotic loans, the adjustable rates, the 327s, 228s. It paid a premium.

And the lenders told me this. You know, I didn't make this up. They came to me, and they said, "Shanna, you want to criticize us for pushing ARMs, but they pay us more to push these loans."

And we all know—some of us are old enough to know that when the adjustable rate loans were first made, the 525s, it was for a niche market. It was for people who had increasing income and lived in neighborhoods where the property was appreciating pretty rapidly, so that it wasn't a risky loan. It was made for that particular demographic. It didn't include me, but it included a lot of other people.

But then they pushed this exotic loan into the full market and onto people who just didn't know that these loans weren't good. They sold it to the real estate agents, who said, "You know, you tell me you are qualified for a $200,000 home, but I can get you into a $300,000 home, and here is your payment."

Lenders would say and real estate agents would say to people, "What do you want your payment to be?", rather than, "What can you really afford in the long term?" And they kept saying, "Oh, you can just refinance it." And I listened to that for a little while, because I pay my bills on time, and I thought, "Well, yes, you could just refinance." Then I realized, well, any time you buy your house, you know, you buy something for the house, or during that 2 years you might get another car, and your debt-to-income ratio has changed, so you can't necessarily refinance it.

So I think if the Attorney General would look at all the players in the market, from the originator all the way up to Wall Street, who created these loan products—I mean, there is nothing wrong with an ARM. It was just marketed to the demographic that it wasn't intended for. And that demographic, then, is suffering.

We are seeing middle-class White Americans now losing their homes left and right, but it was the African-American community who was first targeted. And many, many seniors who were African-American lost their homes years ago.

And now we have to make sure—hold people accountable for what they have done to our communities and how they have stripped our wealth, our taxes, how it is hurting our schools. What is it going to do to grocery stores? What is it going to do to our whole economy?

And if the Government, if the Attorney General holds somebody responsible, I think we can rest assured it won't happen in the future.

Mr. CONYERS. Mr. Carr, you get the last word.

Mr. CARR. I just wanted to say that the subprime market meltdown, I agree with Congressman Franks that it is not solely an issue of discrimination. It was a lot of regional economic downturns; there was speculation on the part of a number of homebuyers. But there was a lot of unfair and deceptive practice, and within that unfair and deceptive practice was a lot of steering of minority consumers.

I would just like to reinforce one of the things that Ms. Smith said also, though, which is the whole system—there was unfair and deceptive and/or just completely irrational business practices throughout the whole system.

And if you just pick one point, the credit rating agencies, if those agencies had not been stamping on loans that were basically subprime junk bonds "investment-grade" and sending them out the door, millions of Americans would not be losing their homes now. And as we look at this issue, that issue has to be one that is focused on.

A final thing, if I could just really quickly say I really appreciate the conversation, Congressman Franks, from you. It was very powerful and very moving for me.

And I just wanted to say, one of the things that I think that we have to do better as a country is not necessarily focus on the past so much. I mean, I think the past is important to understand how we got here. But more important is our future.

And the question is, where is America going to be in the 21st century when, in fact, the communities of color are the fastest-growing populations and they are the most disconnected from opportunity and the ability to compete?

And I think maybe that is an area where, if different sides of the aisle can, sort of, galvanize themselves around the need to really understand what is the competitive landscape for America if we don't succeed, then maybe we can purge a lot of the conversations about, well, it was this, it was that, it was that program, it was, you know, discrimination, it was bad Great Society, and focus on the fact that we have to move forward as one country and succeed.

And then once we have built the resonance among the public to say, "You know what? We have to succeed," then maybe there will be greater understanding of and appreciation for things like: collect better data. What is the harm in collecting data? If you are convinced that discrimination doesn't exist, then why object to collecting the data so we can measure it and monitor it and then, to the extent that we find that it actually exists, do what you have encouraged us to do here in a very, I think, powerful and moving way, which is to end it.

But I don't believe that will happen unless America understands we are all on the same team. And we need to start acting that way and acknowledging it.

Mr. CONYERS. Well, Trent Franks and I are working hard within the Committee to rise above the natural politicization that comes out of the Federal legislative process. And I wanted to commend him.

Mr. FRANKS. Thank you. And I just appreciate Mr. Carr's comments, sir.

Mr. CONYERS. Yes, I do too.

Now I will close the hearing with a comment to the Chairman of the Crime Subcommittee in Judiciary. Because I haven't heard the term "predatory lending" raised since I have been in and out of the hearing. And I think that that requires some investigation.

This is the Constitution Subcommittee, but it seems to me that there has been some predatory activity—you know, I believe in the system, but all these brokers, all these appraisers, all these banks, all these mortgage lenders, all these bundlers, all these Wall Street people—hey, look, I am cynically optimistic, to use the phrase, that somebody knew something about this besides the witnesses here this afternoon.

Mr. SCOTT. And if the gentleman would yield, Mr. Chairman, we intend to inquire with the Justice Department as to whether or not some of the activities could have constituted fraud and misrepresentation, which contributed to the total collapse of this market. People have lost billions of dollars, and there appear to be misrepresentations and fraud all up and down the line. And we will be inquiring with the Justice Department what they are doing about it.

Mr. CONYERS. Well, I will rest more comfortably in my bed tonight, knowing that the Chairman of the Crime Subcommittee is going to be looking at this.

And this has been a very interesting conversation. I thank you all for your attendance.

We are dismissed.

[Whereupon, at 2:21 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND
BALTIMORE DIVISION

MAYOR AND CITY COUNCIL OF BALTIMORE, City Hall 100 N. Holliday St. Baltimore, MD 21202 Plaintiff, v. **WELLS FARGO BANK, N.A.** 464 California Street San Francisco, CA 94104 and **WELLS FARGO FINANCIAL LEASING, INC.,** 207 9th Street Des Moines, IA 50307 Defendants.	L08CV 062 Case No.________

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF AND DAMAGES

NATURE OF THE ACTION

1. The City of Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. From the first to the second quarter of 2007 foreclosure activity in the City increased five-fold. Since 2000, more than 33,000 homes have been subjected to foreclosure filings. The foreclosure crisis has caused severe economic damage to the City. The high rate of foreclosures has resulted in lost revenue in property taxes;

additional costs in social services and police and fire protection; and significant administrative and legal costs.

2. In Baltimore, the foreclosure crisis has hit African-American neighborhoods and homeowners the hardest. Foreclosure rates are significantly higher in Baltimore's minority neighborhoods, due in large part to the practice of "reverse redlining." In contrast to "redlining," which involves denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise unfair lending practices because of the race or ethnicity of the area's residents. Reverse redlining has repeatedly been held to violate the federal Fair Housing Act.

3. Defendant Wells Fargo Bank, N.A., is one of the largest mortgage lenders in Baltimore and the country at large. Together with Defendant Wells Fargo Financial Leasing, Inc. (collectively "Wells Fargo"), it is also one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. In 2005 and 2006, for example, two thirds of Wells Fargo's foreclosures were in Baltimore City census tracts that are more than 60% African-American, while only 15.6% were in tracts that are less than 20% African-American. Wells Fargo's foreclosure rate for loans in African-American neighborhoods is nearly double the overall City average, while the rate for its loans in white neighborhoods is less than half of the average.

4. Wells Fargo's disproportionately high foreclosure rate in Baltimore's African-American neighborhoods is the result of reverse redlining. Wells Fargo has been, and continues to be, engaged in a pattern or practice of unfair, deceptive and discriminatory lending activity in Baltimore's minority neighborhoods that have the

effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit to Wells Fargo without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods.

5. Wells Fargo's lending practices, targeted in this manner at Baltimore's underserved and vulnerable minority neighborhoods, have resulted in the disproportionately high rate of foreclosure in Baltimore's African-American communities, caused substantial and irreparable damage to these neighborhoods, and caused direct and continuing financial harm to the City of Baltimore.

6. This suit is brought pursuant to the Fair Housing Act of 1968, as amended, 42 U.S.C. §§ 3601 *et seq.*, by the Mayor and City Council of Baltimore ("Baltimore" or "City") to seek redress for the injuries caused by Wells Fargo's pattern or practice of illegal reverse redlining. Specifically, Baltimore seeks to recover damages for the injuries caused by the foreclosures in Baltimore's minority neighborhoods as a result of Wells Fargo's unlawful, irresponsible, unfair, deceptive, and discriminatory lending practices, and to obtain injunctive and declaratory relief. Absent judicial relief, the extent of the City's injury resulting from Wells Fargo's actions will continue – and potentially accelerate – as the housing market continues to decline.

PARTIES

7. Plaintiff Mayor and City Council of Baltimore is a municipal corporation, organized pursuant to Article XI-A of the Maryland Constitution. The City is authorized by the Baltimore City Charter to institute suit to recover damages suffered by the City.

8. Defendant Wells Fargo Bank, N.A. is organized as a national banking association under the laws of the United States. Upon information and belief, its

corporate headquarters are located in California. Wells Fargo Bank, N.A. maintains multiple offices in the State of Maryland and in Baltimore for the purposes of soliciting applications for and making residential mortgage loans and engaging in other business activities.

9. Wells Fargo Home Mortgage is a division of Wells Fargo Bank, N.A. that was formerly incorporated in California as a separate company and registered to do business in the State of Maryland under the name Wells Fargo Home Mortgage, Inc. Wells Fargo Home Mortgage, Inc. merged into Wells Fargo Bank, N.A. on May 5, 2004. Wells Fargo Bank, N.A. continues to do business under the name Wells Fargo Home Mortgage, including in the State of Maryland and in Baltimore.

10. Wells Fargo Bank, N.A. has been the largest or second largest provider of mortgage credit to homeowners in Baltimore since at least 2004. From 2004 to 2006, Wells Fargo Bank, N.A. made at least 1,285 mortgage loans a year to Baltimore homeowners with a collective value of over $600 million. Upon information and belief, Wells Fargo Bank, N.A. continues to make loans in Baltimore at a comparable pace. No other lender made more than 1,000 mortgage loans in Baltimore in each year from 2004 to 2006.

11. Defendant Wells Fargo Financial Leasing, Inc. is an Iowa corporation that is registered to do business in Maryland. Upon information and belief, Wells Fargo Financial Leasing, Inc. engages in the solicitation of applications for and origination of residential mortgage loans in Baltimore.

12. Each of the Defendants was and is the agent, employee, and representative of the other Defendant. Each Defendant, in acting or omitting to act as alleged in this Complaint, was acting in the course and scope of its actual or apparent authority pursuant

to such agencies, or the alleged acts or omissions of each Defendant as agent were subsequently ratified and adopted by each agent as principal.

JURISDICTION AND VENUE

13. This Court has jurisdiction over this matter pursuant to 42 U.S.C. § 3613 and 28 U.S.C. §§ 1331, 1343, because the claims alleged herein arise under the laws of the United States.

14. Venue is proper in this district under 28 U.S.C. § 1391(b) because Defendants conduct business in and are residents of the district and a substantial part of the events and omissions giving rise to the claims occurred in the district.

FACTUAL BACKGROUND

A. The Foreclosure Crisis and Baltimore

15. Like many cities across the country, Baltimore is facing an unprecedented crisis of residential mortgage foreclosures. Of the 44 million active mortgages throughout the country currently tracked by the Mortgage Bankers Association ("MBA"), approximately 343,000 entered foreclosure during the third quarter of 2007. This is the highest rate of foreclosures in more than 35 years. Overall, nearly 450,000 properties tracked by the MBA were in some stage of foreclosure during the third quarter of 2007, up 30% from the second quarter.

16. Nationwide, the foreclosure crisis is worsening rapidly and is expected to deteriorate further. The number of foreclosure filings nearly doubled from the third quarter of 2006 to the third quarter of 2007. One out of every seventeen mortgage holders is no longer able to make payments on time, the highest rate in over twenty years. Delinquent payments are a strong indicator of near-term foreclosure filings. Equally important, approximately 150,000 adjustable rate loans are resetting to higher interest

rates every month. In 2008, $362 billion in subprime loans will reset to higher rates. As the housing market continues to decline, many of these adjustments will result in foreclosures. The Joint Economic Committee of Congress predicts that from 2007 to 2009 there could be nearly 2 million foreclosures nationwide on homes purchased with subprime loans.

17. The foreclosure crisis in Baltimore is especially severe. There have been more than 33,000 foreclosure filings since 2000, and the Maryland Department of Housing and Community Development reported in October 2007 that the number of foreclosure-related events in Baltimore – notices of default, foreclosure sales, and lender purchases of foreclosed properties – increased an extraordinary five-fold from the first to the second quarter of this year.

18. Foreclosures have multiple and far-reaching impacts on the cities in which they occur, especially when they are concentrated in distressed neighborhoods that are already struggling with issues of economic development and poverty. Foreclosures in these neighborhoods frequently lead to abandoned and vacant homes. Estimates of the number of vacant homes in Baltimore range from 16,000 to 30,000. Concentrated vacancies driven by foreclosures cause neighborhoods, especially ones already struggling, to decline rapidly.

19. One example of how foreclosures and consequent vacancies harm neighborhoods is by reducing the property values of nearby homes. In Baltimore, as in cities around the country, foreclosures are responsible for the loss of hundreds of millions of dollars in the value of homes. This, in turn, reduces the City's revenue from property taxes. It also makes it harder for the City to borrow funds because the value of the property tax base is used to qualify for loans.

20. Cities with high rates of foreclosure, like Baltimore, also lose revenue from real estate transfer taxes because foreclosures depress the market for home sales. And these cities must spend additional funds for services related to foreclosures, including the costs of securing vacant homes, holding administrative hearings, and conducting other administrative and legal procedures. The funds expended also include the costs of providing additional police and fire protection as vacant properties become centers of dangerous and illicit activities.

B. The Role of Subprime Lending

21. The growing crisis of foreclosures in Baltimore and across the nation is due in large part to the rapid expansion of subprime lending. Subprime lending developed in the mid-1990s as a result of innovations in risk-based pricing and in response to the demand for credit by borrowers who were denied prime credit by traditional lenders.

22. Prior to the emergence of subprime lending, most mortgage lenders made only "prime" loans. Prime lending offered uniformly priced loans to borrowers with good credit. Individuals with blemished credit were not eligible for prime loans. Although borrowers with blemished credit might still represent a good mortgage risk at the right price, prime lending did not provide the necessary flexibility in price or loan terms to serve these borrowers.

23. In the early 1990s, technological advances in automated underwriting allowed lenders to predict with improved accuracy the likelihood that a borrower with blemished credit will successfully repay a loan. This gave lenders the ability to adjust the price of loans to match the different risks presented by borrowers whose credit records did not meet prime standards. Lenders found that they could now accurately price loans

to reflect the risks presented by a particular borrower. When done responsibly, this made credit available much more broadly than had been the case with prime lending.

24. As the technology of risk-based pricing developed rapidly in the 1990s, so did the market in subprime mortgages. Subprime loans accounted for only 10% of mortgage loans in 1998, but within five years grew to 23% of the market. Currently, outstanding subprime mortgage debt stands at $1.3 trillion, up from $65 billion in 1995 and $332 billion in 2003. These subprime loans have allowed millions of borrowers to obtain mortgages, at marginally increased prices, even though their credit profiles do not qualify them for lower-cost prime loans. They have opened the door to homeownership to many people, especially low- to moderate-income and minority consumers, who otherwise would have been denied mortgages. At the same time, subprime lending has created opportunities for unscrupulous lenders to engage in irresponsible lending practices that result in loans that borrowers cannot afford. This, in turn, has led directly to defaults and foreclosures.

25. Enticed by the prospect of short-term profits resulting from exorbitant origination fees, points, and related pricing schemes, many irresponsible subprime lenders took advantage of a rapidly rising real estate market to convince borrowers to enter into loans that they could not afford. Often this was accomplished with the help of deceptive practices and promises to refinance at a later date. These abusive subprime lenders did not worry about the consequences of default or foreclosure to their business because once made, the loans were sold on the secondary market.

26. As the subprime market grew, the opportunities for abusive practices grew with it. These practices, which in recent years have become the target of prosecutors, legislators and regulators, include the following:

a. Failing to prudently underwrite hybrid adjustable rate mortgages (ARMs), such as 2/28s and 3/27s. After the borrower pays a low "teaser rate" for the first two or three years, the interest rate on these loans resets to a much higher rate that can continue to rise based on market conditions. Subprime lenders often underwrite these loans based only on consideration of whether the borrower can make payments during the initial teaser rate period, without regard to the sharply higher payments that will be required for the remainder of a loan's 30-year term. Irresponsible lenders aggressively market the low monthly payment that the borrower will pay during the teaser rate period, misleading borrowers into believing that they can afford that same low monthly payment for the entire 30-year term of the loan, or that they can refinance their loan before the teaser rate period expires.

b. Failing to prudently underwrite refinance loans, where borrowers substitute unaffordable mortgage loans for existing mortgages that they are well-suited for and that allow them to build equity. Such refinanced loans strip much or even all of that equity by charging substantial new fees, often hiding the fact that the high settlement costs of the new loan are also being financed. Lenders that aggressively market the ability of the borrower to pay off existing credit card and other debts by refinancing mislead borrowers into believing that there is a benefit to consolidating all of their debt into one mortgage loan, obscuring the predictable fact that that the borrower will not be able to repay the new loan. The refinanced loans are themselves often refinanced repeatedly with ever-increasing fees and higher interest rates, and with ever-decreasing equity, as borrowers seek to stave off foreclosure.

c. Allowing mortgage brokers to charge "yield spread premiums" for qualifying a borrower for an interest rate that is higher than the rate the borrower qualifies for and can actually afford.

d. Failing to underwrite loans based on traditional underwriting criteria such as debt-to-income ratio, loan-to-value ratio, FICO score, reserves, and work history. These criteria ensure that a borrower is obtaining a loan that he or she has the resources and assets to repay, and ignoring these criteria results in many loans that bear no relation to borrowers' ability to repay them. This allows the lender to make a quick profit from the origination, but sets the borrower up for default and foreclosure.

e. Requiring substantial prepayment penalties that prevent borrowers whose credit has improved from refinancing their subprime loan to a prime loan. Prepayment penalties not only preclude borrowers from refinancing to a more affordable loan, but reduce the borrowers' equity when a subprime lender convinces borrowers to needlessly refinance one subprime loan with another.

f. Charging excessive points and fees that are not associated with any increased benefits for the borrower.

27. As long as housing prices continued to rise, the deleterious effect of these practices was delayed and thus, hidden. When the real estate bubble burst earlier in 2007, the inevitable occurred, and foreclosure rates began their dramatic rise. Bent on maximizing short-term profits and protected by the ability to sell their loans on the secondary market, irresponsible subprime lenders have left countless homeowners saddled with mortgage debts they cannot afford and no way to save their homes in a declining housing market.

C. **The Foreclosure Crisis in Baltimore Hits African-American Neighborhoods the Hardest**

28. In Baltimore, the impact of the foreclosure crisis is felt most acutely in minority communities. This is because of the prevalence of the practice of "reverse redlining." As used by Congress and the courts, the term "reverse redlining" refers to the practice of targeting residents in certain geographic areas for credit on unfair terms due to the racial or ethnic composition of the area. In contrast to "redlining," which is the practice of denying *prime* credit to specific geographic areas because of the racial or ethnic composition of the area, reverse redlining involves the targeting of an area for the marketing of deceptive, predatory or otherwise deleterious lending practices because of the race or ethnicity of the area's residents. This practice has repeatedly been held to violate the federal Fair Housing Act. *See, e.g., Barkley v. Olympia Mortgage Co.*, 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007); *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000).

29. Reverse redlining typically flourishes in cities where two conditions are met. First, the practice afflicts cities where minorities historically have been denied access to credit and other banking services. The legacy of historic discrimination, or redlining, often leaves the residents of minority communities desperate for credit, and without the knowledge or experience required to identify loan products and lenders offering products with the most advantageous terms for which they might qualify. Instead, residents of underserved minority communities often respond favorably to the first offer of credit made, without regard to the fairness of the product. This makes them especially vulnerable to irresponsible subprime lenders who, instead of underwriting carefully to ensure that the loans they offer are appropriate for their customers, engage in the unscrupulous lending practices described in paragraph 26 above.

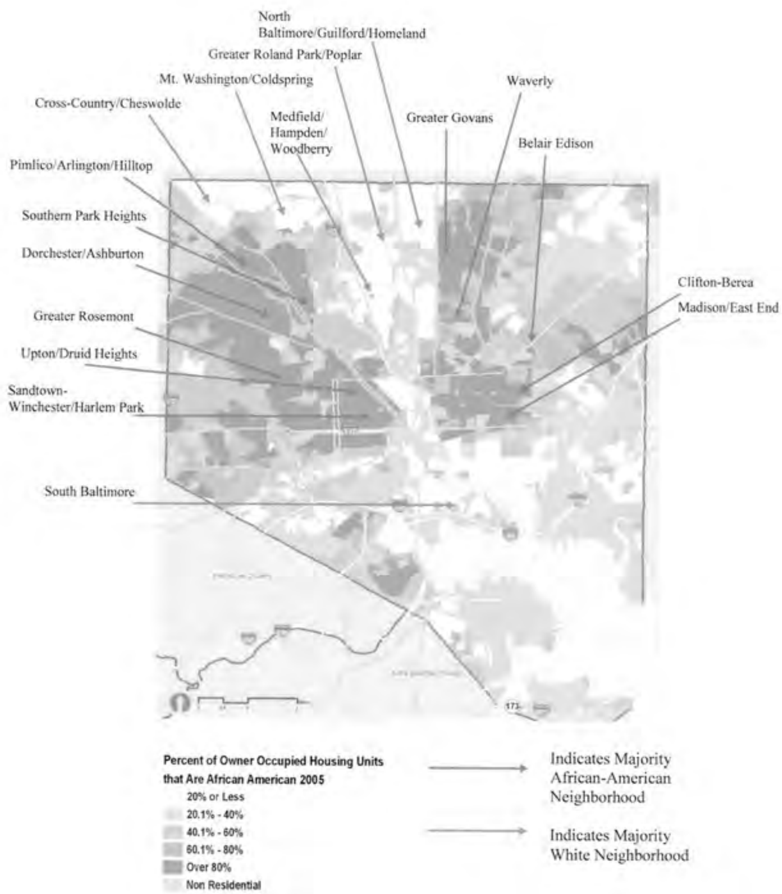
30. Second, reverse redlining arises in cities where there are racially segregated residential living patterns. This means that the people who are most vulnerable to abusive lending practices are geographically concentrated and therefore easily targeted by lenders.

31. Both of these conditions are present in Baltimore. First, Baltimore's minority communities historically have been victimized by traditional redlining practices. Through much of the twentieth century the federal government, mortgage lenders, and other private participants in the real estate industry acted to deny homeownership opportunities and choices to the City's African Americans. The Secretary of the United States Department of Housing and Urban Development admitted in 1970 that the federal government had "refus[ed] to provide insurance in integrated neighborhoods, promot[ed] the use of racially restrictive covenants," and engaged in other methods of redlining. *Thompson v. U.S. H.U.D.*, 348 F. Supp. 2d 398, 466 (D. Md. 2005). The federal government even published a map in 1937 titled "Residential Security Map for Baltimore" designed to facilitate private redlining by mortgage providers. *See id.* at 471. Mortgage lenders actively engaged in redlining for decades, treating "black and [the few] integrated neighborhoods as unstable and risky." Garrett Power, *Apartheid Baltimore Style: The Residential Segregation Ordinances of 1910-1913*, 42 Md. L. Rev. 289, 319, 322 (1983).

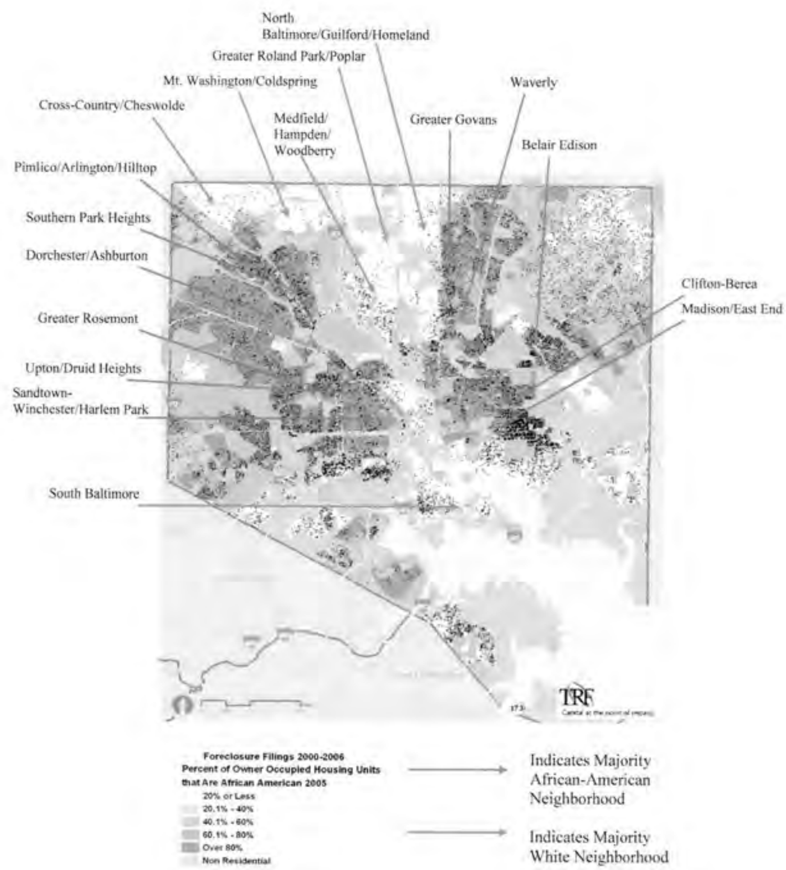
32. The practice and effects of widespread redlining in Baltimore persisted for decades. An analysis of data from the 1980s, long after much of the institutionalized governmental and corporate apparatus of discrimination had been dismantled, found that the more African-American residents in a Baltimore neighborhood, the fewer mortgage loans and dollars the neighborhood received. Anne B. Shlay, *Maintaining the Divided*

City: Residential Lending Patterns in the Baltimore SMSA (Maryland Alliance for Responsible Investment, March 1987). The study also found that while 73% of majority white census tracts received a medium or high volume of single family mortgage loans, the same was true of only 5% of majority African-American tracts.

33. Second, the City is highly segregated between African Americans and whites. As the following map shows, even though Baltimore is 64% African-American and 32% white, many neighborhoods have a much higher concentration of one racial group or the other. For example, the African-American population exceeds 90% in East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, and Greater Govans. It exceeds 75% in Waverly and Belair Edison. At the same time, the white population of Greater Roland Park/Poplar, Medfield/Hampden/Woodberry, and South Baltimore exceeds 80%, and the white population of Cross-Country/Cheswolde, Mt. Washington/Coldspring, and North Baltimore/Guilford/Homeland exceeds 70%.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Waverly
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

34. The location of foreclosures in the City of Baltimore is consistent with the existence of a pattern and practice of reverse redlining by lenders providing mortgages to residents of the City. As shown in the following map, although foreclosures have occurred in many parts of Baltimore, they are disproportionately concentrated in Baltimore's African-American neighborhoods. Neighborhoods like Greater Govans, Greater Rosemont, Madison/East End, and Southern Park Heights, all with African-American populations above 90%, are at the center of the foreclosure crisis. Citywide, census tracts that are above 80% African-American account for 49% of Baltimore's foreclosure filings, even though they account for only 37% of the City's owner-occupied households.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Waverly
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
TRF
Foreclosure Filings 2000-2006
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

D. Wells Fargo is a Major Contributor to the Foreclosure Crisis in Baltimore's African-American Neighborhoods

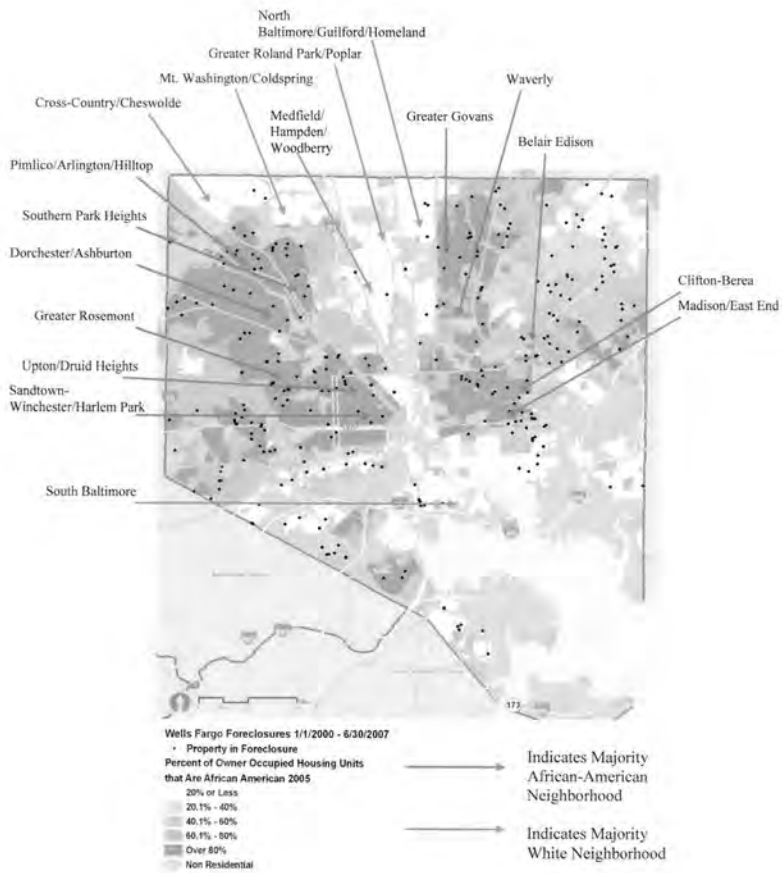
35. Wells Fargo is one of the largest mortgage lenders in Baltimore. It has made at least 1,285 mortgage loans in Baltimore in each of the last three years, with a collective value of over $600 million. In each of these years, it has been one of the top two mortgage lenders in the City. Wells Fargo makes loans in both the white and African-American neighborhoods of Baltimore.

36. Far from being a responsible provider of much-needed credit in minority communities, however, Wells Fargo is one of the leading causes of the disproportionately high rate of foreclosures in Baltimore's African-American neighborhoods. Its foreclosures since at least 2000 have been concentrated in Belair Edison, East Baltimore, Pimlico/Arlington/Hilltop, Dorchester/Ashburton, Southern Park Heights, Greater Rosemont, Sandtown-Winchester/Harlem Park, Greater Govans and Waverly, and other neighborhoods with African-American populations exceeding 75%.

37. Half of Wells Fargo's foreclosures from 2005 to 2006 were in census tracts that are more than 80% African-American and two-thirds were in tracts that are over 60% African-American, but only 15.6% were in tracts that are 20% or less African-American. The figures are virtually identical for Wells Fargo's foreclosures from 2000 to 2004 with more than half in tracts that are more than 80% African-American, 64% in tracts that are over 60% African-American, and only 14.8% in tracts that are 20% or less African-American. Wells Fargo's foreclosures during the first half of 2007 reflect a similar pattern. Almost half are in tracts that are more than 80% African-American, while only 11.4% are in tracts that are 20% or less African-American.

38. At the same time, Wells Fargo has the largest number of foreclosures in Baltimore of any lender – at least 135 from 2005 to 2006. Only two other lenders had

more than 100 foreclosures during this period. With at least seventy foreclosures during the first half of 2007, the pace of Wells Fargo's foreclosures is increasing. In addition, at least 108 Wells Fargo loans in Baltimore resulted in foreclosure from 2000 to 2004. The number of Wells Fargo foreclosures from 2000 through the first half of 2007 is probably much higher because in many cases the foreclosure records analyzed by Plaintiff do not indicate the original lender. The following map represents the concentration of Wells Fargo's foreclosures in African-American neighborhoods from 2000 through the first half of 2007.


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Waverly
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Clifton-Berea
Madison/East End
Wells Fargo Foreclosures 1/1/2000 - 6/30/2007
• Property in Foreclosure
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

39. The likelihood that a Wells Fargo loan in a predominantly (60% or greater) African-American neighborhood will result in foreclosure is significantly greater than the likelihood of foreclosure for a loan in a predominantly white neighborhood. While 8.2% of Wells Fargo's loans in predominantly African-American neighborhoods result in foreclosure, the same is true for only 2.1% of its loans in predominantly white neighborhoods. In other words, a Wells Fargo loan in a predominantly African-American neighborhood is nearly four times as likely to result in foreclosure as a Wells Fargo loan in a predominantly white neighborhood.

40. The overall foreclosure rate in Baltimore, based on loans from all lenders, is 4.5%. Thus, Wells Fargo's foreclosure rate for loans in African-American neighborhoods is nearly double the overall City average, while the ratio for its loans in white neighborhoods is less than half the average.

E. Wells Fargo Targets Baltimore's African-American Neighborhoods for Improper and Irresponsible Lending Practices

41. Wells Fargo's failure to underwrite loans in minority and underserved communities in a responsible manner has been the subject of public attention and concern for years. For example, its practices are the focus of a 2004 report from the Center for Responsible Lending. The report concluded that the company's customers "too often face the loss of their home or financial ruin as a result" of its "predatory practices." Center for Responsible Lending, *A Review of Wells Fargo's Subprime Lending* (Apr. 2004) at 10 (available at http://www.responsiblelending.org/pdfs/ip004-Wells_Fargo-0404.pdf).

42. Wells Fargo's pattern or practice of failing to follow responsible underwriting practices in Baltimore's African-American neighborhoods is evident from the type of loans that result in foreclosure filings in those neighborhoods. Approximately

70% of Wells Fargo's Baltimore loans that result in foreclosure are fixed rate loans. This ratio is the same in both African-American and white neighborhoods. This establishes that there is no legitimate reason for the stark difference in Wells Fargo's foreclosure rates by race.

43. Unlike adjustable rate loans, where the price may fluctuate with changing market conditions, the performance of fixed rate loans is relatively easy to predict using automated underwriting models and loan performance data because monthly payments do not vary during the life of the loan. Using these sophisticated risk assessment tools, and relying on traditional underwriting criteria such as FICO scores, debt-to-income ratios, loan-to-value ratios, and cash reserves, any lender engaged in responsible underwriting practices designed to identify qualified borrowers can predict with statistical certainty the likelihood of default and/or delinquency. Lenders engaged in marketing fixed rate loans in a fair and responsible manner should have no difficulty sifting out unqualified borrowers, or borrowers whose loans would likely result in delinquency, default or foreclosure.

44. Because the percentage of fixed rate loans is so high and the same in both African-American and white neighborhoods, Wells Fargo should, if it properly underwrites, have comparable foreclosure rates in both communities. The fact that Wells Fargo's underwriting decisions result in foreclosure nearly four times as often with respect to African-American than white neighborhoods means that it is not following fair or responsible underwriting practices with respect to African-American customers.

45. The disparate foreclosure rates are instead consistent with the type of unscrupulous subprime lending practices described in paragraph 26 above. Upon information and belief, and as explained below, Wells Fargo engages in these and

similarly inappropriate practices when making loans to African Americans and in African-American neighborhoods. This pattern or practice of targeted activities fully explains the disparate rates of foreclosure.

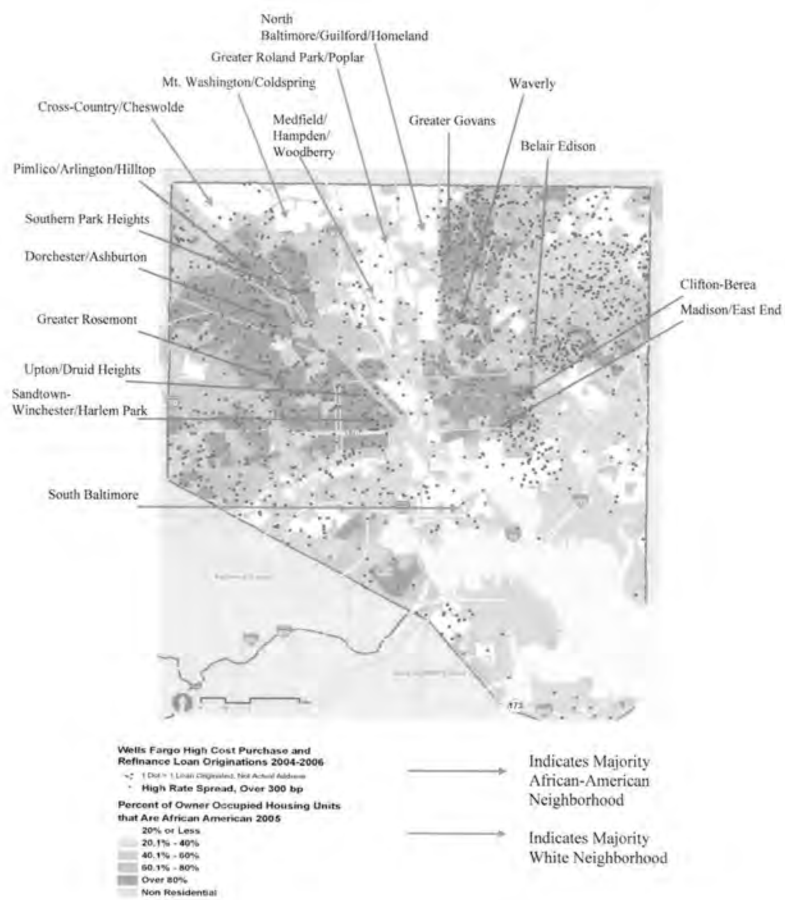
46. A closer look at the characteristics of the loans made by Wells Fargo in Baltimore demonstrates that it is engaged in a pattern or practice of reverse redlining with respect to the City's African-American neighborhoods. As described in sections E.1 through E.6 below, examination of Wells Fargo's loans indicates it is engaged in unfair and discriminatory practices in Baltimore's African-American neighborhoods that have the effect and purpose of placing inexperienced and underserved borrowers in loans they cannot afford. These practices maximize short-term profit without regard to the borrower's best interest, the borrower's ability to repay, or the financial health of underserved minority neighborhoods. This targeted pattern or practice has resulted in the disproportionately high rate of foreclosures found in Baltimore's African-American neighborhoods.

1. Publicly Available Home Mortgage Disclosure Act Data Shows that Wells Fargo's High-Cost Loans are Disproportionately Located in African-American Neighborhoods in Baltimore

47. Publicly available data reported by Wells Fargo to federal regulators pursuant to the Home Mortgage Disclosure Act shows that in 2006, Wells Fargo made high-cost loans (*i.e.*, loans with an interest rate that was at least three percentage points above a federally-established benchmark) to 65% of its African-American mortgage customers in Baltimore, but only to 15% of its white customers in Baltimore. In 2005, the respective rates were 54% and 14%; in 2004, the respective rates were 31% and 10%. The proportion of refinance loans that are high cost is especially pronounced. In 2004,

2005, and 2006, a Wells Fargo refinance loan to an African-American borrower was 2.5 times more likely to be high cost than a refinance loan to a white borrower.

48. The maps that follow show the geographic distribution of high-cost loans in African-American and white neighborhoods in Baltimore. These maps demonstrate that Wells Fargo's high-cost loans are disproportionately located in Baltimore's African-American neighborhoods, including, among others, Sandtown-Winchester/Harlem Park, Upton/Druid Heights, Dorchester/Ashburton, and Madison/East End.


North
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Mt. Washington/Coldspring
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Waverly
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Clifton-Berea
Madison/East End
Wells Fargo High Cost Purchase and
Refinance Loan Originations 2004-2006
High Rate Spread, Over 300 bp
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood


North
Baltimore/Guilford/Homeland
Greater Roland Park/Poplar
Mt. Washington/Coldspring
Waverly
Cross-Country/Cheswolde
Medfield/
Hampden/
Woodberry
Greater Govans
Belair Edison
Pimlico/Arlington/Hilltop
Southern Park Heights
Dorchester/Ashburton
Clifton-Berea
Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
173
Wells Fargo High Cost Refinance Loan
Originations 2004-2006
High Rate Spread, Over 300 bp
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

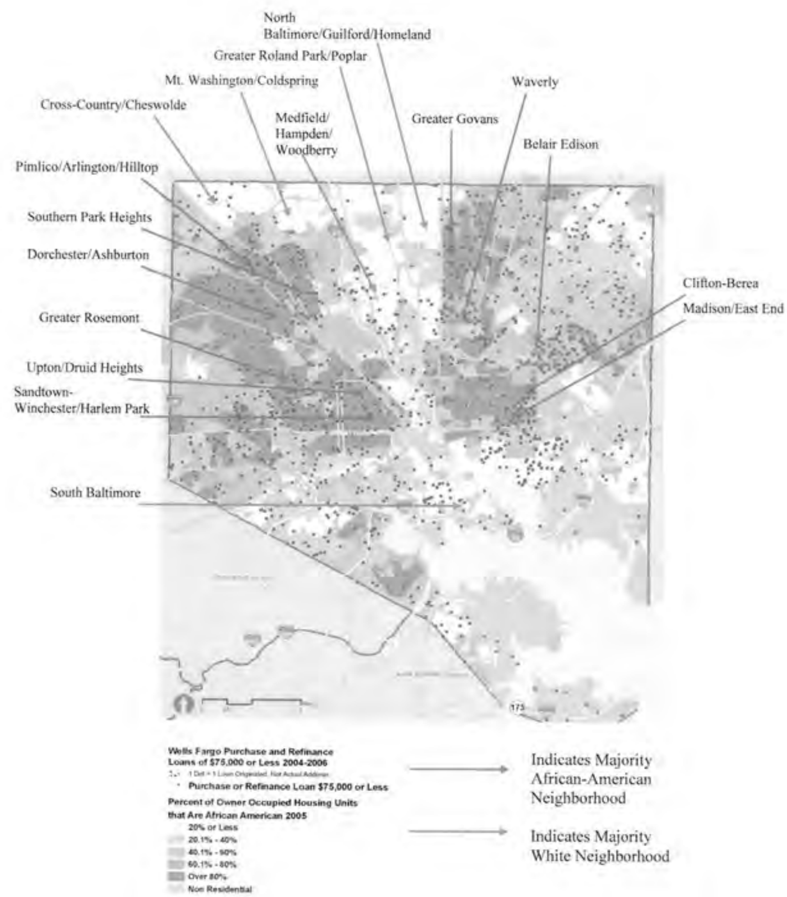
49. The fact that high-cost loans involving all of Wells Fargo's loan products are more heavily concentrated in Baltimore's African-American neighborhoods is consistent with the practice of reverse redlining and, upon information and belief, has contributed significantly to the disproportionately high rate of foreclosures in Baltimore's African-American communities. Within the subset of high-cost loans, however, the fact that a disproportionately large percentage of Wells Fargo's high-cost loans in African-American neighborhoods are refinance loans is particularly significant, for it is both consistent with and indicative of a deceptive and predatory subprime practice that involves encouraging minority borrowers who already have loans to refinance at excessive cost with little benefit. This increases the likelihood of foreclosure and, upon information and belief, has contributed to the disproportionately high rate of foreclosures in Baltimore's African-American communities.

2. Wells Fargo's Pricing Sheets Show that it Targets Homes that are More Likely to be Located in African-American Neighborhoods for Interest Rate Increases, and Lowers Rates for Homes that are Disproportionately Located in White Neighborhoods

50. One reason that residents of Baltimore's African-American neighborhoods are more likely to pay higher prices for Wells Fargo loans than residents of Baltimore's white neighborhoods is the discriminatory pricing found on its pricing sheets. As set forth explicitly on the Wells Fargo Home Mortgage 2005 pricing sheet, attached as Attachment A, Wells Fargo requires a 50 basis point increase in the loan rate for loans of $75,000 or less, a 12.5 basis point decrease for loans of $150,000 to $400,000, and a 25 basis point decrease for loans larger than $400,000. This means that a borrower with a $75,000 thirty-year fixed rate loan who qualifies for an 8% interest rate instead receives an 8.5% interest rate, which costs an extra $9,493 over the life of the loan. An equally creditworthy borrower with a $150,000 loan receives a 7.875% interest rate, which costs

$4,698 less than an 8% loan. A similarly qualified borrower with a $400,001 loan would receive a 7.75% interest rate, which costs $24,987 less than an 8% loan.

51. These pricing rules have a clear and foreseeable disproportionate adverse impact on African-American borrowers. As demonstrated by the maps that follow, loans originated by Wells Fargo in Baltimore from 2004 through 2006 in the amount of $75,000 and less were nearly twice as likely to be in census tracts where the population is predominantly African-American than in tracts where the population is predominantly white. By contrast, loans originated by Wells Fargo in Baltimore of more than $150,000 were nearly six times as likely to be in tracts that are predominantly white than in tracts that are predominantly African-American.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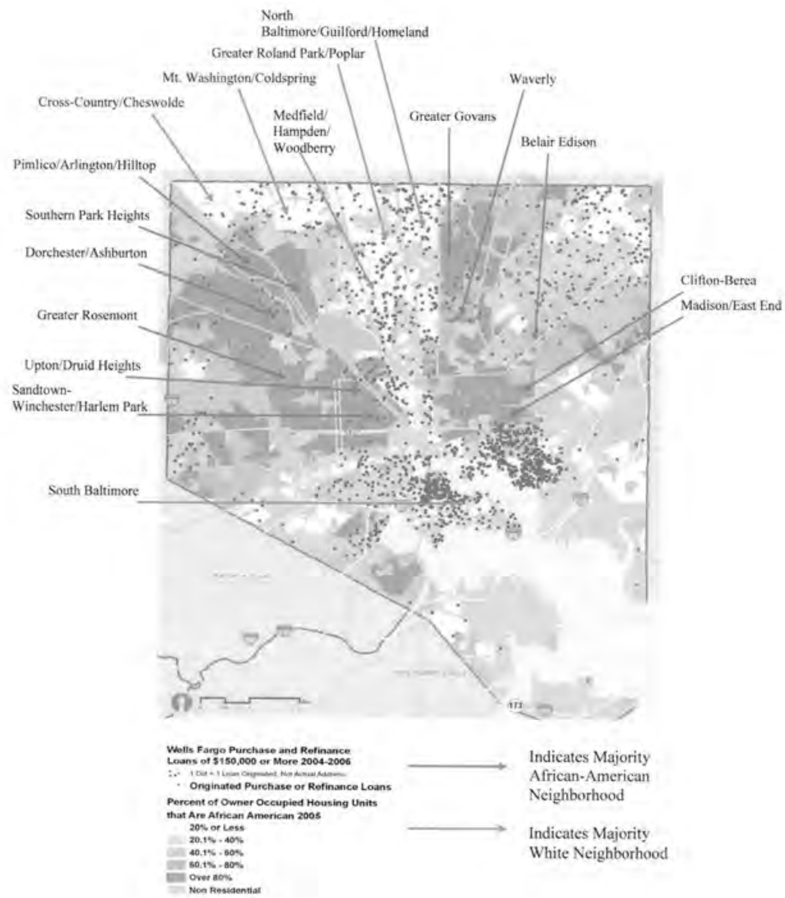
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Originated Purchase or Refinance Loans
Percent of Owner Occupied Housing Units
that Are African American 2005
20% or Less
20.1% - 40%
40.1% - 60%
60.1% - 80%
Over 80%
Non Residential
Indicates Majority
African-American
Neighborhood
Indicates Majority
White Neighborhood

52. Upon information and belief, the discriminatory pricing reflected in Wells Fargo's pricing sheets is consistent with unfair practices associated with reverse redlining and has contributed significantly to the disproportionately large number of foreclosures found in Baltimore's African-American communities.

3. Investigation of Wells Fargo's Pricing Practices in Philadelphia Further Demonstrates the Company is Targeting the African-American Community for Unfair and Improper Lending Practices

53. Discriminatory pricing observed in Wells Fargo's loan data in Baltimore is consistent with findings drawn from data obtained in litigation brought against Wells Fargo in Philadelphia. An expert report in a pending lawsuit based on Wells Fargo's Philadelphia loans concluded that "African American borrowers, and borrowers residing in African American neighborhoods (i.e., census tracts), pay more than comparable non-African Americans and residents of communities in which White people predominate." Aff. of I. Goldstein, *Walker v. Wells Fargo Bank, N.A.*, No. 05-cv-6666 (E.D. Pa. July 20, 2007) at ¶ 7 (Docket No. 24, Attach. 1).

54. Upon information and belief, Wells Fargo's pricing practices in Philadelphia are consistent with its practices in Baltimore, and provide further evidence that the company is engaged in a pattern or practice of unfair lending that contributes significantly to the disproportionately high rate of foreclosure found in Baltimore's African-American neighborhoods.

4. Wells Fargo Underwrites Adjustable Rate Loans in Baltimore's African-American Neighborhoods That Borrowers Cannot Afford

55. Wells Fargo frequently originates, or until earlier in 2007originated, "2/28" and "3/27" adjustable rate mortgages to borrowers from predominantly African-American neighborhoods in Baltimore. Thirty percent of Wells Fargo's foreclosures

from 2000 to 2006 involved such loans. Unless properly underwritten, such loans are destined to fail.

56. Upon information and belief, Wells Fargo does not properly underwrite these loans when made to African Americans and in African-American neighborhoods. Wells Fargo does not adequately consider the borrowers' ability to repay these loans, especially after the teaser rate expires and the interest rate increases. The fact that these loans would result in delinquency, default and foreclosure for many borrowers was, or should have been, clearly foreseeable to Wells Fargo at the time the loans were made.

57. The use of "2/28" and "3/27" adjustable rate mortgages in the manner described above is consistent with the practice of reverse redlining, has subjected African-American borrowers to unfair and deceptive loan terms, and has contributed significantly to the high rate of foreclosure found in Baltimore's African-American neighborhoods.

5. The Caps on Wells Fargo's Adjustable Rate Loans are Higher in African-American Neighborhoods

58. Upon information and belief, Wells Fargo has discretion to apply different caps on adjustable rate loans. The cap is the maximum rate that a borrower can be charged during the life of an adjustable rate loan.

59. The average cap on a Wells Fargo adjustable rate loan that was subject to foreclosure in 2005 or 2006 in predominantly African-American neighborhoods was 14.13%. The cap on such loans in predominantly white neighborhoods was only 13.61%.

60. The disparity observed in caps imposed on adjustable rate loans in predominantly African-American neighborhoods and predominantly white neighborhoods further demonstrates that Well Fargo is engaged in a pattern or practice of

unfair and improper lending in Baltimore's African-American communities that contributes significantly to the high rate of foreclosure in these neighborhoods.

6. Wells Fargo's Loans in African-American Neighborhoods Result in Especially Quick Foreclosures

61. A comparison of the time from origination to foreclosure of Wells Fargo's loans in Baltimore shows a marked disparity with respect to the speed with which loans in African-American and white neighborhoods move into foreclosure. In African-American neighborhoods, the average time to foreclosure is 2.06 years. In white neighborhoods it is 2.45 years, or 19% longer.

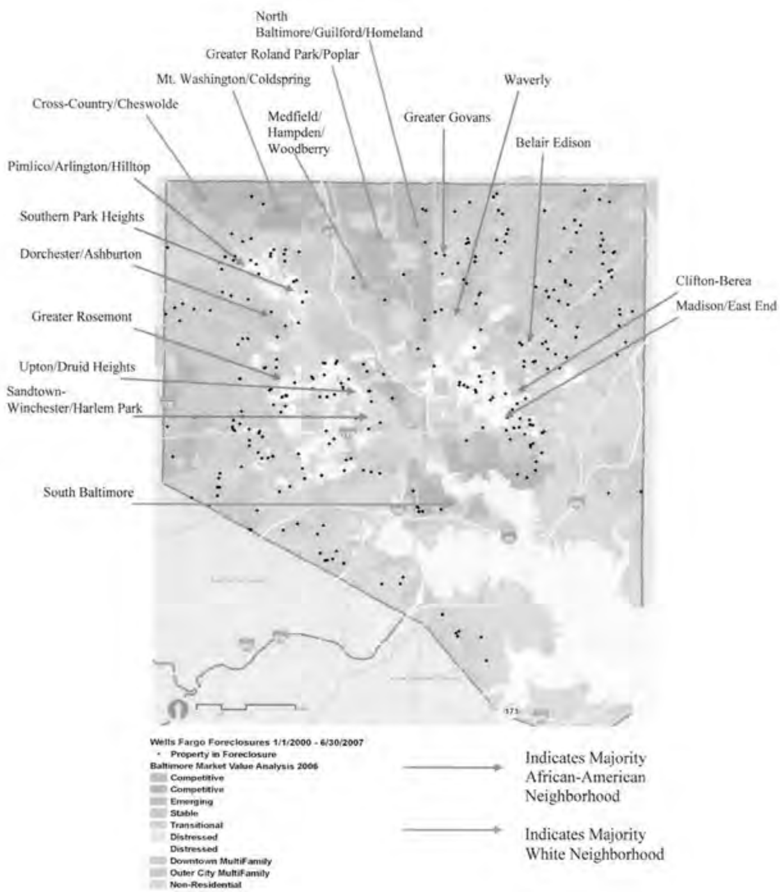
62. This disparity in time to foreclosure is further evidence that Wells Fargo is engaged in lending practices consistent with reverse redlining. As with all of the practices identified in paragraphs 47-60 above, and like the abusive practices identified in paragraph 26 above, the disparity in time to foreclosure demonstrates that Wells Fargo is engaged in irresponsible underwriting in African-American communities that does not serve the best interests of borrowers. If Wells Fargo were applying the same underwriting practices in Baltimore's African-American and white neighborhoods, there would not be a significant difference in time to foreclosure. Were Wells Fargo underwriting borrowers in both communities with equal care and attention to proper underwriting practices, borrowers in African-American communities would not find themselves in financial straits significantly sooner during the life of their loans than borrowers in white communities. The 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.

63. This difference in time to foreclosure is especially important because foreclosures occur more quickly in Baltimore than in neighboring jurisdictions. For all lenders, the average time from loan origination to foreclosure in Baltimore is three years, while in Philadelphia it is four years and in New Castle County, Delaware (which includes Wilmington) it is 4.3 years. This means that the injuries that result from foreclosures in Baltimore are compounded, and therefore grow, at a faster pace.

INJURY TO BALTIMORE CAUSED BY
WELLS FARGO'S DISCRIMINATION IN MORTGAGE LENDING

64. Wells Fargo has engaged in a pattern or practice of reverse redlining that has resulted in a disproportionately high rate of foreclosure on loans to African Americans and in Baltimore's majority African-American neighborhoods. Wells Fargo continues to engage in this discriminatory pattern or practice with similar and continuing deleterious consequences for Baltimore's African-American neighborhoods.

65. The foreclosures caused by Defendants' discriminatory lending practices are particularly injurious because they are concentrated in distressed and transitional neighborhoods, as reflected on the following map. These neighborhoods include, among others, Greater Rosemont, Upton/Druid Heights, Clifton-Berea, and Madison/East End, all with African-American populations over 90%. These neighborhoods have high vacancy rates, low rates of owner occupancy, substantial housing code violations, and low property values. These characteristics make these neighborhoods most vulnerable to the deleterious effects of foreclosures.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Dorchester/Ashburton
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Madison/East End
Greater Rosemont
Upton/Druid Heights
Sandtown-
Winchester/Harlem Park
South Baltimore
Wells Fargo Foreclosures 1/1/2000 - 6/30/2007
Property in Foreclosure
Baltimore Market Value Analysis 2006
Competitive
Competitive
Emerging
Stable
Transitional
Distressed
Distressed
Downtown MultiFamily
Outer City MultiFamily
Non-Residential
Indicates Majority African-American Neighborhood
Indicates Majority White Neighborhood

66. The foreclosures caused by Defendants' discriminatory reverse redlining practices have caused, and continue to cause, multiple types of injuries to Baltimore, including:

a. A significant decline in the value of nearby homes, resulting in a decrease in property tax revenue;

b. An increase in the number of abandoned and vacant homes;

c. An increase in criminal and gang activity as abandoned and vacant homes become centers for squatting, drug use, drug distribution, prostitution, and other unlawful activities;

d. Increased expenditures for police and fire protection;

e. Increased expenditures to secure abandoned and vacant homes;

f. Additional expenditures to acquire and rehabilitate vacant properties; and

g. Additional expenditures for administrative, legal, and social services.

67. Damages suffered by the City of Baltimore as a result of Wells Fargo's foreclosures are fully capable of empirical quantification. Recent studies demonstrate that the precise financial impacts of the different types of injuries caused by foreclosures are quantifiable. A study published by the Fannie Mae Foundation, using Chicago as an example, determined that each foreclosure is responsible for an average decline of approximately 1% in the value of each single-family home within a quarter of a mile. *See* D. Immergluck & G. Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 Housing Policy Debate 57 (2006).

68. Other studies have focused on the impact of abandoned homes on surrounding property values. A recent study in Philadelphia, for example, found that each home within 150 feet of an abandoned home declined in value by an average of $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542. Anne B. Shlay & Gordon Whitman, *Research for Democracy: Linking Community Organizing and Research to Leverage Blight Policy*, at 20 (2004).

69. The costs of increased municipal services that are necessary because of foreclosures have also been analyzed empirically. A study commissioned by the Homeownership Preservation Foundation isolated twenty-six types of costs incurred by fifteen government agencies in response to foreclosures in Chicago. *See* W. Apgar, M. Duda & R. Gorey, *The Municipal Costs of Foreclosures: A Chicago Case Study* (Feb. 27, 2005) at 24-26 (available at http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/documents/2005Apgar-DudaStudy-FullVersion.pdf). It then analyzed the amount of each cost based on different foreclosure scenarios, such as whether the home is left vacant, whether and to what degree criminal activity ensues, and whether the home must be demolished. The study found that the total costs ran as high as $34,199 per foreclosure.

70. The damages and costs to Baltimore of the foreclosures caused by Defendants' discriminatory lending practices, including but not limited to those described above, are in the tens of millions of dollars.

71. Defendants' actions set forth herein constitute a pattern or practice of discriminatory lending and a continuing violation of federal law. Unless enjoined, Wells Fargo will continue to engage in the unlawful pattern or practice described above.

72. Baltimore has been, and continues to be, adversely affected by the acts, policies, and practices of Defendants, their employees, and/or their agents.

73. The extent of Baltimore's injuries will increase unless and until Wells Fargo ceases to discriminate against African Americans and borrowers in majority African-American neighborhoods.

74. Defendants' unlawful actions described above were, and are, intentional and willful, and/or have been, and are, implemented with callous and reckless disregard for Baltimore's federally protected rights.

CAUSE OF ACTION
(Federal Fair Housing Act)

75. Plaintiff repeats and incorporates by reference all allegations contained in Paragraphs 1 through 74 as if fully set forth herein.

76. Defendants' acts, policies, and practices constitute reverse redlining and violate the Fair Housing Act, as amended, 42 U.S.C. §§ 3604 and 3605:

(a) Defendants' acts, policies, and practices have made and continue to make housing unavailable on the basis of race and/or color, in violation of 42 U.S.C. § 3604(a);

(b) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions, and privileges of sale of housing, as well as different services and facilities in connection therewith, on the basis of race, and/or color, in violation of 42 U.S.C. § 3604(b);

(c) Defendants' published policies and statements have expressed and continue to express a preference on the basis of race and/or color, in violation of 42 U.S.C. § 3604(c); and

(d) Defendants' acts, policies, and practices have provided and continue to provide different terms, conditions and privileges on the basis of race and/or color in connection with the making of residential real estate-related transactions, in violation of 42 U.S.C. § 3605.

DEMAND FOR JURY TRIAL

77. Pursuant to Fed. R. Civ. P. 38(b), Plaintiff demands a trial by jury on all issues triable as of right.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully prays that the Court grant it the following relief:

(1) enter a declaratory judgment that the foregoing acts, policies, and practices of Defendants violate 42 U.S.C. §§ 3604 and 3605;

(2) enter a permanent injunction enjoining Defendants and their directors, officers, agents and employees from continuing to publish, implement, and enforce the illegal, discriminatory conduct described herein and directing Defendants and their directors, officers, agents and employees to take all affirmative steps necessary to remedy the effects of the illegal, discriminatory conduct described herein and to prevent additional instances of such conduct or similar conduct from occurring in the future;

(3) award compensatory damages to Plaintiff in an amount to be determined by the jury that would fully compensate Plaintiff for its injuries caused by the conduct of Defendants alleged herein;

(4) award punitive damages to Plaintiff in an amount to be determined by the jury that would punish Defendants for the willful, wanton and reckless conduct alleged herein and that would effectively deter similar conduct in the future;

(5) award Plaintiff its reasonable attorneys' fees and costs pursuant to 42 U.S.C. § 3613(c)(2); and

(6) order such other relief as this Court deems just and equitable.

January 8, 2008

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MORTGAGE LENDING TO MINORITIES: WHERE'S THE BIAS?

THEODORE E. DAY and S. J. LIEBOWITZ*

This paper examines mortgage lending and concludes that studies based on data created by the Boston Fed should be reevaluated. A detailed examination of these data indicates that irregularities in these data, when combined with the most commonly used research methodology, appear to have biased previous research toward a finding of discrimination against minority applicants. When the most severe data irregularities are eliminated, evidence to support a hypothesis of discrimination disappears. The currently fashionable "flexible" underwriting standards of mortgage lenders may have the unintended consequences of increasing defaults for the "beneficiaries" of these policies. (*JEL* J7, G28)

I. INTRODUCTION

Anyone who has seen "It's a Wonderful Life" understands the emotional association of home ownership and the American Dream. In contrast to the flexible and good hearted George Bailey, whose bank is willing to look at a person's character when assessing credit worthiness, Mr. Potter, the movie's miserly and larcenous commercial banker, is unwilling to grant mortgages to worthy but poor applicants from the wrong side of town. This view that bankers are inflexible, insensitive, and inhospitable to certain groups of customers in their financing of home mortgages is not just a Hollywood creation, however. Similar stories have been told in many newspapers across the country, particularly since the government started to report data collected under the Home Mortgage Disclosure Act (HMDA) in 1990.[1]

The HMDA data allow a comparison of mortgage denial rates by race. These comparisons inevitably reveal that minorities (defined as Blacks and Hispanics) are denied mortgages far more frequently than are white applicants.[2] This has again led to the specter of mortgages being denied to worthy applicants, but this time the bankers are not fictional. Even when mortgage lenders are not accused of consciously practicing racial discrimination, they are often accused of "hidden" or "unconscious" discrimination.[3]

Unfortunately, the HMDA data contain little information that might help control for the economic characteristics of mortgage applicants, making it extremely difficult to conduct meaningful analyses.[4] This has not proven to

ABBREVIATIONS
HMDA: Home Mortgage Disclosure Act
MTBM: Munnell, Tootell, Browne, and McEneaney

* We would like to thank the editors of *Economic Inquiry* for their guidance, although all errors are our responsibility.

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1. Congress, in 1989, amended the Home Mortgage Disclosure Act (HMDA), requiring banks to report certain details for every mortgage loan application that they received, including the loan decision, the income, the race, and sex of the applicant. Numerous analyses of these data have indicated that loan applications from members of certain minority groups are rejected far more frequently than are loan applications from whites, leading some to conclude that mortgage lenders are biased against these groups.

2. As an example see the Wall Street Journal for February 13, 1996 for a set of articles and analyses of HMDA data.

3. For example, a publication from the Federal Reserve Bank of Boston [1993] claims "Overt discrimination in mortgage lending is rarely seen today. Discrimination is more likely to be subtle, reflected in the failure to market loan products to potential minority customers and the failure of lenders to hire and promote staff from racial and ethnic minority groups. Unintentional discrimination may be observed when a lender's underwriting policies contain arbitrary or outdated criteria that effectively disqualify many urban or lower-income minority applicants."

4. This is not to say that controlled analyses using HMDA data are impossible. For example, Leong's dissertation examined mortgage dispositions for matched samples of white and minority owned banks before concluding that there was no evidence of discrimination by white-owned banks.

Economic Inquiry
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Vol. XXXVI, January 1998, 3–28

be a deterrent, however, to numerous news and community organizations that have used the data for their analyses.[5] The yearly comparisons of mortgage rejection rates using the HMDA data are generally very superficial, with little if any attempt to control for characteristics of loan applicants that should be relevant for mortgage dispositions. Examination of average rejection rates for demographic groups of loan applicants, for example, cannot provide a basis for reaching conclusions regarding discriminatory practices, since different groups can and do have very different economic characteristics such as income, wealth, credit histories, and so forth. In such cases, differential rejection rates might represent a perfectly rational and nondiscriminatory response by lenders to the differential risk and credit capacity evidenced by borrowers.

This unsatisfactory state of affairs was apparently altered when the Federal Reserve Bank of Boston conducted a survey of banks in the Boston vicinity in an attempt to augment the HMDA data with additional information relevant to mortgage lending decisions. The stated purpose of creating this new data set was specifically to allow serious researchers to control for various economic characteristics not available in the original HMDA data. We shall refer to this augmented data set as the "Fed-extended" HMDA data throughout the paper.

Based on their analysis of this data set, Munnell, Tootell, Browne and McEneaney (MTBM [1996]) concluded that race was a significant factor in explaining the tendency for minority applications to be rejected more frequently than white applicants. A 1992 report by the same authors (MBMT) that was a precursor to the 1996 publication received a great deal of publicity, and has had a major impact on policy.

As a result, banks have become the focus of increasing regulatory oversight. Several mergers between banks have been jeopardized because of putative impropriety in their fair-lending activities.[6] Additionally, some banks have failed soundness evaluations based on their minority lending records.[7] The recent adoption of "flexible" underwriting standards, permitting bankers to grant loans to minority customers who would have failed to receive a mortgage under the old standards, can be viewed as a response to this negative publicity. This may be, at least in part, responsible for recent increases in defaults.[8] Government agencies are apparently encouraging a weakening of lending standards through the quid pro quo of more favorable decisions on bank mergers for banks with aggressive lending policies to minorities.[9]

In this paper we reexamine the issue of mortgage discrimination using the HMDA data and the Boston Fed extensions. We have discovered that the Boston Fed extensions to the data are plagued with inconsistencies, making highly suspect any conclusions based on analyses using this data set. These inconsistencies fall into two categories: (1) variables contained in the Fed-extended data that are internally inconsistent with one another; (2) inconsistencies between the public HMDA data and the HMDA data found in the Fed-extended sample. Additionally, we were granted access to a second data set that listed some inconsistencies between the information in the actual loan applications and the variables in the data set.

The paper proceeds as follows. First, we briefly describe the mortgage lending decision. Then we examine the likely impact of data errors on measured discrimination and demonstrate that measurement errors are not likely to bias the measure of discrimination toward zero. Next we discuss the data errors.

5. See for example Young [1997].

6. A merger proposed by Shawmut bank was disallowed by the Fed because of its mortgage lending record to minorities. See Bacon [1993].

7. According to Thomas [1992] 20% of banks in 1992 failed their soundness evaluations for this reason.

8. See Hirsch [1995] or Blumenthal [1996] who report increasing rates of defaults in the last few years, particularly on loans with small downpayments. Our conversations with underwriters indicates that defaults on loans with flexible underwriting standards are running at least 50% above the default rate of the weakest category of mortgages, those with 5% down. Since the flexible underwriting standards have smaller downpayments, and often do not have mortgage insurance, any default is more likely to result in a financial loss to the bank than would be the case for defaults on loans based on traditional underwriting guidelines.

9. Wilke [1996] reports that some bankers offered below market rates on zero downpayment loans in minority areas. This behavior by banks was attributed in part to their hope to win regulatory approval for proposed mergers with other banks.

Finally, we attempt to benchmark the impact of the data errors on attempts to measure discrimination in mortgage lending. We conclude that there is no evidence in these data to support a conclusion of discrimination against minority applicants although we caution that our best efforts can not remove all data problems and the attendant biases.

II. THE MORTGAGE LENDING DECISION AND RACIAL DISCRIMINATION

Mortgage lending decisions are primarily financial in nature, or at least are supposed to be. As a business decision, mortgage applications are more likely to be approved when a loan applicant seems likely to be able to repay the loan, or when, if default should occur, the collateral underlying the loan is sufficient to protect the lender from loss. Many loans are eventually sold in the secondary market, and many mortgage lenders have no intention of keeping the loans they make. In the Boston MSA in 1990, approximately half of the conventional loans (8322 of 17,006) were sold in the secondary market within two years, according to the HMDA data. Purchasers of mortgages in secondary markets have concerns similar to those of the bankers originating the mortgage and have detailed guidelines under which these loans may be purchased.

Mortgage lenders use several financial guidelines when assessing the quality of a loan, such as the ratio of monthly mortgage payments to income (expense/income ratio), the size of the loan relative to the value of the property (loan-to-value ratio), and the credit history of the applicant.[10] The expense to income ratio measures the likelihood of default based on the applicant's ability to meet the mortgage payments. The loan-to-value ratio is a proxy for the size of the loss that might occur in the event of default. Prior credit history should indicate whether the applicant is likely to overestimate his ability to meet future mortgage payments.

Rational mortgage lenders in competitive markets should approve any loan that has an expectation of earning a positive return. Although racial discrimination in commercial transactions might sometimes be a rational financial response to third party effects, the existence of financial gains from racial discrimination seems far less likely for mortgage lending. For example, in housing markets, real estate agents may discriminate against minorities because they are afraid of alienating potential white customers who might prefer not to have minorities in their neighborhoods. Similarly, the owners of retail establishments might discriminate against minority customers because their white customers prefer not to associate with minorities. Or white managers might discriminate against minority workers because their white workers prefer not to have minority coworkers. In each of these examples, the discriminator suffers a specific economic harm by engaging in discrimination: lost real estate commissions, lost sales, or lower productivity. This direct loss, however, might be outweighed by the indirect gain brought about by avoiding the alienation of a large customer base or work force. Thus economic self-interest and competition can not necessarily be counted on to keep discrimination at bay in a world where third parties are bigoted.[11]

For mortgage lenders, however, there is little concern with third party effects. Mortgage lenders making loans to minority applicants are not likely to suffer negative consequences from other customers for the simple reason that bigoted homeowners objecting to new minority neighbors have more direct objects of scorn—the seller, or the real estate agent. Further, the source of the loan is generally un-

10. Mortgage lenders are usually willing to offer loans of up to 95% of the purchase price of the home. However, the loan applicant will generally have to purchase 'mortgage insurance' if the amount of the loan is greater than 80% of the price of the home, particularly if the loan is to be sold in the secondary market. Some special programs provide exceptions to these general rules, allowing for example, a mortgage with no downpayment. In other instances, loans for more than the price of the home are sometimes made when extensive renovations on the home are going to be undertaken.

11. Nevertheless, as has been remarked in the literature, in each of these cases economic forces might argue for segregation, but not necessarily an inferior economic result. Minorities might not be allowed in certain areas, but that doesn't mean that the areas they inhabit need be inferior to majority areas. And economic forces, by themselves, imply that the lack of employment in some firms should be compensated for by the establishment of firms that have work forces that do not resent minority workers. Similarly, there would be an economic incentive to create retail establishments that cater to minorities, and there is no reason that these establishments need be of lower quality than the establishments that cater to the majority.

known to the neighbors. Thus, economic self-interest punishes any act of bigotry in the home mortgage market more fully than might be expected in many other circumstances.[12] Economic self-interest, therefore, should reduce racial discrimination in this market more completely than in many others. In addition, special programs and regulatory incentives inducing banks to increase their mortgage lending to minorities are countervailing forces that might be thought to provide minorities some advantages in securing mortgage financing.

Additionally, it seems logical to expect that competitive forces should work to eliminate discrimination. If one bank declines profitable loans in minority areas, it is natural to expect that other banks will step into the breach to provide those loans.[13] Still, if bigotry is common among mortgage lenders, it is conceivable that mortgage discrimination might be systematic.

When all the theorizing is finished, however, this important policy question can only be answered with careful empirical analysis.

III. HMDA DATA AND PROBLEMS WITH THE BOSTON FED EXTENSIONS

The starting point for creation of the extended data by the Boston Fed was the 1990 HMDA data.[14] The follow-up survey conducted by the Boston Fed asked banks that had made at least 25 mortgage loans in the Boston MSA to provide additional information above and beyond the HMDA data they had already provided.[15] Information was requested for each minority (Black and Hispanic) loan application in the Boston MSA, and a random sample of 3300 white applicants.[16] The additional data reported by the banks were then transcribed and merged with the original HMDA data. The final sample made available to outside researchers contained information on 2932 loan applications although the sample size in MTBM is 2925.[17] If the data were carefully recorded, transcribed, and then double-checked for errors, the resulting data set should have been very useful. Unfortunately, something appears to have gone awry in this process.

Our examination of the data revealed many instances of what we would define as data errors. We define error in this case as an instance where the value contained in one variable is inconsistent with values contained in other variables for the same observation. For example: a particular observation (mortgage application) that has one variable indicating that the application was rejected by the bank, but another variable indicating that the bank sold that mortgage in the secondary market must be a data error since only approved mortgages can be sold in the secondary market. Similarly, if an observation has a ratio of monthly mortgage payments to monthly income that is reported as zero, we treat that observation as contami-

12. Loan officers usually receive a commission upon successful completion of a loan application.

13. One of the earliest criticisms is associated with Becker [1993a, 1993b] who argued that examining the profitability of loans would allow a more appropriate test of the hypothesis.

14. The original HMDA variables include: type of loan, purpose of loan, type of occupancy, loan amount, loan decision, property location, applicant and co-applicant race and sex, applicant income, purchaser of loan, reason for denial.

15. Variables in the extension include: number of units in property purchased, marital status, number of dependents, dummy for two years employed in current line of work, dummy for two years in current job, whether self-employed, monthly housing expense, purchase price of property, amount of: other financing, liquid assets; number of credit reports in loan file; whether credit history meets guidelines; number of consumer credit lines on credit reports; mortgage credit history; consumer credit history; public credit history; Housing expense to income; Total obligations to income; Fixed or adjustable loan, term of loan, whether special program; appraised value of property; type of property; whether mortgage insurance sought; whether mortgage insurance approved; whether gifts as downpayment; whether co-signer of loan; whether unverifiable information; number of reviews; net worth. Also, the census information from the HMDA data was modified to make it difficult to determine the exact location of an applicant. For example, the relative income of a tract became a dummy variable indicating whether income was greater or lower than the MSA average. Similarly, information on the bank that the applicant dealt with was removed from the data.

16. Less than perfect returns from the survey reduced the size of the sample to 3062 in the 1992 report. The public data set had 2932 observations (Fed researchers report that they inadvertently included 130 VA and FHA loans in their 1992 work).

17. The 1996 article does not explain why the public sample had seven extra observations. Also missing from the public sample were data on the bank that held the loan, detailed data on the length of time that the applicant and co-applicant had been employed on the job and in the line of work (converted to a dummy indicating less than two years), years of education for applicant and co-applicant (converted to college dummy), and detailed census tract information. We leave it to the editors of the American Economic Review to determine if these differences contravene its policy that data must allow for fully reproducible results.

nated by errors since any mortgage requires repayment, and incomes can not be infinite. Additionally, we classify as errors those instances where variables take on values that are highly improbable compared to other variables in the same observation. For example, if a mortgage of $125,000 is listed as having a monthly payment of $50, implying an interest rate of –10.3%, we assume that one of the values is in error. *Note that each of these examples actually occurs in the data—they are not hypothetical.*

Appendix A lists these errors in detail and should be read by anyone wishing to comprehend the nature and severity of these inconsistencies that are the central focus of this paper. Nevertheless, we present here a brief summary of these problems. There were seven applications where the ratio of monthly mortgage expense to income was reported as zero. Hundreds of mortgage applications had imputed interest rates either far below or far above market rates. There were several dozen seemingly absurd cases of reported net worth. For example, in one case the applicant has a net worth of –$7,919,000 and a yearly income of only $30,000, yet was approved for a mortgage. There were 44 loan applications sold in the secondary market even though the loans were classified as rejected. Given that 41 of these 44 cases were applications from minorities, this error appears to be anything but random.

Similarly, there were hundreds of loan applications that were approved, even though they did not meet the requirements for sale in the secondary market, such as the requirement that mortgage insurance be purchased when the downpayment is less than 20%. Although it is possible that banks may hold portfolios of mortgages that do not meet secondary market requirements, our discussions with underwriters indicated that the very large number of loans that failed to meet these requirements seems highly improbable. Further, after making allowance for the possibility that the banks in this sample may hold large numbers of mortgages that do not meet secondary market requirements, there were 119 loan applications that failed to meet these secondary market guidelines and yet were reported to have been sold in the secondary market.

Yet for all the suspicious observations we were able to uncover, we were able to perform tests of internal consistency for only a small number of variables used in the study. It is important to note that most of the variables included in the study do not allow for consistency checks. Thus, it is likely that there are many more errors in the data than we have been able to document.

In addition to checks for internal consistency, we attempted to determine whether the HMDA component of the Fed-extended data is consistent with the public HMDA data. Since the Fed researchers started with the HMDA data and then added to it, the HMDA component of their extended data set should have been identical to the original HMDA data. Our examination, discussed below, indicates that there are over 400 observations in the Fed-extended data set that are inconsistent with the original HMDA data.

Since the authors of the Boston Fed report made no mention of any such inconsistencies in their 1992 report, we must assume that they were at that time unaware of them. Since then they have either claimed that what we are terming inconsistencies or data errors are not actually inconsistencies (Browne and Tootell [1995]), or they have largely ignored these problems (MTBM [1996]).[18]

After Liebowitz [1993] and Zandi [1993] first noted these data inconsistencies, virtually all follow-up research has accepted the view that there were serious errors in the data. Carr and Megbolugbe [1993] concluded that one third of the observations were questionable and Hunter and Walker take this as their starting point [1995].[19] Glennon and Stengel

18. MTBM barely mention these problems, focusing instead on a few observations mentioned as errors in Horne [1994, 1997]. Browne and Tootell [1995] provide a far more detailed defense of the data as reported in the Appendix.

19. Carr and Megbolugbe attempted to remove observations containing questionable data. In their Table III they found 1045 suspicious observations out of 2816 total observations. They claim that after removing these observations the basic results of the Boston Fed hold up. Yet on their interest rate screen, they allow loans with interest rates as low as 4% and as high as 19% to remain in the sample, even though mortgage interest rates in 1990 were generally in a narrow range far removed from these values. Additionally, although consistency checks can only be performed for a small number of variables, Carr and Megbolugbe are comfortable in assuming that there are no other errors in the data. Glennon and Stengel (on page 27) are far less sanguine about cleansing the data of errors. They state "There is no obvious way these errors can be corrected short of reexamining the loan files, a solution we believe is impractical."

TABLE I
Summary Statistics

	Whites (n=2247)			Minorities (n=685)		
	Mean	Minimum	Maximum	Mean	Minimum	Maximum
Mortgage Rejected	10.37%	0	1	28.32%	0	1
Meets Credit Guidelines	93.60%	0	1	77.40%	0	1
Unable to Verify	4.00%	0	1	10.90%	0	1
Total Obligation/income	32.76%	0%*	300%**	34.76%	6%	111%**
Denial of Mortgage Insurance	27.6400	0%	100%	39.420	0%	100%
Housing Expense/income	25.18%	0*	300%**	26.24%	0*	73%
High Expense to Income***	31.02%	0%	100%	36.50%	0	100%
Loan-to-value	73.60	2%**	830%**	84.40	18.8%	939%**
Amount of Loan (000's)	143.9500	2	980	128.79	30	802
Income (000's)	77.6100	4	796	56.67	13	972
Liquid Assets (000's)	98.6700	0.0	8650	40.80	0	020
Net Worth (000's)	283.3300	−7919**	28023	91.64	−858	346

*Indicative of an error.

** Most likely an error.

*** Defined as greater than 28%.

[1994] report many errors in the data. Horne [1994] finds that, for the narrow subset of the actual loan files that he was permitted to examine, more than half of the observations contain serious errors.

We now turn to an empirical examination of the mortgage discrimination hypothesis.

IV. RESULTS WITH THE ORIGINAL DATA

Table I reports summary statistics for several key explanatory variables that are included in the Fed enhanced data. These values are virtually identical to those reported in MTBM (remember that full replication is impossible since the data set they use is different than the one they provided to the public). The summary statistics indicate that minority loan applications have characteristics considerably different from those for the white population. For example, white applicants have considerably greater wealth, are far more likely to meet credit guidelines, and are far less likely to submit information that cannot be verified. Further, they are less likely to have loan-to-value ratios greater than 80%, and thus have less need for mortgage insurance. Note also that the minimum and maximum values for certain variables (e.g., obligation to income ratios of zero) immediately indicate problems with the data.

The rejection rate for minorities is almost three times as great as that for whites, with an absolute difference of 18 percentage points. It is this simple statistic that is responsible for much of the negative publicity received by mortgage lenders.

In column 1 of Table II we estimate a regression using an OLS specification[20] that is similar to that of MTBM.[21] The coefficients and t-statistics are quite similar to those of MTBM although our measure of discrimination has a larger t-statistic. As is common in studies of discrimination, the coefficient on minority group membership is taken to measure the degree of racial discrimination. The .073 coefficient for the minority variable in regression 1 of table II indicates that seven out of 100 minority applicants are rejected for reasons other than the economic characteristics controlled by the regression. This number

20. Although we ran all regressions in both logit and OLS, the results from the two techniques were nearly identical in all important characteristics. Therefore, we report only the results from OLS regressions since they provide a natural and linear interpretation of the regression coefficients, greatly simplifying the analysis. The logit regression results are available upon request.

21. We follow the specification on the 1992 MBMT report for a single loan-to-value ratio whereas in the 1996 article this variable is separated into three variables. This has little effect on the results and is done to save space.

TABLE II
Explaining Loan Rejection***

Variable	Fed-style Specification B	T	Alternative Specification B	T
Minority	0.073	5.12	0.028	2.38
Probability of Unemployment*	0.008	2.79	0.005	2.14
High Expense/income Ratio	0.052	3.58	0.027	2.17
Loan to Value Ratio	0.063	3.42	0.033	2.15
Denial of Mortgage Insurance	0.667	18.94	0.455	14.98
Obligation/income Ratio	0.005	8.62	0.003	6.71
Self-employment	0.053	3.06	0.045	3.03
Neighborhood	0.014	1.27	0.018	1.89
Multifamily home	0.057	3.41	0.055	3.90
Consumer Credit History**	0.036	10.33		
Mortgage Credit History**	0.028	2.62		
Public Credit History**	0.205	9.54		
Unable to Verify Data			0.300	14.17
Loan Meets Credit Guidelines			−0.550	−32.67
(constant)	−0.290	−10.01	0.430	15.79
Adjusted R Squared	0.290		0.492	
# Of Observations	2931		2928	
B = Coefficient; T = t-statistic				

*MTBM measured a loan applicant's probability of unemployment by the unemployment rate of the major industrial group in which the applicant worked. The economic characteristics of two-digit industrial groups are generally poor proxies for the more detailed component industries (see Liebowitz, 1982) and the unemployment rate in the two digit industrial group is not even the aggregate of the unemployment rate in the component occupations. For these reasons, and also because this measure contradicts empirical evidence, (it implies that minorities have a lower probability of unemployment) we do not include this variable in later regressions. Its inclusion would have a minor positive impact on measured discrimination.

**Higher values for these credit history variable indicate an inferior credit history.

***Dependent variable = 1 if loan is rejected

appears quite large relative to the 10 out of 100 whites or 21 out of 100 minorities that are rejected for economic reasons.

Note that two variables are available in the Fed-extended data that dramatically increase the explanatory power of the regression. One variable is a measure of whether the bank was able to verify the information provided by the loan applicant. The motivation for including this variable is straightforward—if mortgage lenders are unable to verify the information on the loan application, then the information on the application is not informative. Including this variable has not proven particularly contentious since it has only a relatively small effect on the minority coefficient.

The second variable with great explanatory power indicates whether the applicant meets the internal credit guidelines of the bank. The use of this variable has been the source of some controversy since it dramatically reduces measured discrimination.[22] The most serious criticism is that this variable might reflect bias on the part of bankers. We do not believe that this conclusion is warranted. First, credit histories are often rated mechanically (a process known as credit scoring) by a computer program, or at least in a separate

22. Browne and Tootell claim that this variable is merely a proxy for loan denial., i.e., that bankers merely indicated that each rejected loan did not meet the credit guidelines so as to enhance consistency with their lending decision. We see no reason that bankers would have answered the meets-guideline question any less seriously than they answered the other questions in the survey. Also, the persons answering the survey questionnaire obviously did not just blindly state that rejected applicants didn't meet the guidelines since 45% of all rejected loans met the banks' credit guidelines.

department, where the race of the applicant may not even be known. Second, our attempts to check this hypothesis did not provide any support.[23] The alternative is to use a set of three credit history variables constructed by the Boston Fed.[24] So as to sidestep controversy at this time, we shall present results using both measures of credit history.[25] There are many other specification problems that can be raised, but we largely wish to sidestep this particular quagmire.[26]

V. THE IMPACT OF MEASUREMENT ERRORS ON THE DISCRIMINATION COEFFICIENT

There is often a tendency to ignore, or at least minimize, the impact of randomly occurring errors in data. Although such errors reduce the precision of estimated regression coefficients, the presence of errors in the data is often a convenient explanation for the fact that a model fails to fit the data perfectly.

The impact of data errors on the analysis of discrimination in mortgage lending can be much more serious, however. The motivation for collecting additional information on the financial characteristics of loan applications is to determine whether the higher rejection rate for minority loan applications is attributable to the generally weaker financial condition of minority applicants or to the impact of racial discrimination on lending decisions.

If data errors were truly random, they would affect the mortgage outcome variable and the measurement of race, as well as all other variables. In this instance, the measured differential in rejection rates between ethnic groups would diminish as measurement errors increased. The measured rejection rate differential in the Fed-extended data, however, does not show any indication of being biased toward zero. Note from Table I that the average rejection rate for minorities relative to whites is 28:10 for the Fed-extended data. This is in general agreement with previous examinations based on HMDA data, and also in line with the HMDA data for the Boston MSA which has a ratio of 29:10. Therefore, data errors in the Fed-extended data do not seem to impact the group rejection rates.

This should not be too surprising. Not all variables are equally likely to be the victims of data errors. Given that the racial classification of the loan applicant was used as the basis for creating the survey sample, there should be few errors in the dummy variable for the race of the applicant. Further, the variable that measures loan outcome (accept/reject) should not be subject to the same degree of error as the financial variables included in the data set. This is true because (1) the different rejection rates for each race are so well documented that had the data not conformed to this empirical regularity, the researchers would surely have reexamined the data to discover the source of this discrepancy; (2) the loan outcome and race variables are both represented

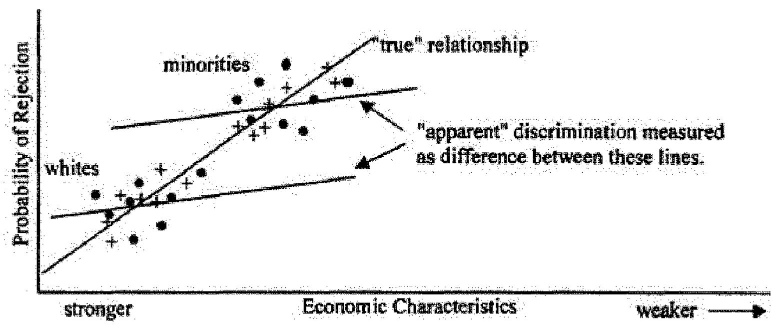
23. If banks wanting to deny minority loan applications falsely state that the loan did not meet guidelines, then it would have the effect of increasing the share of minority loans not meeting the guidelines that are rejected, ceteris paribus. Such discrimination would increase the power of the meets guidelines variable in a regression for the minority subset. In actuality, a regression using the subset of minority applicants indicates that the meets guidelines variable has a smaller coefficient than a regression for the subset of white applicants (.535 vs. .570), a result inconsistent with this tainted variable hypothesis. The simple correlation between rejection and meets guidelines is virtually identical between the two groups. The share of minority applicants not meeting the credit guidelines that turn out to be rejected is greater than is the share of loans to white applicants not meeting the guidelines that turn out to be rejected (81.9% vs. 74.8%) which might seem to support the tainted variable hypothesis, but of course these groups have different economic characteristics. If a regression is run on applications that do not meet the credit guidelines the (insignificant) coefficient measuring discrimination is smaller than for the sample of loans that meet guidelines and for the sample as a whole, which is also inconsistent with the view that this variable is tainted by discrimination. Nevertheless, we need to proceed with caution.

24. The Fed's three credit history variables do not account for the age of the credit problem, the size of a delinquency, or the possibility that different banks will have different guidelines. Thus the MTBM credit history variables are not likely to reflect the full impact of an applicant's credit history on a bank's lending decision. Nor do they provide information on the financing limits of credit cards or the usage patterns of checking accounts.

25. It has also been mentioned (Browne and Tootell, Carr and Megbolugbe) that if the meets-guidelines variable is made the dependent variable in a regression with race and other explanatory factors, that these other factors often prove to be significant. We do not believe that this is either decisive or surprising. In fact, if the three Boston Fed Credit History guidelines are made independent variables in such regressions, exactly the same type of results are found.

26. There are undoubtedly many imperfections in the specification used by MTBM and ourselves that we will largely ignore. For example, the relationship between measures of financial ability to carry the loan and mortgage decisions are not likely to be related in a linear fashion. There are also questions regarding the inclusion of applications requiring mortgage insurance, since rejection of mortgage insurance is not made by the mortgage lender. These questions, while of importance, are not the focus of this study. Also, there are potential simultaneity problems (see Yezer et al., [1994]).

FIGURE 1



by a variable of a single digit that can take on only three values,[27] thus making it less likely for errors to be introduced than would be the case for variables requiring multiple digits; and (3) these variables both come from the original HMDA data and did not have to be collected in the survey.[28] Data collected from scratch should be more prone to (transcription) error than data moved from one data set to another.[29]

With loan disposition and minority variables less likely to be impacted by error, any noise introduced through data errors in variables related to the economic strength or weakness of an application (and thus the probability of rejection or approval) is likely to increase measured discrimination. This is illustrated in Figure 1. In Figure 1, the "+"s represent the true relationship between loan disposition and the economic variables which is represented by the regression line in the figure. Note that noise in the measurement of variables on the x-axis moves the measured observations randomly to the left or right of the true values, as indicated by the dots. This noise obscures the true relationship, so that the differences between groups now pick up most of the variation in the dependent variable.[30] This masking of the true relationship has the effect of loading the differential acceptance rates for minorities and whites into the race variable instead of the economic characteristics variables.

The question now becomes whether it is possible to sufficiently "cleanse" the data of errors so that a better understanding of the true relationship can be ascertained. If some of the observations contain errors, and others do not, the purpose of cleansing will be to eliminate the former observations while preserving the latter. Given the very large number of errors found examining only a small number of variables, however, it is not necessarily the case that removing the observations that

27. In the HMDA data, loan outcome and race each can take on more than three values, but the Boston Fed limited their sample to three values.

28. Note, however, that errors were apparently introduced in the transcription from HMDA to Boston Fed data for applications classified as both rejected and sold, as discussed above. Also, as discussed below, there are some errors in the variable that measured acceptance or rejection.

29. Although, as we report below, there appear to have been serious problems in moving HMDA data to the Boston Fed data.

30. Technically, this argument is valid when there is but a single independent variable measuring economic characteristics. When there are multiple variables measuring economic strength it is no longer possible to say precisely what the effect of noise on any one variable is on the measured discrimination. But it is clear that with enough noise in variables measuring economic strength, the measurement of discrimination will equal the differential rejection rates between groups. Even more importantly, there is no reason to believe that measured discrimination approaches zero as the noise in the economic variables increases.

contain known errors necessarily reduces the density of errors in the remaining data.

We presume, in the following sections, that errors are not randomly distributed, but are likely to cluster in certain observations. This would be true if, say, individuals transcribing the data at the behest of either the mortgage lender or the Fed researchers, tended to get tired at certain times of day, or if certain individuals were unusually unreliable. In these instances an error in one variable would increase the likelihood that the observation would contain errors in other variables and thus provides a rationale for removing that observation even if that variable plays no role in the regression analysis. If this assumption is correct, the removal of observations with known errors in any variable should reduce the proportion of errors in the data. We are certain, however, that errors will remain even after our best efforts to remove them but hope that the errors are less preponderant.

VI. THE IMPACT OF ERRORS FOUND BY EXAMINING LOAN FILES

Not all data errors are created equal—some are far more likely to distort results than are others. And no error is as likely to influence results than an error in the dependent variable, assuming that these errors are not random. Horne [1994] documented a number of misclassified mortgage decisions by examining the actual loan files for the subset of the loan applications from the banks insured by the FDIC.[31] He identified 26 loans for which the information in the loan files indicated that the bank's actions should not have been classified as rejections, yet were classified as "rejections" by the Boston Fed.[32]

We used the Freedom of Information Act to obtain a list of these loans. The list indicated that five applications were misclassified as rejections when the applications were actually accepted. Of the remaining classification problems, four were applications to special lending programs (i.e., designed to help low income applicants) that were rejected by the program administrator (rather than the bank) on the grounds that these applicants were overqualified. Note that since these (primarily minority) applicants are relatively well qualified, a statistical analysis would indicate no economic justification for the bank itself to reject these applications, and these applications would inappropriately support a hypothesis of discrimination. In eight cases the applicant rejected the bank's offer of a loan with slightly different terms than those requested in the loan application.[33] Finally, although nine applications were withdrawn before the bank reached a decision, they were classified as rejections.

To ascertain the impact of these misclassifications, we reestimated the model after removing these 26 applications from the sample.[34] The results, which are reported in Table III, show that excluding the incorrectly coded observations reduces the estimated coefficient for the minority variable from .0271 to .0068, a level that is not statistically significant. A similar size change in the minority coefficient holds for the specification that includes the original MTBM credit history variables. When the 26 misclassified loans are removed, the coefficient drops from .053 to .033, although it remains statistically significant.

It is important to note that the 26 misclassified loans found by Horne come from the subset of loan applications obtained from banks insured by the FDIC, which represents only 45% of the entire sample of loans. Since there is no reason to believe that the frequency of misclassification is substantially different for the non-FDIC component of the Boston Fed sample, it is reasonable to expect that the elimination of the classification errors in the remaining 55% of the sample would have reduced the estimated coefficient of the minority variable even further.

Unfortunately, these misclassifications are "unobservable" and therefore cannot be cor-

31. Horne, working for the FDIC, was able to gain access to the actual loan files for the subset of banks regulated by the FDIC. He focused his examination on 95 rejected loans that the MTBM regression model indicated should have been approved. His is the only study that had access to the loan files.

32. MTBM dispute Horne's assessment of these applications. Regardless of who is correct, as we show below, almost all of these 26 observations exhibit other problems, in that the HMDA variables for these observations are inconsistent with the public HMDA data.

33. Horne finds that for the sample of the loan applications examined by the Boston Fed, minorities were much more likely to decline these counter offers than were whites.

34. We classified two of these applications as rejected special programs, although Horne did not so classify them that way. In these cases the special program appeared to be devised by the Bank.

TABLE III
Explaining Loan Rejection*

	"Meets Guidelines" Credit History				Boston Fed Credit History			
	Full Data Set		Removing 26 Misclassified Applications		Full Data Set		Removing 26 Misclassified Applications	
Variable	B	T	B	T	B	T	B	T
Minority	0.0271	2.27	0.0068	0.58	0.0531	3.96	0.0325	2.45
High Expense/income Ratio	0.0264	2.14	0.0235	1.95	0.0450	3.26	0.0432	3.18
Loan to Value Ratio	0.0326	2.11	0.0359	2.38	0.0419	2.41	0.0454	2.67
Denial of Mortgage Insurance	0.4549	14.98	0.4677	15.81	0.5802	17.27	0.5943	18.06
Obligation/income Ratio	0.0030	6.74	0.0031	6.96	0.0040	7.93	0.0040	8.20
Self-employment	0.0496	3.42	0.0500	3.53	0.0542	3.33	0.0541	3.39
Neighborhood	0.0182	1.89	0.0170	1.814	0.0143	1.33	0.0133	1.26
Multifamily home	0.0569	4.02	0.0624	4.51	0.0554	3.50	0.0596	3.83
Unable to Verify Data	0.3027	14.23	0.2808	13.17	0.4377	18.87	0.4218	18.05
Loan Meets Credit Guidelines	−0.5490	−32.68	−0.5542	−33.37				
Consumer Credit Problems					0.0312	9.51	0.0310	9.59
Mortgage Credit Problems					0.0233	2.33	0.0215	2.20
Public Credit Problems					0.2008	9.89	0.2007	10.00
(constant)	0.4497	17.31	0.4518	17.67	−0.2243	−8.60	−0.2256	−8.81
Adjusted R Squared	0.4920		0.4970		0.3650		0.3650	
# Of Observations	2928		2902		2931		2905	

*Dependent variable = 1 if loan is rejected

rected or eliminated from the sample, as was done with the classification errors documented by Horne. However, if there is a linear relation between the number of misclassified applications and the estimated minority coefficient, we can use the results presented in Table III to assess the impact of any remaining classification errors on the estimated coefficient for the minority variable.

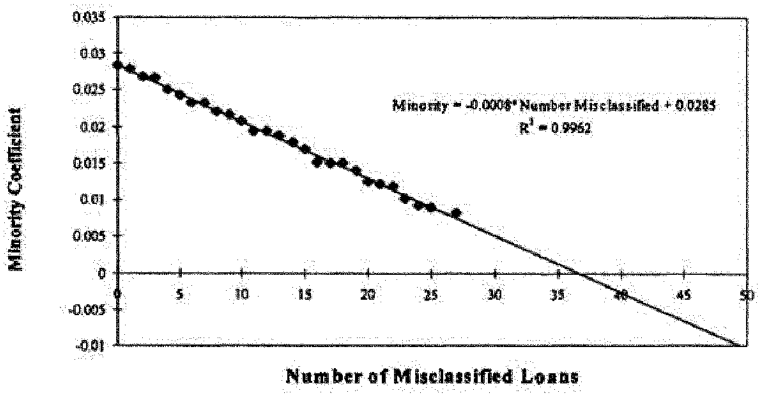
To test the linearity assumption, we approximate the relation between the estimated minority coefficient and the number of misclassified applications by successively eliminating a larger and larger number of misclassified loans and reestimating the coefficient for the minority variable. To hold constant the characteristics of the misclassified loans as the number of misclassified applications eliminated from the sample changes, we performed several replications for each possible number of misclassifications to be eliminated, randomly choosing the misclassifications to be eliminated and then averaging the estimated coefficients of the minority variable from each replication.[35] The results are presented in Figure 2.

Figure 2 shows that the relation between the number of misclassified loans and the estimated coefficient for the minority variable appears to be linear (this diagram is based on our alternative regression model). Therefore, it seems reasonable to extrapolate the trend line in Figure 2 to predict the impact of the misclassification errors for the non-FDIC component of the sample.[36] Note that if the

35. For example, to determine the impact of eliminating ten misclassified applications from the sample, we randomly remove ten of the 26 misclassified applications from the sample. The minority coefficient was then estimated using the remaining data. This procedure was repeated a dozen times, removing ten randomly selected misclassifications at each iteration. The twelve estimates of the minority coefficient were then averaged to determine an average for the minority coefficient given that ten misclassified applications have been eliminated from the sample. Similar calculations were performed to reflect the impact of removing each possible number of misclassified applications, from one to 25.

36. This line actually understates somewhat the impact of the misclassified observations on the minority coefficient because it is based on removing the faulty observations, whereas several of the misclassified observations could actually be fixed, and when they are changed the coefficient falls by a larger amount than if they are removed.

FIGURE 2
Relationship between Number of Misclassified Loans and Minority Coefficient



trend line is extrapolated to a total of 37 misclassified applications, which is consistent with only eleven additional misclassifications among the non-FDIC applications, the estimated coefficient for the minority variable goes to zero becoming negative as the number of misclassifications in the non-FDIC data increases. Even using the Fed credit history variables, all statistical significance is lost.

Thus we conclude that when a small number of the most egregious errors in the data are removed, the impact of race on lending decisions becomes statistically insignificant, and even might reverse sign. Note that this still leaves intact the great majority of data errors and any associated bias in the coefficient measuring discrimination.

VII. REMOVING INTEREST RATE EXTREMES

The size of the loan and the monthly loan payment are linked by the rate of interest charged on the mortgage. Since this rate was relatively constant during the period in which these loan applications were processed, consistency of the reported loan amount with the monthly payment requires that the implied interest rate on the loan lie within a band of interest rates whose width is determined by the variation in rates during the year 1990 (ranging approximately from 9.75%–10.75%).[37] By successively estimating the results for subsets of the data lying within progressively narrower bands on the imputed interest rates, we are able to examine whether the measured impact of discrimination increases or decreases as we narrow the bounds on the acceptable degree of error in the data.[38] This particular check on the internal consistency of the data is of importance since it revealed a very large number of suspicious observations for variables that are central to many of the financial ratios that are used to estimate the probability of a loan's approval.

Table IV presents the results of this filtering. After removing the 26 observations identified by the FDIC as having errors in the dependent variable (with no extrapolation for the FDIC type errors still in the sample), we removed observations having abnormal interest rates. We created two levels of filters. First, we took cutoffs at 14% and 5%, which

37. FHA monthly mortgage rates, St. Louis Fed.

38. The interest rates are calculated after removing estimates of property taxes and insurance.

removed about 10% of the observations. Then we applied a stronger filter, removing observations with interest rates higher than 12% and lower than 7%. This had the impact of removing about 20% of the observations.

We include two specifications for the regression. The first contains our specification with the meets-guidelines variable. The second uses the Boston Fed credit history variables. Clearly, as the filter restricts the sample of loans toward more and more reasonable interest rates, the minority coefficient diminishes. With either specification, evidence for discrimination is too weak for us to accept a hypothesis suggesting that banks discriminate against minorities. Further, we are only filtering out those observations for which this limited check on variables could be conducted. Noise is still a likely problem.

VIII. USING THE PUBLIC HMDA DATA TO MEASURE BANK "TOUGHNESS"

Examination of the public HMDA data allows us to perform some tests not possible using the Fed-extended data, and also provides a check on the Fed-extended data. For example, it is possible to examine the propensity of a bank to reject applications using the public HMDA data since one of the variables is the identity of the bank to which a mortgage application was submitted, whereas the publicly available Fed-extended data removes this information.[39]

Although we use the term "toughness" for banks with high rejection rates, this variable may well be a proxy for other factors having little to do with toughness *per se*. For example, it is likely that the variability in average rejection rates is related to the characteristics of the neighborhood and clientele of the bank that are not fully picked up by the other neighborhood variables. Banks with well-informed customers, for example, are likely to have fewer customers applying for loans for which they are extremely unqualified.

Variations in average rejection rates are also likely to be related to variations in prescreening, the efforts of banks to match loan applicants with the loan product that best fits their needs. Prescreening will, among other things, tend to reduce the number of weak loan applicants filing a formal loan application.[40] Those banks with weak prescreening will tend to have higher rejection rates than banks with strong prescreening. Note that if banks were sensitive to charges of discrimination on a prescreen, causing them to be less vigilant in preventing weak minority borrowers from filing formal applications, the rejection rate of formal applications for minority customers would increase.

A bank's "toughness" appeared to be surprisingly consistent across various types of customers. For example, we found that a bank's average rejection rate for whites was a very good predictor of the bank's average rejection rate for minorities. The simple correlations ranged from .38 for all banks (123 cases), to .66 for banks with more than 10 minority applications (30 cases), to .78 for banks with more than 15 minority applications (23 cases). Similarly, a bank's average rejection rate for refinancing-loans was a good predictor of the bank's average rejection rate for conventional loans, with the two measures having a correlation coefficient of .50. Clearly, a bank's propensity to reject one type of mortgage application is related to its propensity to reject other types of mortgage applications. Banks also varied greatly in their propensity to reject, with average rejection rates for the four quartiles taking on values of 0%, 2%, 11%, and 27%.

This variation in rejection rates across banks suggests that the distribution of white and minority loan applicants across lenders may well be important in explaining differences in group rejection rates. In other words, if minorities frequented mortgage lenders that had a high propensity to reject applications, they would, as a group, be expected to have higher rejection rates than if they frequented banks that are more typical. To ascertain the potential importance of bank toughness on the

39. In their initial 1992 report, MTBM created their own variable for "bank toughness" and concluded that bank toughness was not important. In the 1996 paper they create dummy variables for each bank but do not report the results. This is one of the variables to which outside researchers do not have access.

40. For a discussion of prescreening, see Rosenblatt [1996]. He reports that for each formal application that was rejected (for a particular bank that allowed him access to its data), the bank lost approximately $750 (in addition to the money lost by the applicant). If this is typical, banks obviously have an incentive to reduce rejections, which they can do with prescreens.

TABLE IV
Removal of Questionable Interest Rate Observations

Restricting Loans to Imputed Rates Between:	Using "Meets Credit Guidelines" for Credit History				Using Boston Fed Credit History			
	14% and 5%		12% and 7%		14% and 5%		12% and 7%	
Variable	B	T	B	T	B	T	B	T
Minority	0.0014	0.11	0.0020	0.15	0.0293	2.12	0.0249	1.69
High Expense/income	0.0206	1.66	0.0237	1.78	0.0413	2.94	0.0430	2.87
Loan-to-value	0.0611	3.15	0.0970	3.34	0.0676	3.06	0.1379	4.18
Denial of Mortgage Insurance	0.4816	15.74	0.4464	13.22	0.6052	17.68	0.5865	15.62
Obligation/income	0.0031	6.82	0.0034	6.93	0.0041	8.01	0.0045	8.26
Self-employed	0.0580	3.91	0.0390	2.42	0.0592	3.52	0.0377	2.08
Neighborhood	0.0123	1.26	0.0128	1.22	0.0116	1.05	0.0112	0.95
Multifamily Home	0.0569	3.80	0.0557	3.59	0.0532	3.14	0.0510	2.92
Unable to Verify Data	0.2830	12.80	0.2783	11.61	0.4212	17.26	0.4203	15.98
Loan Meets Guidelines	−0.5553	−32.35	−0.5520	−28.84				
Consumer Credit History					0.0302	8.96	0.0285	7.90
Mortgage Credit History					0.0189	1.85	0.0150	1.36
Public Credit History					0.2008	9.69	0.1792	7.87
(constant)	0.4339	15.67	0.3955	11.63	−0.2386	−8.57	−0.2931	−8.95
Number of Observations	2640		2289		2643		2292	
Adjusted R Square	0.50		0.49		0.36		0.35	

B = Coefficient; T = *t*-statistic;
Property Tax and Insurance Adjustment included in imputed rates

group rejection rates, we computed a measure of the propensity to use tough banks for our two groups of customers.[41]

If we use a bank's overall rejection rate as a measure of toughness, a bank that discriminated against minorities might appear to be tough merely because of its discriminatory behavior. We avoid this problem by measuring toughness using only the rejection rate for each bank's white loan applicants. The average toughness of banks frequented by minority loan applicants is then estimated by computing an average of each bank's white rejection rate, weighted by the number of minority customers. A similar calculation is used in calculating the average toughness of banks frequented by white customers.

The results, reported in Table Va, indicate that on average, minority customers patronize banks that are approximately twice as tough as the banks patronized by white customers.[42] Thus if minorities were identical to the white customers at the banks that they patronized, and if there were no racial discrimination by any banks, minority applicants would be rejected about twice as often as whites.

Note that in constructing a measure of toughness to be used in regressions explaining the disposition of mortgage applications, it is important to avoid any circularity arising from the use of the originating bank's rejection rate to explain the disposition of a loan that was itself used to determine the rejection rate. For the pure HMDA data, we can avoid this problem by constructing a measure of lender toughness based on the lender's rejection rate for refinancings, whereas our regressions will be based only on home purchases.

The HMDA data also provide more detailed information on neighborhood character-

41. Since we can create a toughness variable that avoids all possibility of discrimination, we believe it is superior to use this variable as an independent variable in a regression as opposed to a dummy for each bank, which would be unable to distinguish between discrimination and toughness.

42. Leong [1996] has also found the minorities tend to use banks that are tougher, although his results are not this dramatic. We are not at all sure how general these very strong results are. A single bank with a very large number of minority applicants is largely responsible for this result.

TABLE Va
Average Toughness of Banks
(based on Bank's Rejection Rate for Whites)

		Number of Observations
Banks Frequented by White Applicants	0.10	19823
Banks Frequented by Minority Applicants	0.19	1338

TABLE Vb
Explaining Loan Disposition (Home Purchase) With Public HMDA Data

	B	T	B	T	B	T	B	T
Minority	0.197	21.99	0.170	18.60	0.093	10.41	0.122	13.38
Relative Income in Purchase Neighborhood*			-9.20e-04	-2.38	-0.000632	-8.85	-0.00079	-10.85
Bank Toughness (home Purchase)					0.913	41.94		
Bank Toughness (refinancing)							0.581	32.19
(constant)	0.0980	41.68	0.198	23.57	0.0698	8.13	0.105	11.99
Adjusted R Square	0.0250		0.0330		0.116		0.085	
Number of Observations	19158		18754		18754		18326	

B = Coefficient; T = t-statistic
*Relative to MSA average.

istics than the Fed-extended data. The Fed-extended data converted the detailed neighborhood data (such as income in the census tract) into dichotomous dummies that measured whether the neighborhood income was above or below average.

Table Vb provides regression results based on loan applications for home purchases from the public HMDA data. To examine the sensitivity of the results to the precise definition of lender toughness, the results are presented using a measure of bank-toughness based on conventional loans (which is subject to some circularity), and a second measure of toughness based on refinancings.

The results show that bank toughness is very influential in explaining rejection rates, regardless of how toughness is defined. Further, bank toughness and neighborhood income reduce the differential rejection rates for whites and minorities by about half, in spite of the fact that detailed financial characteristics for individual loan applicants are unavailable in these data. This reduction in rejection differentials is almost as large as that found using the complete set of variables in the Fed-extended data. Thus, it is apparent that bank toughness plays an important role in mortgage approvals with neighborhood income playing a smaller but important role. We will include these variables in the work reported below.

IX. COMPARING PUBLIC HMDA WITH FED-EXTENDED HMDA

Given that the public HMDA data was the starting point for the Fed-enhanced data, any inconsistency between the observations common to both data sets constitutes evidence that the Fed-enhanced HMDA has been contaminated at some point. Since errors in any of the HMDA variables crucial to the regression model, such as loan disposition, race, size of loan and so forth, will distort regression results, we will examine our results after removing any loan applications for which the Fed-enhanced HMDA data did not correspond with the public HMDA data.

Matching Fed-enhanced and HMDA Data

If the Fed's migration of data somehow alters the base HMDA variables, we are immediately alerted to the possibility of data errors. In this section, we search for observations where the HMDA data did not remain intact after the migration to the Fed-extended data. Given that these observations are likely carri-

TABLE VI
Matched Data

Variable (mean)	Whites (1678)	Minority (496)
Application Rejected	0.070	0.175
Self-employed	0.135	0.081
High Expense to Income Ratio	0.188	0.224
High Loan to Value Ratio	0.100	0.230
Income	80.780	60.610

ers of contaminated data, they are removed from the sample so as to cleanse the data of this particular type of error.

The public HMDA data include variables on the loan decision, the amount of the loan and the applicant's income, the race and sex of the applicant and co-applicant, and the purchaser of the loan. The values that can be taken by these variables allow for a very large number of possible combinations. In fact, the values of these variables will generally allow each observation to be uniquely identified. Therefore, we can use these variables to construct a key, or unique identifier, for each observation that can be used to match the Fed-extended data with the public HMDA data. Clearly, the key will not be perfect, since there are some instances where the key can not distinguish between several observations in either the public HMDA data or the extended Fed data. Nevertheless, this approach allows most observations in the two data sets to be matched. Appendix 2 provides details of the matching procedure and the determination of unmatched cases.

The key created from these variables was able to uniquely identify 2833 of the 2932 possible extended-Fed observations. Our matching procedure allowed us to match 2174 of these 2833 observations to unique HMDA observations, leaving 659 cases that could not be matched. The imperfect ability of the key to distinguish among several non-uniquely identified cases in the HMDA data set was responsible for 228 cases not being matched. This implies that in 431 cases the Fed-extended data did not match up with the public HMDA data.

These 431 unmatched cases are a serious cause for concern. There was every reason to expect that the two data sets would contain identical values for the HMDA variables since the Fed researchers did not endeavor to alter the HMDA data.[43] The large number of unmatched cases appears consistent with the general pattern of data errors found in this data set, presumably caused by the data handling process engineered by the Fed researchers. Can we trust the 431 observations that apparently did not migrate intact from one data set to another? Since the failure of these observations to match the HMDA data is likely to be attributable to errors in the data, the inclusion of these observations could bias any regression results. Therefore, we focus attention on the observations that were consistent with the original HMDA data.

The economic characteristics of the white and minority borrowers included in the 2174 matched cases are generally similar to those of the applicants in the more complete data set, as can be seen from Table VI. Note that the difference in rejection rates for the two groups is 10.5 percentage points, which is quite a bit smaller than for the entire Fed-extended sample, although the ratio of minority to white rejection rates is approximately 2.5:1.

The matched HMDA/Fed-extended data allow us to include information from the original HMDA, such as bank toughness and neighborhood income, as well as all the variables collected by the Fed. Examination of the matched data indicates that observations with unusually high and low interest rates, high

43. Munnell et al. [1992] report on page 20 that they discovered some errors in the HMDA data, such as when one suburban bank discovered that 51 applicants were incorrectly coded as Hispanic. However, the Fed removed questionable HMDA observations from the sample and did not attempt to alter them, since they state that these errors had the effect of reducing the sample size. Therefore, deviations between the Fed data and the HMDA data are not due to intentional changes made to the HMDA data by the Fed.

TABLE VII
Dependent Variable = 1 if Loan is Rejected

Variable	Fed-Type Specification (1) B	T	Adding Bank Toughness and Unable to Verify (2) B	T	Restricting Observations to Interest Rates between 14% and 5% and Removing Four FDIC Problems (3) B	T	Replacing Fed Credit History Variables with Meets-guidelines Variable and Interest Rates between 12% and 7% (4) B	T
Minority	0.0377	2.57	0.0277	2.00	0.0156	1.07	−0.0065	−0.48
High Expense to Income Ratio	0.0333	2.16	0.0330	2.28	0.0266	1.76	0.0154	1.08
Loan To Value Ratio	0.0832	3.46	0.0684	3.01	0.1611	4.47	0.1489	4.25
Denial of Mortgage Insurance	0.7038	12.48	0.6744	12.69	0.6830	12.27	0.6251	12.00
Obligation to Income Ratio	0.0023	3.36	0.0018	2.76	0.0015	2.01	0.0020	2.71
Self-employment	0.0646	3.73	0.0631	3.87	0.0649	3.77	0.0476	2.88
Neighborhood	−0.0004	−2.00	−0.0003	−1.60	−0.0003	−1.37	−0.0003	−1.83
Multifamily Home	0.0364	2.10	0.0308	1.89	0.0222	1.24	0.0311	1.90
Consumer Credit Problem	0.0257	7.21	0.0225	6.68	0.0224	6.38		
Mortgage Credit Problem	0.0133	1.22	0.0088	0.85	0.0037	0.34		
Public Credit Problem (bankruptcy)	0.2196	9.66	0.2040	9.51	0.2039	9.18		
Toughness of Bank			0.6261	8.88	0.6332	8.67	0.4390	6.21
Unable to Verify Data			0.4055	13.71	0.3812	12.01	0.2628	8.47
Loan Meets Credit Guidelines							−0.5344	−23.45
(constant)	−0.1330	−3.26	−0.1851	−4.74	−0.2345	−5.26	0.3640	7.58
Adjusted R Squared	0.1940		0.2850		0.2730		0.4020	
# of Observations	2174		2174		1979		1722	

B = Coefficient; T = *t*-statistic

loan-to-value ratios, and so forth are still present in the sample.

Before we turn to regression results with these matched data, we note that the measure of toughness used in these regressions was constructed to avoid circularity. The matched Fed observations were removed from the HMDA data, and bank rejection rates were constructed for the remaining observations. These bank rejection rates were then included in the matched data.

Results From the Matching Experiment

Table VII provides the results from the regressions with this matched data set. In the first column we use a specification that closely resembles the Boston Fed's original specification. The minority coefficient in column 1 is only about half as large as for the complete Fed-enhanced sample, indicating that the bias related to inconsistencies in the HMDA data may well play an important role in studies based upon the Fed-extended data set.[44]

Successive enhancements to the regression specification and data cleansing are then applied in the following columns of Table VII. First, in column 2, we add bank toughness and the unable-to-verify-data variable. This reduces to minority coefficient to 2.7% and borderline significance.

Next, we remove the FDIC misclassifications that remain in the data. The nature of the FDIC reported misclassifications for the original Fed-extended and our matched Fed-

44. Note that this smaller differential between minority and white rejection rates should only alter the results if the regression techniques and data are unable to provide an unbiased measure of the relationship between economic characteristics and mortgage decisions.

TABLE VIII
Reported Misclassifications

Type of Misclassification	Fed Sample	Matched Fed-HMDA
Withdrawn by Applicant	9	2
Counter Offer	8	0
Rejected by Special Program Because Overqualified	4	2
Really Approved	5	0
Number of Misclassifications	26	4
Number of Observations	2932	2174

HMDA sample are reported in the Table VIII. Note that almost all of the serious errors found by Horne appear to come from the sample of applications that do not match the HMDA data. Therefore, there are only four remaining FDIC errors to remove. Removing the four FDIC indicated misclassified rejections lowers the coefficient to 2.1% and the t-statistic to 1.55, though to save space we do not report this complete regression in the table.

Second, we attempt to restrict the sample to more reasonable interest rates. First we limit our observations to those with interest rates between 5% and 14%, which lowers the minority coefficient to 1.6% and the t-statistic to 1.07.[45] Restricting observations to those with interest rates between 7% and 12% lowers the coefficient to 1%, and the t-statistic to .66 (this regression is also not shown).

Finally, replacing the Boston Fed credit history variable with the meets-guidelines variable lowers the coefficient to −.6% with a t-statistic of −.47.

What can we conclude from the sample of observations for which the HMDA variables are correctly reported in the Fed-enhanced data set? First, this cleansing of the data provides results of the same general variety as the earlier attempts at cleansing the data. Clearly, given the likelihood of errors in the remaining data, there is little or no support for the hypothesis that mortgage lenders systematically discriminate against minorities. Taking our results in combination with our understanding that noise might very well bias upward the coefficient measuring discrimination, there is even a hint that mortgage lenders might favor minority applicants. We caution, however, that these results can not warrant such a conclusion at this time.

45. This is the imputed interest rate adjusted for property tax and insurance.

X. CONCLUSION

There are good economic reasons to be skeptical of claims that lenders discriminate against minorities in their approval of mortgage applications. Discriminators who would turn down a good loan harm themselves by turning down a profit opportunity. Further, the current regulatory climate has put great pressure on mortgage lenders to ensure that its employees do not discriminate against minorities.

The support for the belief that banks discriminate is based largely on the data constructed by the Boston Fed. Yet, we have shown this data set to be deeply flawed in a way that is likely to bias the results. Although some other researchers believe that the errors in the data can be repaired and that such repaired data support the conclusion of the Boston Fed, our analysis of this data indicates otherwise. Our reworking of the data provides no evidence for the conclusion that banks systematically discriminate against minority groups. But we find it unreasonable to think that all the errors in this data set can be found with the techniques at hand. It seems imprudent, to us, to base any policy decisions on analyses of these data.

Unfortunately, the Boston study has had a tremendous influence on public policy. Its recent publication in a leading economics journal can only increase its standing. Listen to Lawrence Lindsay's assessment made after being informed of the numerous problems with the study: "The study may be imperfect, but it remains a landmark study that sheds an important light onto the issue of potential discrimination in lending."[46]

Spokesmen for the banking industry have remained relatively silent. Their public actions have been largely limited to statements of repentance, payments of money to minority organizations, and promises to develop new techniques for marketing loans to the minority community, such as the euphemistically named "flexible underwriting standards."[47] Although their silence might be taken as an admission of guilt, other forces in the regulatory climate have operated to constrain bankers from acting any differently. Thus, serious academic studies are the only method for determining the truth of the matter.

If we are correct, the media frenzy associated with the release of the HMDA data every year has been largely counterproductive for achieving an even playing field in the mortgage market. The "progress" that has been made in "helping" minorities may not be progress at all. After the warm and fuzzy glow of "flexible underwriting standards" has worn off, we may discover that they are nothing more than standards that led to bad loans. Certainly, a careful investigation of these underwriting standards is in order. If the "traditional" bank lending processes were rational, we are likely to find, with the adoption of flexible underwriting standards, that we are merely encouraging banks to make unsound loans. If this is the case, as preliminary evidence suggests, these policies will have done a disservice to their putative beneficiaries if in future years they are dispossessed from their homes due to an inability to make their mortgage payments. It will be ironic and unfortunate if minority applicants wind up paying a very heavy price for a misguided policy based on badly mangled data.

Finally, we must ask whether this type of problem is endemic to other studies of discrimination. If imperfect data tend to cause findings of discrimination where none may occur, then extreme vigilance is required by those conducting such studies to ensure that the data used are pristine. Have researchers taken sufficient care in their creation and use of data? Are the data used sufficiently good proxies for the purposes to which they are put? At this time we can only ask the questions—others will have to provide the answers.

APPENDIX A

Internal Inconsistencies in the Data—Critique, Response, Rejoinder

The following is a listing of the internal inconsistencies that we encountered with the data. After listing each data "error" we describe the response put forward by the Boston Fed researchers when they have done so, and then provide our reply. Although we get the last word here, we believe that we have accurately reflected the arguments of the Fed researchers.

Interest Rates

Both the term of the loan and the monthly payments are included in the Boston Fed data, allowing us to calculate an interest rate on the each of the loans in the data set. Since the monthly payment generally includes taxes and insurance, our calculated interest rate will overstate the actual interest rate on the loan, although we attempt to ameliorate this bias as described below.

We discovered dozens, if not hundreds, of observations for which our imputed interest rates were either too high or too low to be believed. The majority of errors appeared to be in either the amount of the loan application or in the reported monthly housing expenditure. Since both of these variables are used to compute other variables that are central to the statistical analysis (the expense ratio and loan-to-value ratio), these cases must be classified as serious transcription errors.

For example, we found many loans with interest rates well above market. There were 155 loans with interest rates above 16% and 60 loans with interest rates above 20%.

Appendix Table I lists a few loans with very high imputed interest rates (found in the first column) ranging from 42% to 85%. Most readers will recognize these rates as being outlandish.

Although property taxes and insurance are included in the monthly payments, thus overstating the true interest rates, it seemed unlikely that property taxes and insurance could even begin to account for the very high interest rates that appear in these observations.[48] In a previous correspondence to the Federal Reserve's Board of Governors, however, Tootell had claimed that these high interest rates were due entirely to the inclusion of property taxes and insurance:

> Low loan-to-value ratios make the housing expense for these applications seem high given the loan amount, simply because the taxes and insurance premiums on a house with a small loan relative to its value are a large percentage of the housing expense. Thus using

46. Correspondence dated March 1, 1994.

47. See Hansell [1993].

48. We had a footnote about the impact of property taxes and insurance in our earliest working paper.

APPENDIX TABLE I
Some Applications with Unreasonably High Interest Rates

Imputed Interest Rate	Net Worth	Loan Amount	Loan to Value Ratio	Monthly Mortgage Expense	Yearly Income	Appraised Value of Home	Corrected Interest Rate
42%	−1,000	77,000	0.20	2,691	120,000	386,000	34%
44%	−357,000	103,000	0.67	3,792	277,000	155,000	42%
49%	103,800	40,000	0.28	1,638	32,000	142,000	44%
55%	56,000	29,000	0.21	1,336	61,000	140,000	48%
58%	−34,000	26,000	0.20	1,260	66,000	130,000	51%
61%	174,900	48,000	0.15	2,421	87,000	325,000	50%
65%	230,000	43,000	0.15	2,319	91,000	288,000	55%
70%	106,600	40,000	0.15	2,324	60,000	270,000	60%
85%	43,000	9,000	0.15	636	28,000	62,000	74%

> the housing expense to impute the interest rate is completely invalid for observations with low loan-to-value ratios.[49]

Browne and Tootell largely repeat this:

> This [imputing interest rates] is a rough technique and will not work for multi-unit properties or properties for which the mortgage loan is small in relation to other elements of housing expenses... Almost all the imputed rates that they [Day and Liebowitz] find are too high involve properties for which the loan-to-value ratios are very low (less than 35%). In a few cases the term of loan may be incorrect, throwing off imputations of interest rates.[50]

It is true that imputed interest rates for loans with loan-to-value ratios might appear unreasonably high due to the relatively greater fraction of the monthly payment that is attributable to taxes and insurance. But first note that it is definitionally true that when interest rates are too high then either the payment is too high, or the loan amount too low. Thus, it would not be surprising that loan-to-value ratios are frequently small for this group of applications if the loan amount is understated.

Most importantly, however, we can examine directly the impact of property taxes and insurance. Browne and Tootell apparently think that the possibility that high interest rates might be explained in this manner is sufficient to conclude that they are. But they did not examine whether insurance and property taxes actually did account for the unreasonably high interest rates.

As it turns out, the property tax rate in the Boston Area is publicly available information, and typical insurance payments can be easily approximated. The last column in Appendix Table I provides interest rates adjusted exactly in this manner. Note that although this adjustment does lower the imputed interest rates somewhat, the adjusted rates are still far in excess of the rates prevailing in the mortgage market during the sample period, and in fact, in any period that we are familiar with. The most plausible explanation for the extreme levels of these imputed rates is a serious error in either the reported amount of the loan or the estimated monthly payment.[51]

Naturally, there are similar problems with very low interest rates, as shown in Appendix Table II. Here we have a set of loans with negative interest rates (there are 47 such loans in the data, and 68 if we adjust for taxes and insurance) which are part of a larger set of loans with interest rates that, from the point of view of the consumer, are simply too good to be true. For example, there are 100 fixed rate loans with imputed rates below 7% (unadjusted for taxes and insurance) and 202 fixed rate loans with rates below 7% (adjusted for taxes and insurance), at a time when interest rates were in the vicinity of 10%.

Upon examining the data, it is clear that for some of the most outrageous interest rates, the reported loan term most likely has a digit missing, as the loan term is indicated to be 18 or 36 months (20 such loans), although it is conceivable that we could have some very short balloon payments. In other instances, the loan amount, or monthly payment must be incorrectly recorded.

Once again, Browne and Tootell put forward an explanation:

> Almost all of the imputed rates that they [Day and Liebowitz] conclude are too low involve two-to-four-unit properties, for which the housing expense is reduced by rental income.[52]

49. Page 2 in a memo from Geoff Tootell dated January 20, 1994, sent to Laurence Lindsay.

50. Page 74 in Browne and Tootell.

51. The property tax rate for Boston in 1993 was 1.4%, which we were told was higher than the 1990 property tax rate since housing prices had increased, so we set it at 1.3%. We also examined the "Places Rated" almanac to determine the highest property rates in the country, which, if used, would not have altered our conclusions. We set the insurance rate at .5%.

52. Browne and Tootell, page 74.

APPENDIX TABLE II
Some Applications with Unreasonably Low Interest Rates

Loan Amount	Loan to Value	Imputed Rate	Loan Term (months)	Monthly Mortgage Expense	Expense/ Income	Yearly Income	Value of Home
145,000	0.73	−109%	36	441	6	85,000	199,000
400,000	0.55	−533%	12	154	8	34,000	730,000
125,00	0.58	−10%	360	50	32	50,000	217,000
55,000	0.50	−8%	180	156	4	97,000	110,000
184,000	0.94	−6%	360	188	5	52,000	195,000
802,000	6.68	−5%	360	1024	31	58,000	120,000
182,000	0.93	−3%	360	301	32	32,000	196,000
183,000	1.11	−3%	360	306	10	42,000	165,000
75,000	0.43	−2%	360	160	25	76,000	175,000
60,000	0.35	−2%	300	162	4	80,000	170,000

There are two types of errors indicated in this explanation. As a factual matter, of 47 loans with negative interest rates, defined without adjusting for insurance and taxes so as to be consistent with Browne and Tootell, only 10 are multi-unit properties. For 80 loans with interest rates below 4%, only 30 are multi-unit homes. Thus not even a majority, to say nothing of Browne and Tootell's "almost all," are two-to-four unit properties. Three of the loans in the table above are multi-unit homes.

Browne and Tootell state that for multi-unit homes, banks reduce the monthly payment on the mortgage by the expected rental income. This is possible, but if it were true as a general rule we should expect to see that multi-unit homes would have below normal interest rates and, as well, four unit homes should have lower interest rates than three unit homes, and so forth. In fact, what we find is that four-unit homes have higher imputed interest rates than single family homes, (12.2% to 10.6%) whereas two and three unit homes have average imputed rates of 9.2% and 9.3%. What actually appears to happen in this market is that banks sometimes reduce the monthly payment by the rental amount when that is necessary to help get the loan approved.

This leads to a serious conceptual error in the econometrics. Since rent from tenants is sometimes subtracted from monthly payments and sometimes added to income, two economically indistinguishable applications for multi-unit homes might have very different measured income and monthly housing payments. One application might add rental income to the denominator of the obligation ratio, the other might subtract it from the numerator. When the ratio of mortgage payments to income is constructed in these two different ways how can any analysis using the ratio as an independent variable be expected to provide useful results? One answer might be to remove multi-unit homes from the analysis as we had suggested in earlier work, but Browne and Tootell warn us "splitting the sample is not justified."[53] They apparently never realized that their own analysis requires that they do exactly that.

Loans Rejected and Sold

There were 44 mortgages that were classified as rejections although they were also classified as having been sold in the secondary market. This is clearly impossible, but it does not appear to be a random transcription error since 41 out of the 44 mortgages were applications from minorities, an event very unlikely to happen by chance.

MTBM have not attempted to explain how a loan that is rejected can then be sold to the secondary market. Instead they note that both the mortgage disposition (accept/reject) variable and the variable indicating if and to whom a mortgage is sold come from the original HMDA data, and not from the additional data collected in their survey.

> Day and Liebowitz also note that some rejected mortgage applications were apparently sold. Both [variables] came from the original HMDA survey... We did not use data on loan sales and did not try to validate these figures.[54]

Thus, they claim that this error is not their doing. Upon further examination, however, it appears that these errors were not in the original HMDA data. The original HMDA data for the Boston MSA, which consists of over nineteen thousand (conventional) loans, contain only ten observations which have the attributes (error) of being both sold and rejected. Only one of these is a minority observation. So, at a minimum, 40 of these 44 inconsistencies are not in the original HMDA data. Further examination revealed that none of the 44 errors in MTBM's data matched the HMDA errors, so we can actually attribute all of these errors to MTBM's data set. The variables may have the same names as those in the HMDA data, but the inconsistent values appear to have developed during the creation of the Boston Fed data set.

53. Browne and Tootell, page 73.

54. Browne and Tootell, page 74.

APPENDIX TABLE III
Approved Loans that Seemingly Can Never Be Paid Off

Net Worth	Loan Amount	Imputed Interest Rate	Loan Term	Monthly Mortgage Expense	Yearly Income	Home Appraisal
−7,919,000	55,000	18%	180	895	30,000	174,000
−4,333,000	103,000	12%	360	1,030	51,000	114,000
−4,288,000	145,000	−109%	36	441	85,000	199,000
−1,969,000	187,000	16%	360	2,553	165,000	390,000
−1,483,000	160,000	13%	360	1,718	78,000	234,000

Net Worth

Our review of the reported net worth of applicants in the Boston Fed sample revealed that there are at least five mortgage applications where the applicant has a net worth of less than negative one million dollars. But this is only the tip of the iceberg. Assuming that 50% of income was used to repay indebtedness, there are 27 mortgage applicants who would need more than ten years to pay their (prior to this mortgage) debt off, even if the interest rate were zero.

Appendix Table III lists five extreme cases of negative net worth where the mortgage application was approved.

The application on the first row indicates an applicant with almost eight million dollars in net debt, and an income of thirty thousand dollars, being approved for a mortgage of fifty five thousand dollars. To us this seems unreasonable. For this loan, as well as many others, the applicants do not have sufficient income to even pay off the interest on their debt, even at a modest 10% rate of interest. Is this evidence of data errors? Not according to Browne and Tootell. Here is their explanation:

> Thus [Liebowitz] cites as obvious examples of errors applicants who were approved for loans despite having negative net worth. This is an effective rhetorical technique since, at first glance it does seem odd that someone with negative net worth would be approved for a loan. On reflection, however, one can posit many reasons for why a negative net worth would not preclude receiving a loan, particularly as the net worth figures do not include the value of human capital.[55]

Browne and Tootell seem to have come up with an effective rhetorical technique of their own: tell only part of the story. They neglect to tell the reader that these negative net worth figures are in the millions of dollars. They go on:

> We chose not to exclude unusual observations from the data base because we had no standard, other than intuition, for what were reasonable values... For example, there were physicians with very large assets and even larger liabilities... Other researchers can choose to drop these observations.[56]

55. Browne and Tootell, page 66.

56. Page 73 of Browne and Tootell.

We find it implausible that these observations represent loan applications from medical doctors since the level of debt is far beyond the cost even of medical school and the incomes seem too low for doctors. There is a deeper issue involved here as well: Does common sense and intuition have no role in economic analysis?

Loan-to-value Ratios And Mortgage Insurance

The authors of the Boston Fed study state on page 17 of their 1992 report that:

> More importantly, the secondary market will not accept a mortgage loan that has a loan-to-value ratio in excess of 80% without private mortgage insurance. Thus, any applicant with a high loan-to-value ratio who is refused private mortgage insurance is likely to be denied the loan.

and go on to state on page 31 of their report:

> A high loan to value ratio raises the probability of denial, but the effect is relatively small. This result occurs because virtually all applicants with loan-to-value ratios over 80% must secure private mortgage insurance.

Our discussions with bankers indicate that MTBM are correct in these statements. Consequently, we were surprised to find that out of 1129 loans with loan-to-value ratios greater than 80%, 517 loan applicants, almost half, failed to apply for mortgage insurance, yet most of them were approved. Additionally, 119 applications were reported as sold in the secondary market even though the loan-to-value ratio exceeded 80% and the applicant did not apply for mortgage insurance.

There also were 55 applications with loan-to-value ratios greater than 100% (meaning that the mortgage was larger than the purchase price of the home), which we have been told by several bankers is very unusual, yet 20 of these loans were approved. Additionally, there were 123 applications having loan-to-value ratios in excess of .95, most of which were also approved. This is particularly surprising since .95 is usually the maximum allowable loan-to-value ratio. Many of these loans are recorded as having been sold in the secondary market even though they were in clear violation of secondary market requirements.

APPENDIX TABLE IV
Inconsistent Measures of Income

Expense to Income Ratio in Boston Survey	Calculated Ratio Using Monthly Total Income	Calculated Ratio Using Employment Income	Calculated Ratio Using Yearly HMDA Data	Yearly Income (HMDA; 000's)	Calculated Income from Fed Survey
35	41.12	44.06	35.25	35	30
26	41.03	45.90	26.13	44	28
47	42.74	67.46	47.17	46	51
28	11.28	43.52	27.81	58	143
13	49.82	63.62	13.78	120	33
35	49.89	74.58	35.68	60	43
23	230.31	230.31	23.02	61	6
29	39.67	41.22	29.41	43	32
28	43.75	46.12	27.93	59	38
28	33.75	34.44	27.98	64	53
17	39.13	57.02	17.03	101	44
29	287.29	287.29	28.66	140	14
34	25.29	28.35	34.07	23	31
33	61.38	71.41	32.74	53	28

After we reported these facts,[57] the Boston Fed researchers decided that the need for mortgage insurance was not as great as they stated in 1992. Browne and Tootell state:

> Because Fannie Mae generally requires mortgage insurance on high loan-to-value loans, the existence of such applications, [Liebowitz] argues, is proof of error. But while the secondary market usually requires mortgage insurance on such loans, exceptions can be made. More importantly, many of these applications were denied and others were kept in the lenders' portfolio and, thus, not subject to secondary market guidelines.[58]

Is it really reasonable to conclude that hundreds of loans in this sample were "exceptions"? Also, it is our understanding that even when loans are not sold, they generally conform to secondary market guidelines.

Income And Expense/Income Ratios

The Boston Fed collected data on both the monthly employment income and monthly other income for both the loan applicant and the co-applicant. In addition, the original HMDA data set includes a separate variable for the aggregate yearly income of the applicant and the co-applicant. One might expect that these variables should be consistent with each other. Yet, there are 157 applications where the two measures of income differ by more than 20% and 66 cases where the difference is more than 50%. Some of these instances can be found in the two rightmost columns of Appendix Table IV.

As a defense to the difference between the HMDA income and the Fed extended income variable, Browne and Tootell state:

> Another misstatement [by Liebowitz] is categorizing as errors observations where yearly and monthly income figures do not agree. The yearly figures are from the lenders' original HMDA submissions. They were not part of the Boston Fed survey nor were they used by the Boston Fed, although they were made available to researchers as part of the public data set. The Boston Fed did not use the HMDA income figures and instead requested the monthly income figures from the loan applications form because the latter were more precisely defined.[59]

There are several problems with their claim. First, Appendix Table IV presents numerous instances (out of a much larger group) where the expense/income ratio collected in the Fed survey (left column) fits better with the HMDA yearly data (fourth column) and not the "more precisely defined" Boston Fed monthly data (second and third column). Of course, an alternative explanation is merely that the monthly income in the Fed survey is a data error, or perhaps the reported expense/income ratio is at fault. Given the plethora of data errors, either of these possibilities would come as no surprise.

Note that the Boston Fed collected data on the monthly housing expense as well as the ratio of monthly housing expense to monthly income, which is then used as an explanatory variable in their study. We used the Fed collected monthly income and monthly housing expense figures in our checks for consistency with the reported expense to income ratio. When we constructed the ratio of

57. We pointed out many of these problems in Liebowitz [1993], letters to the Fed, a seminar at the Dallas Fed, and various working papers.

58. Browne and Tootell, page 66.

59. Browne and Tootell, Page 73.

APPENDIX TABLE V
Inconsistent Expense to Income Ratios

Expense to Income Ratio in Fed Survey	Calculated Ratio Using Monthly Total Income	Calculated Ratio Using Monthly Employment Income	Calculated Ratio Using Yearly HMDA Data	Monthly Employment Income Applicant	Monthly Employment Income Co-Applicant	Monthly Total Income Applicant	Monthly Total Income Co-Applicant	Monthly Housing Expense	Yearly Income (HMDA) (000's)
0	31.44	34.39	32.45	3539	0	3871	0	1217	45
3	24.76	53.94	33.41	0	1600	1885	1600	863	31
38	78.08	78.08	80.24	1884	0	1884	0	1471	22
67.96	20.86	30.12	24.16	2320	1690	3030	2761	1208	60
0	71.14	104.04	68.84	0	1213	561	1213	1262	22
41	18.83	22.22	18.78	3333	1666	4233	1666	1111	71
0.29	29.00	34.52	34.80	4200	0	5000	0	1450	50
0.14	13.55	14.75	14.75	9833	0	10700	0	1450	118
37	26.91	26.91	47.38	2382	2166	2382	2166	1224	31
58	43.38	43.38	29.52	1350	465	1350	465	787.3	32
0.37	36.73	36.73	36.73	3000	0	3000	0	1102	36
0	26.74	26.74	26.74	7083	0	7083	0	1894	85
0.35	35.33	42.79	43.81	3042	2333	3860	2650	2300	63
0	37.17	42.70	37.12	4347	0	4993	0	1856	60
0.085	32.85	32.85	15.19	3467	0	3467	0	1139	90
38.24	20.83	25.52	17.62	1805	4293	3177	4293	1556	106
4	27.32	27.32	38.46	3250	4375	3250	4375	2083	65
0	68.10	211.12	67.38	1250	0	3875	0	2639	47
110	11.50	13.86	11.50	6500	0	7833	0	901	94
110	11.50	13.86	11.50	6500	0	7833	0	901	94
0.29	28.56	36.79	321.05	8000	0	10303	0	2943	11
0	45.90	45.90	45.89	2083	0	2083	0	956	25
4	18.25	20.06	18.18	6875	0	7555	0	1379	91
66.1	77.88	92.27	44.82	931	0	1103	0	859	23
47.2	18.65	29.89	20.10	8667	4333	11500	9333	3886	232
0	49.75	74.61	48.49	1733	0	2599	0	1293	32
0.52	52.45	90.38	52.17	2213	0	3813	0	2000	46

housing expense to income, we were often unable to replicate the ratio that is included as a separate explanatory variable.[60] The differences that we find are quite dramatic. In 55 instances the deviations in the ratios are greater than 50%, in 140 cases the deviations are greater than 25% and in 337 cases the deviations are greater than 10%.

What this says to us is that for the hundreds of cases where the calculated ratio disagrees with the reported ratio, either the monthly expense is misstated, or the monthly income, or the income/expense ratio. The Fed researchers wish to assume that the expense to income ratio is correct, since it is an important variable in the regressions, and that all the errors are in the separate numerator and denominator. But this appears to be just wishful thinking. For example, Appendix Table V presents cases where it seems fairly easy to conclude that the expense to income ratio is improperly recorded.

60. In other words, the Boston Fed data include as separate variables the numerator, the denominator and the ratio, yet the three variables are inconsistent.

Among these cases are seven observations where the expense to income ratio was reported as zero, an impossibility if the loan was to be paid off. In other instances, it is quite clear that the ratio had the decimal point in the wrong place. In yet other cases the reported ratio is unreasonably high compared to the calculated ratio. These are, however, a minority of the cases where the reported ratios differ from the calculated ratios. In most of those (as in Appendix Table IV) we really can not be sure where the error leading to the inconsistency lies.

Miscellaneous Problems

The same observation appears twice, but since both were rejected it could be the same applicants applying at two different banks.

There are three loans that were approved with expense to income ratios greater than .70, and an additional eight with ratios over .50 (.28 is the usual cutoff). There were three applications with expense/income ratios over 1.

There were nine applications with obligation to income ratios over 100%, one of which, remarkably, was listed as approved. Five out of 23 appli-

APPENDIX TABLE VI
Matching HMDA and Boston Fed Data

1.	Observations in Fed-extended Data	2932
2.	Unique Observations Based on Key Variables	2833
3.	Observations in HMDA Data (MSA1120)	50484
4.	Removing Refinancings, Government Insured and Races other than White, Black and Hispanic	19163
5.	Eliminating Banks with Less Than 25 Loans	17885
6.	Unique Observations Based on Key Variables	15473
7.	# of Unique Permutations of Key Variables for 2412 Duplicate HMDA Observations	1061
8.	Matches of 2833 Fed-extended and 15743 HMDA Observations	2174
9.	Unmatched Fed-extended Observations [2–8]	659
10.	Matches of 2833 Fed-extended and 1061 HMDA Observations	228
11.	Unmatched Fed-extended Observations [9–10]	431

cations with obligation/income ratios above 70% were approved (36% is the normal cutoff).

There were five applications with obligation/income ratios of less than 1%. Why even bother getting a loan under these circumstances?

There were six applications where the obligation ratio is reported to be less than the expense ratio, although that is impossible.

APPENDIX B

Matching the Fed-Extended and HMDA Data

Our merging procedure consisted of taking the 1990 HMDA data for the Boston MSA and removing all loan applications that were not considered in the Boston Fed sample. These included loans not for the purchase of a home, or that were insured by the government (FHA, VA, FmHA), or that were made to individuals classified as a belonging to a race other than white, Hispanic or black. This reduces the number of loans from 50,484 to 19,163. Removing loans from banks with less than 25 loans (to further mimic the Boston Fed) reduced the sample to 17,885, with 1299 black and Hispanic applications. It is from this group that the Boston Fed derived their sample of 2932 applicants, with 685 minority applicants.[61]

Using nine HMDA variables as a key,[62] we matched the two samples. First we removed any observations that contained duplicate information for these nine variables. This reduced the HMDA sample by 14%, to 15419 cases, and the Boston Fed sample by 3%, to 2833 cases. Then we matched the HMDA data to the Boston Fed data using these same nine variables. We were able to successfully match 2174 cases, or approximately 77% of the remaining Fed-extended sample. Appendix Table VI illustrates the process of matching the data.

Because there were 2833 cases in the Fed-extended data that were unique with respect to the key variables, but only 2174 observations were matched, this left 659 instances where the Fed-extended data did not match up to the HMDA data. Our inability to match some of these 659 cases was due to non-unique cases in the HMDA data. We calculated the number of unmatched cases that were due to nonunique HMDA data in the following way. For the nonunique HMDA observations, we formed a list of all unique combinations of the nine key variables. This list was then matched with the Fed-extended data to see how many "non-matches" were due to "duplicate" HMDA observations. Every observation in the Fed-extended data should have been a match with some observations in this complete list of all permutations of the nine variables found in the HMDA data. In fact, only an additional 228 of the 659 unmatched Fed-extended observations were matched in this experiment. Thus, we conclude that at least 431 observations in the Fed-extended data do not match up with the HMDA for those variables that were supposed to be common between the two data sets. This estimate of 431 is biased downward slightly since it does not include the 99 observations in the Fed-extended data set that were not unique with respect to the nine key variables. It is impossible to know how many of these latter observations have a match with the HMDA data.

For the 431 non-matched observations, our working hypothesis is that the Fed researchers most likely made some errors in their manipulation of the data, although the cause of the mismatch is largely irrelevant to our purposes.[63]

61. Again, this is based on the Fed's publicly available data, not the sample on which their 1992 report or 1995 paper is based, each of which differs slightly.

62. The variables were: loan action, race and sex of applicant and co-applicant, income, loan amount, if and by whom the loan was purchased, and whether the applicant intended to occupy the home.

63. It is possible that the Fed researchers worked with an early and error prone sample. But even if the differences in the data were not the fault of the Fed researchers, the later data should allow a more accurate answer to the questions at issue.

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Journal of Housing Research • Volume 4, Issue 2 277

The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited

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Abstract

This study confirms the findings of the 1992 Boston Federal Reserve Bank report that revealed statistical evidence of mortgage discrimination in the Boston metropolitan area. Boston Fed researchers concluded that after controlling for all objective indicators of applicant risk, lenders still rejected minorities 56 percent more often than otherwise identical whites. However, the study has been criticized for miscoded data and omitted variables. We obtained the data used by the Boston Fed and replicated its work, addressing each criticism in turn.

Our analysis shows that the Boston Fed data did contain miscoded or atypical observations but that data errors are not responsible for the negative race effect. We also find the omitted-variable criticism to be unsubstantiated. In fact, we generated additional support for the finding of discrimination by comparing a subjective measure of credit risk with objective credit history determinants.

Introduction

This article is a by-product of a broader research effort conducted by Fannie Mae's Office of Housing Research (OHR) to assess the validity of the Boston Federal Reserve Bank's data for use in OHR's research on mortgage market behavior. It addresses recent criticisms leveled at the 1992 Boston Fed study on racial discrimination in the Boston mortgage market (Munnell et al. 1992)—primarily by reestimating the Boston

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Fed's mortgage application accept/reject model with the same data set used in the original work. Critics of the Boston Fed study (e.g., Liebowitz 1993; Zandi 1993) have charged that the study's authors did an inadequate job of cleaning their data and omitted important variables that are both correlated with race and included in the data set. Other critics (e.g., Becker 1993) have questioned the theoretical and conceptual context from which the results should be viewed: Specifically, if mortgage markets are competitive, how can racial discrimination persist, since lenders unwilling to make good loans would be driven out of business? Implicit in this argument is the allegation that the data or empirical methods that purport to show discrimination are flawed. Moreover, Becker and others note that default rates for minority mortgages are at least as high as those of white borrowers. They interpret such evidence as indicating that discrimination does not affect minority access to credit. They base their conclusion on the argument that if discrimination existed, it would force minority loan applicants to satisfy more stringent credit standards, which in turn would result in minority default rates lower than those for white borrowers, all else being equal.

In responding to the critics of the Boston Fed study, this article adopts a two-part strategy. First, it reports the systematic cleaning of the Boston Fed data in a manner that addresses many of the concerns raised by Liebowitz and Zandi. It also argues that some of the omitted variables identified by Liebowitz or Zandi should in fact be omitted. Second, the article argues that the Becker-type arguments are misplaced because racial discrimination at the accept/reject level of the loan application process is illegal regardless of whether such discrimination affects minority access to credit.

Background

Home Mortgage Disclosure Act Data

In 1992, the Boston Federal Reserve Bank released a comprehensive report on mortgage lending discrimination. Entitled *Mortgage Lending in Boston: Interpreting HMDA Data* (Munnell et al. 1992), the Boston Fed study was prompted by the resurgence of interest in lending discrimination, which culminated in the 1989 overhaul of the data disclosure requirements of the Home Mortgage Disclosure Act (HMDA). For the first time, extensive information on individual home mortgage loan applications became available. Initial examination of the HMDA data showed that minority applicants were denied credit far more often than whites even after controlling for differences in borrower income and loan size. While some observers suspected discrimination, the HMDA measures of applicant creditworthiness were not rich enough to gauge discrimination with certainty.

In response to this shortcoming, the Boston Fed enhanced the 1990 Boston-area HMDA data with an extensive collection of applicant information and analyzed the augmented data set. Although mortgage lending is a broad process that involves several distinct stages—including market area delineation, advertising and marketing, prescreening, application processing, product steering, loan servicing, and administration—the study focuses on assessing the role of race in the disposition of mortgage loan applications.

Loan Applications

The application stage of the mortgage lending process is when the mortgage transaction occurs, so it has received the most research attention. The interest is due in part to the availability of objective data, which makes it possible to apply traditional econometric techniques.

Theory suggests that credit is a rationed good. Stiglitz and Weiss (1981) and Williamson (1986, 1987) demonstrated that under plausible conditions, lenders set a fixed rate and deny certain applications rather than offer a rate commensurate with the risk of each application. Such rationing is strictly risk based; if the default risk is too great, the lender rejects the application. In practice, the mortgage lending market shows some risk-based pricing (such as requiring private mortgage insurance and cosigners), but the primary mechanism for dealing with risk is outright rejection. Discrimination at the application stage occurs when, after adjusting for all legitimate risk factors, the race of the applicant or neighborhood affects the disposition of the application.

The first studies to consider application-stage discrimination examined data aggregated over applicants or areas. For example, studies compared credit delivery rates or average rejection rates for whites with those of minorities. Alternatively, the delivery and rejection rates can be compared across geographic areas with different socioeconomic profiles. While not directly examining the application process, studies of delivery and rejection rates assume that adverse behavior against protected classes will manifest itself in the aggregate data (Avery and Buynak 1981; Bradbury, Case, and Dunham 1989; Schafer and Ladd

1981; Shlay 1987, 1988; Squires and Velez 1988). These studies have gained popularity because of the availability of such aggregate information as census data and the early HMDA data. Lately, however, researchers have grown dissatisfied with discrimination studies based on aggregate data. Specifically, several authors have noted that data on aggregate credit delivery say nothing about credit demand or other features of the lending process (Benston 1981; Galster 1992a, 1992b; King 1980; Maddala and Trost 1982; Perle, Lynch, and Horner 1993). Therefore, disparities in credit delivery cannot be attributed to discrimination alone. Rather than using aggregate data, researchers have performed other studies that directly examine the lending process.

The Boston Fed Study

Accept/Reject Model

The Boston Fed study examined the lending process rigorously, and it is the best known study of mortgage application data to date. This study and others measure the effect of protected variables on the disposition of individual applications after controlling for legitimate indicators of risk (Avery, Beeson, and Sniderman 1993; Black, Schweitzer, and Mandell 1978; King 1980; Schafer and Ladd 1981; Warner and Ingram 1987).

The Boston Fed study adopted the most popular strategy for examining disparate treatment at the application stage of the lending process, which is the estimation of a probability function of the form

$$p(R_i) = f\,[\mathrm{RISK}_i, \mathrm{RACE}_i],$$

where $p(R_i)$ is the probability of rejection for applicant i;

RISK_i represents the legitimate risk factors associated with applicant i, including locational risk characteristics of the underlying collateral; and

RACE_i is the race or ethnicity of applicant i.

This specification conveys the effect of applicant race on the probability of rejection after controlling for differences in legitimate risk factors. For studies of discrimination against other protected classes, the relevant status of individuals is substituted for RACE_i.

Given adequate application-level data, the specification can be estimated empirically. Common RISK variables in application rejection studies include the loan-to-value ratio, applicant income, and instrument type (Black, Schweitzer, and Mandell 1978; King 1980; Schafer and Ladd 1981). Logit and probit functional forms are well suited to estimating the disposition relationship and, overall, can effectively gauge disparate treatment in the disposition decision (Baldus and Cole 1980). The specification says nothing about prescreening, product steering, or the adverse impact of credit guidelines on minorities.

The most damaging charge against the probability-of-rejection model is the omitted-variable criticism. If the study does not account for every RISK variable, the estimated effect of RACE on the probability of rejection may be biased. Omitted-variable bias occurs when the following conditions hold:

1. Variables that help determine the probability of rejection are omitted.

2. The omitted variables are correlated with RACE.

When these conditions obtain, the estimated coefficient on RACE not only represents the direct effect of race on disposition but also proxies for the legitimate effect of the omitted variable. Applicant net worth, conspicuously absent from the HMDA data, was not included in most earlier studies of application disposition. Many observers maintain that higher net worth increases the probability of application approval.[1] In addition, average net worth is substantially higher for whites than for minorities. Thus, the omission of net worth from the probability specification violates both conditions and biases the estimated effect of RACE on disposition. A strong positive effect of RACE on rejection might reflect lower net worth among minorities rather than application-stage discrimination. The requirement that every legitimate RISK factor be accounted for makes the omitted-variable criticism especially vexing. It is important to realize, however, that the accept/reject model will always be vulnerable to the omitted-variable criticism until the development of a data set that allows estimation of fixed-effect models.

[1] Munnell et al. (1992) claimed that lenders rarely use net worth in the disposition decision. Duca and Rosenthal (forthcoming) find that net worth has no effect on the likelihood of credit constraints after controlling for credit history, income, and demographic effects. Since results from the present study suggest that net worth is not a significant predictor in the accept/reject model, perhaps earlier views in the research community were incorrect on this point.

Boston Fed Methodology and Results

The primary innovation introduced by the Boston Fed study is the data set, which contains information on every important RISK variable cited by a panel of bankers involved in the study. The data set was specifically designed to address the omitted-variable criticism. Consequently, the findings are relatively immune to that criticism as compared with other studies from that time. The estimated coefficient on RACE was reliably explained as disparate treatment discrimination. It is this advance that prompted the initial excitement over the report.

The Boston Fed study adhered to a clearly structured methodology. Step 1 called for data collection. Boston-area lenders and other researchers were consulted to develop a comprehensive list of important application factors. Of more than 16,000 Boston-area applications recorded in the 1990 HMDA data set, the Boston Fed collected detailed information on about 4,000. Step 2 involved the logit regression of loan disposition on a series of independent variables. The Boston Fed estimated several specifications to help identify the most important application characteristics. Step 3 called for analysis of the regression results. If applicant race helps predict application disposition even after correcting for legitimate application characteristics, the disparate treatment hypothesis is supported.

In each of the Boston Fed empirical specifications, African Americans and Hispanics were denied credit more often than otherwise identical whites. The most general specification implies that minorities in the Boston area are rejected 56 percent more often than equally creditworthy whites. This result provides the most powerful evidence to date of disparate treatment in application processing. Still, each of the three steps taken in the Boston Fed study has been criticized as improperly influencing the results. The following discussion briefly reviews the criticisms leveled at the study.

Criticisms of the Boston Fed Study

Data Problems

The recent release of a slightly modified version of the Boston Fed data set has hastened critical examinations of the report. The first step in the Boston Fed methodology—data collection—was the subject of an attack by Stan Liebowitz (1993) with Ted Day as summarized in the *Wall Street Journal*. In their study, Liebowitz and Day alleged that typographical errors in the Boston Fed data set accounted for the negative race effect. When records with inconsistent entries (incompatible monthly and yearly incomes and negative interest rates) or extreme observations (multimillion-dollar loans and net worths) were excluded, the authors claimed, the estimated effect of race on loan disposition disappeared.

Model Specification Problems

Criticism of step 2 in the Boston study—empirical estimation—is exemplified by a recent study authored by Mark Zandi (1993) and summarized in the *American Banker*. Zandi noted that although the Boston Fed collected a wide array of risk-related variables, it used only 12 in the final analysis. Zandi found that one excluded variable—the lender's subjective assessment of the application vis-à-vis institution credit guidelines—was an especially important determinant of rejection. When this variable was included as a control for legitimate application risk, the race effect largely disappeared. In other words, Zandi claimed that the Boston Fed study was plagued by omitted-variable bias, the primary problem it was intended to overcome.

Interpretation Problems

The interpretation of Boston Fed results has been questioned. As noted, the Boston Fed concluded that minorities were rejected 56 percent more often than equally creditworthy whites: 17 percent versus 11 percent of the time. The study relied on a technique popularized in labor economics (Blinder 1973; Oaxaca 1973) that separately estimated a probability-of-rejection model for white and minority subsamples. The estimated coefficients from the two subsamples represent the prospects of whites and minorities with certain application characteristics. Thus, for any set of risk controls, the expected probability of rejection can be computed for white or minority applicants. The Boston Fed used average control variable values of white applicants in the Boston area for the reference applicant. The expected rejection rate for this hypothetical applicant was 11 percent if the applicant was white and 17 percent if the applicant was African American or Hispanic. Zandi asserted that the average control variable values of *minority* applicants in the Boston area would be more appropriate for the reference applicant.[2] Although he ultimately used an entirely different technique,

[2] From both theoretical and practical standpoints, the Boston Fed was correct in using the white applicant as the reference to compare treatment of white and minority loan applicants. As Neumark (1988) argued in the context of wage discrimination in labor markets, the nondiscriminatory world is the white person's world. Consequently, the treatment of white applicants should be the benchmark for measuring the extent of discrimination in mortgage lending.

Zandi claimed that using the average control variable values of minority applicants substantially altered the study's results.

Default Rates

The criticisms by Becker (1993), Brimelow (1993), and Brimelow and Spencer (1993) received much attention but fundamentally misrepresented the scope of the Boston Fed report. Using an average default methodology, these researchers essentially claimed that discrimination against minorities meets a legitimate business purpose. Because Boston-area default rates among whites and minorities are equal, the authors reasoned, lenders are properly evaluating the true default risk of whites and minorities. Thus, they claimed that a positive coefficient for race in the rejection probability equation is permissible because it serves a rational (if not legal) business purpose.

A Reexamination of the Boston Fed Data

The data methods employed in the Boston Fed study are the first possible point of criticism. This discussion briefly examines sampling properties, coding mistakes, and the distribution of the data.

Sampling

The data set released by the Boston Fed has passed through two important filters. First, the Boston Fed collected and used as its data set detailed information on 4,200 of 16,344 HMDA conventional home-purchase loan applications. Second, the Boston Fed made raw data available for 2,816 of these loans. The smaller data set is the subject of this discussion. Ideally, we should examine the sampling properties of both filters. However, since only the first and last of the three data sets are available, we consider the sampling properties of the limited Boston Fed data.

The variables used in this article are defined in table 1. Five nonrace variables appear in both the HMDA and Boston Fed data sets: loan disposition (APPROVE), applicant sex (APPSEX), geographic location (COUNTY), applicant income (APTOTINC), and requested loan amount (LOANAMT). Comparative t tests are presented in table 2 for equal means across the two data sets for white and minority applicant groups. For both groups, the Boston Fed data contained a greater proportion of accepted applications than the HMDA data. This is surprising and suggests that lenders probably choose or are better able to collect

Table 1. **Definitions of Variables**

Code	Description	Definition
AGE	Age	Applicant age from question 21
APPROVE	Loan disposition	Probability of loan approval for the applicant
APPSEX	Sex	1 if applicant was male 0 otherwise (lender's HMDA report)
APTOTINC	Income	Sum of applicant's and coapplicant's total monthly income
CONSHIST	Consumer credit history	1 if no "slow pay" accounts 2 if one or two slow pay accounts 3 if more than two slow pay accounts 4 if delinquent credit history with 60 days past due 5 if serious delinquencies with 90 days past due 0 if insufficient credit history for determination
COSIGN	Presence of cosigner	1 if cosigner 0 otherwise
COUNTY	County	1 if Suffolk County 0 otherwise
EXPDUMMY	Housing expense/income	1 if housing expense is greater than 30 percent of income 0 otherwise
FANNIE	Fannie Mae guideline	1 if application meets Fannie Mae guidelines 0 otherwise
FRM	Fixed-rate loan	1 if fixed rate 0 otherwise

Table 1. **Definitions of Variables** *(continued)*

Code	Description	Definition
GOTGIFT	Gift or grant in down payment	1 if applicant received gift for down payment 0 otherwise
GOTPMI	Denied private mortgage insurance (PMI)	1 if applicant applied for and was denied PMI 0 otherwise
GUIDELIN	Lender's credit history guideline	1 if application meets lender's credit history guidelines 0 otherwise
LIQUID	Liquid assets	Value of applicant's liquid assets
LOANAMT	Loan amount	Value of loan amount
LTV	Loan/appraised value	Value of loan amount divided by appraised value
MARRIED	Marital status	1 if applicant was married 0 otherwise
MORTHIST	Mortgage credit history	1 if no late payments 2 if one or two late payments 3 if more than two late payments 0 if no payment history
MULTIFAM	Number of units in structure	1 if unit is in two- to four-family structure 0 otherwise
NETWORTH	Net worth	Value of applicant's net worth

Table 1. **Definitions of Variables** *(continued)*

Code	Description	Definition
PRUNEMPL	Probability of unemployment	1989 Massachusetts unemployment rate for applicant's industry (from question 29), from U.S. Bureau of Labor Statistics
PUBHIST	Public record	1 if any public record of credit problems 0 otherwise
RACE	Race	1 if applicant was African American or Hispanic 0 otherwise (lender's HMDA report)
SELFEMP	Self-employed	1 if applicant was self-employed 0 otherwise
TERM	Term of loan	Loan term in months
TIMESAPP	Number of application reviews	Number of times application was reviewed by lenders
TOTTOINC	Total debt payments/income	Total debt payments divided by APTOTINC
UNVERIFY	Unverifiable information	1 if application contains unverifiable information 0 otherwise
VACTRACT	Housing units vacant	Percent of vacant housing units in census tract in which property was located, from 1990 census
GREATCON	Consumer: no slow accounts	1 if CONSHIST = 1 0 otherwise
GOODCON	Consumer: one or two slow accounts	1 if CONSHIST = 2 0 otherwise

Table 1. **Definitions of Variables** *(continued)*

Code	Description	Definition
OKCON	Consumer: more than two slow accounts	1 if CONSHIST = 3 0 otherwise
BADCON	Consumer: delinquencies	1 if CONSHIST = 4 0 otherwise
AWFULCON	Consumer: serious delinquencies	1 if CONSHIST = 5 0 otherwise
GOODMORT	Mortgage: no late payments	1 if MORTHIST = 1 0 otherwise
OKMORT	Mortgage: one or two late payments	1 if MORTHIST = 2 0 otherwise
BADMORT	Mortgage: more than two late payments	1 if MORTHIST = 3 0 otherwise

Table 2. **Differences in Means: 1991 HMDA Data and Boston Fed Follow-up Data**

Variable	White Applicants				Minority Applicants			
		N	Mean	Prob>|t|		N	Mean	Prob>|t|
APPROVE	Boston Fed	2,078	0.908	0.0036	Boston Fed	658	0.719	0.0027
	HMDA	14,284	0.889		HMDA	1,114	0.650	
APPSEX	Boston Fed	2,066	0.815	0.7096	Boston Fed	650	0.691	0.2908
	HMDA	14,284	0.812		HMDA	1,114	0.715	
COUNTY	Boston Fed	2,078	0.118	0.2577	Boston Fed	658	0.588	0.8765
	HMDA	14,284	0.127		HMDA	1,114	0.584	
APTOTINC	Boston Fed	2,078	75.944	0.1364	Boston Fed	658	56.358	0.743
	HMDA	14,010	78.647		HMDA	1,099	57.223	
LOANAMT	Boston Fed	2,078	144.475	0.7265	Boston Fed	658	128.280	0.2758
	HMDA	14,284	145.268		HMDA	1,114	131.339	

additional data on approved rather than rejected applications.[3] For the other variables, t tests cannot reject the possibility that the means are equal. Overall, there is little reason to believe that the Boston Fed data set misrepresents lending activity in Boston. The original Boston Fed report extensively examined sampling properties and concluded that the sample was unbiased (Munnell et al. 1992, 19–23).

Coding Errors

Coding errors refer to obviously miscoded or contradictory observations. Liebowitz (1993) and Day noted that several observations contained miscoded data. Our review of the Boston data is summarized in table 3. The data were subjected to eight qualifying criteria that screen questionable observations. More than one-third of the observations violated at least one of the criteria. Criterion 1 requires a loan-to-value ratio less than 3. Criteria 2 and 3 limit the range of the effective interest rate calculated from the loan amount, monthly housing expense, and loan term data. While technically possible, loans exceeding a loan-to-value ratio of 3 or carrying effective interest rates over 20 percent or under 3 percent are highly irregular. Five of the 2,816 records had loan-to-value ratios exceeding 3, 36 had interest rates exceeding 20 percent, and 11 had interest rates less than 3 percent. Visual inspection confirmed that these records were probably miscoded. Accordingly, these observations were excluded from later analysis.

Criteria 4 through 7 flag observations containing logical inconsistencies. Criterion 4 excludes any loan with a back-end ratio greater than its front-end ratio; only six applications failed this test. Criteria 5 and 6 flag loans with inconsistent income and expense data. Criteria 7 and 8 identify applications whose unit price exceeds the applicant's total source of funds or total liquid funds. Criterion 9 flags rejected applications that are later recorded as sold in the secondary market.

As shown in table 3, criteria 5 through 8 account for most of the miscoded observations. Visual inspection of observations failing criterion 5 suggested that the HMDA-recorded income data were incorrect. Therefore, subsequent analysis used only the Boston Fed-reported income data. For records failing criterion 6, the expense-to-income ratio was calculated directly from reported expense and income figures, and the precalculated front-end ratio was discarded. Treatment of applications violating criteria 7 and 8 was more complex; most of these applications had typical loan-to-value ratios, but the applicants had

[3] HMDA requires lenders to retain information on *all* loan applications for at least two years.

Table 3. **Criteria for Cleaning the Boston Fed Data**

Total observations in raw data	2,816
Observations that failed	
Criterion 1: Loan-to-value ratio exceeds 3	5
Criterion 2: Effective annual interest rate exceeds 20 percent	36
Criterion 3: Effective annual interest rate less than 3 percent	11
Criterion 4: Back-end ratio exceeds front-end ratio (housing expense-to-income ratio exceeds total expense-to-income ratio)	6
Criterion 5: HMDA-reported total income not equal to Boston Fed-reported total income	415
Criterion 6: Housing expense-to-income ratio not equal to housing expense divided by income	460
Criterion 7: Purchase price exceeds the sum of the loan amount, applicant net worth, and "other money" available to applicant	223
Criterion 8: Purchase price exceeds the sum of the loan amount, applicant liquid assets, and "other money" available to applicant	415
Criterion 9: Application is rejected but loan is sold in the secondary market	36
Fail at least one criterion	1,045
Fail criterion 1, 2, 3, or 4	53

either negative net worth or low liquid assets. Low liquid assets are explainable if applicants planned to make the down payment with the equity in an unsold previous home. Applications failing criterion 7 were more unusual, but still conceivable. Oddly, 81 percent of the applications that violated criterion 7 were approved for loans. While we suspected miscoding, we retained these observations for later analysis. Securitized loans, for example, might violate this criterion and still gain approval. Applications violating criterion 9 were clearly miscoded but were retained because secondary market sales data were not employed in later analysis (although secondary market guidelines were). Visual inspection showed that most of the 36 miscoded loans were indeed rejected and not sold in the secondary market.

Fifty-three observations—those that violate at least one of criteria 1 through 4—were excluded from later analysis. These 53 observations were the worst examples of generally careless data construction. As many as 37 percent of the Boston Fed records were inaccurate.

Regardless of their effect on the study's material results, clearly miscoded data undermine the report's credibility. In addition to screening for logical inconsistencies, the Boston Fed should clarify its reporting instructions if it ever repeats such a survey. Some coding errors undoubtedly resulted from unclear instructions.

Influential Observations

Unlike miscoded observations, influential observations are accurate but lie so far from the sample mean that they can unduly influence estimation results. For example, the Boston Fed study contains several multimillion-dollar loans. Treatment of these applications is less clear than that of obviously miscoded records. We decided to concentrate on modeling "normal" observations, where discrimination is most likely to occur. Thus, we excluded observations that had a *C* statistic greater than 0.6 or a *DFBeta* for the race variable greater than 0.73 or less than 0.55 in the original Boston Fed model. The *C* statistic measures the influence of a single variable on the entire set of estimated coefficients. *DFBeta* measures the observation influence on a single coefficient—in this case, the effect of race on disposition. Belsley, Kuh, and Welsch (1980) discuss these statistics in greater detail. We identified and excluded the 27 most influential observations. The resulting data set more accurately depicts "typical" mortgage applications.

One result of excluding influential observations was the loss of a dummy variable that reflected the denial of private mortgage insurance (PMI). As noted in the Boston Fed report, PMI rejection almost guarantees application denial. In fact, only 5 of 2,800 applicants were denied PMI but granted a loan. These five observations were clearly atypical of Boston loan applications. As discussed in the Boston Fed report, there were strong arguments for excluding this variable from analysis. Therefore, we dropped the PMI variable in subsequent specifications.

Effect of Clean Data

In table 4, the results of the Boston Fed study are compared with and without the use of questionable data. Model A replicates the Boston Fed study as closely as possible. One variable used in the Boston Fed report—estimated rent-to-value ratio in the property census tract—was not made available; therefore, our results differ slightly. In addition, only 2,816 of the original 3,062 Boston Fed observations were made available. Model B excludes the 53 observations that violate miscoding criteria 1 through 4. Model C further excludes observations

Table 4. **Logit Regression of APPROVE: Effect of Clean Data**

Variable	Model A: All Observations	Model B: Dropping 53 Core Miscodes	Model C: Dropping 53 Core Miscodes plus Insufficient Funds	Model D: Dropping All Potential Miscodes	Model E: Dropping 53 Core Miscodes plus Influential Observations	Model F: Dropping 53 Core Miscodes plus Influential Observations[a]
Intercept	26.9099 0.0001	25.8507 0.0001	26.157 0.0001	28.3352 0.0001	26.5808 0.0001	26.7418 0.0001
EXPDUMMY	0.3735 0.0176	0.3409 0.0145	0.1493 0.3748	0.0128 0.9554	0.2587 0.0931	0.3134 0.0278
TOTTOINC	0.0567 0.0001	0.000313 0.0516	0.00933 0.0090	0.0549 0.0001	0.00571 0.0593	0.00586 0.0415
NETWORTH	0.000101 0.1227	0.000089 0.222	0.000114 0.0926	0.000144 0.0946	0.00006 0.6757	20.00003 0.8579
CONSHIST	0.3103 0.0001	0.3230 0.0001	0.3081 0.0001	0.3098 0.0001	0.3444 0.0001	0.3128 0.0001
MORTHIST	0.3792 0.0020	0.3225 0.0095	0.3145 0.0327	0.2156 0.2850	0.2884 0.0291	0.296 0.0186
PUBHIST	1.1862 0.0001	1.2252 0.0001	1.3774 0.0001	1.2462 0.0001	1.2577 0.0001	1.2505 0.0001
PRUNEMPL	0.0807 0.0060	0.0861 0.0029	0.0741 0.0243	0.0456 0.2867	0.0660 0.0351	0.0633 0.0301

Table 4. **Logit Regression of APPROVE: Effect of Clean Data** *(continued)*

Variable	Model A: All Observations	Model B: Dropping 53 Core Miscodes	Model C: Dropping 53 Core Miscodes plus Insufficient Funds	Model D: Dropping All Potential Miscodes	Model E: Dropping 53 Core Miscodes plus Influential Observations	Model F: Dropping 53 Core Miscodes plus Influential Observations[a]
SELFEMP	0.4776 0.0133	0.6228 0.0010	0.7060 0.0008	0.9114 0.0006	0.6451 0.0013	0.609 0.0015
LTV	0.5605 0.0020	1.7676 0.0001	1.8786 0.0001	2.7157 0.0006	2.5135 0.0001	3.0463 0.0001
GOTPMI	4.6276 0.0001	4.5342 0.0001	4.5233 0.0001	5.1005 0.0001	39.7717 0.0001	
MULTIFAM	0.4848 0.0052	0.2932 0.0895	0.1813 0.3467	0.5331 0.0580	0.1716 0.3462	0.2768 0.0944
RACE	0.7999 0.0001	0.7730 0.0001	0.7223 0.0001	0.8487 0.0001	0.7841 0.0001	0.7619 0.0001
Concord[b]	84.1%	82.3%	82.2%	84.2%	83.4%	79.9%
Discord	15.5%	17.3%	17.3%	15.3%	16.1%	19.6%
Tied	0.4%	0.5%	0.5%	0.5%	0.4%	0.4%
Observations	2,816	2,759	2,258	1,691	2,736	2,736

Note: The first number in each cell is the logistic regression coefficient; the second is the chi-square statistic.
[a]PMI variable excluded.
[b]Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

without sufficient funds to pay for the unit (criteria 5 and 6). Model D includes only observations that pass *all* qualifying criteria. Model E excludes the 53 core miscoded observations and the influential observations. Model F replicates Model E but discards the PMI variable; this last data set was used in subsequent analyses.

Note that the signs and magnitudes of the estimated coefficients generally change little across the specifications in table 4 (a higher coefficient implies a greater chance of rejection)—particularly in the case of the race variable, which remains significant in all specifications. The most conspicuous differences across models are the estimated coefficients for net worth and loan-to-value ratio. In the Boston Fed study, the coefficient for loan-to-value ratio was weak, and the coefficient for net worth carried the wrong sign. Exclusion of the miscoded and influential variables gives both variables the expected sign and accords greater weight to loan-to-value ratio. The proportion of correct predictions as a measure of model fit is lower in the final model than in the Boston Fed study because of the exclusion of PMI. In general, data mistakes do not drive the race effect. Liebowitz and Day correctly asserted that the Boston Fed data are plagued by errors, but the errors are not necessarily responsible for the finding of disparate treatment.

The Omitted-Variable Criticism

American Banker *Study Specifications*

Zandi's chief criticism was that the Boston Fed's empirical specification incorrectly excluded or included certain variables. For this section, we test several alternative specifications of the loan disposition process. In all models, we used the Boston Fed data without the miscoded or influential variables as defined above.

In his *American Banker* study, Zandi (1993) added four variables to the Boston Fed study: a dummy variable denoting credit policy conformity (GUIDELIN), a dummy variable denoting unverifiable information (UNVERIFY), a dummy variable denoting the presence of a cosigner (COSIGN), and the loan amount (LOANAMT). He suggested that the addition of four variables severely suppressed the negative effect of race on approval. Of Zandi's four variables, only UNVERIFY appears to be exogenous and, in that sense, legitimate. Furthermore, adding only one of these variables—GUIDELIN—is enough to diminish the race effect. The coefficients of four models are compared in table 5: the Boston Fed model, the Boston Fed model with GUIDELIN, the Boston Fed model with UNVERIFY, and the Boston Fed model with both

Table 5. **Logit Regression of APPROVE: Boston Fed and *American Banker* Specifications**

Variable	Model A: Boston Fed Specification	Model B: Boston Fed Specification plus GUIDELIN	Model C: Boston Fed Specification plus UNVERIFY	Model D: Boston Fed Specification plus GUIDELIN and UNVERIFY
Intercept	26.7418 0.0001	21.8619 0.0013	26.9747 0.0001	22.2946 0.0001
EXPDUMMY	0.3134 0.0278	0.2723 0.1071	0.2972 0.0531	0.2856 0.1084
TOTTOINC	0.0059 0.0415	0.0066 0.0327	0.0048 0.1345	0.0055 0.1013
NETWORTH	0.0000 0.8579	20.0001 0.5778	0.0000 0.7983	20.0002 0.8884
CONSHIST	0.3128 0.0001	20.0330 0.5074	0.3110 0.0001	20.0146 0.7769
MORTHIST	0.2960 0.0186	0.0282 0.8510	0.2629 0.0521	20.0166 0.9153
PUBHIST	1.2505 0.0001	0.2122 0.3734	1.3902 0.0001	0.3780 0.1207
PRUNEMPL	0.0633 0.0301	0.0423 0.2117	0.0553 0.0803	0.0357 0.3258
SELFEMP	0.6090 0.0015	0.5967 0.0079	0.5847 0.0044	0.6021 0.0101
LTV	3.0463 0.0001	2.7812 0.0001	3.1484 0.0001	2.9352 0.0001
MULTIFAM	0.2768 0.0944	0.4584 0.0202	0.3370 0.0611	0.4762 0.0223
RACE	0.7619 0.0001	0.5574 0.0006	0.6497 0.0001	0.4642 0.0070
GUIDELIN		23.8089 0.0001		23.6114 0.0001
UNVERIFY			3.0280 0.0001	2.7312 0.0001

Table 5. **Logit Regression of APPROVE: Boston Fed and *American Banker* Specifications** *(continued)*

Variable	Model A: Boston Fed Specification	Model B: Boston Fed Specification plus GUIDELIN	Model C: Boston Fed Specification plus UNVERIFY	Model D: Boston Fed Specification plus GUIDELIN and UNVERIFY
Concord*	79.9%	85.8%	83.9%	88.1%
Discord	19.6%	13.6%	15.7%	11.4%
Tied	0.4%	0.6%	0.4%	0.5%
Observations	2,736	2,734	2,736	2,734

*Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

GUIDELIN and UNVERIFY. Note that the magnitude of the estimated RACE coefficient decreases but remains significant as the two variables are added. This decrease led Zandi to conclude that omitted-variable bias in the Boston Fed study was driving the race effect.

This effect is further dramatized in table 6. Model A, which does not include GUIDELIN, has relatively strong explanatory power and a significant positive coefficient on RACE. Simply adding GUIDELIN (Model B) reduces the RACE coefficient by nearly half. Zandi was correct in noting that the addition of GUIDELIN severely modifies the race effect.

Stepwise Regression

The Boston Fed report noted that research into theoretical and empirical lending offers little guidance in specifying an accept/reject model. Theoretically, only those variables that influence the expected return of a loan (e.g., default probability) should be included in the equation. All others, including race, should be excluded from the lending decision. While recent modeling efforts have examined the underwriting specification, model building of this type still involves guesswork. As a result, stepwise regression seems to be an appropriate tool for identifying important variables.

Model A in table 7 contains the subset of Boston Fed variables that survived stepwise regression on APPROVE. UNVERIFY and GUIDELIN

Table 6. **Logit Regression of APPROVE: Effect of Adding GUIDELIN**

Variable	Model A: without GUIDELIN	Model B: with GUIDELIN
Intercept	25.9965	22.8246
	0.0001	0.0001
UNVERIFY	3.1048	2.8322
	0.0001	0.0001
TOTTOINC	0.00531	0.00792
	0.0768	0.0150
MULTIFAM	0.3653	0.4548
	0.0397	0.0314
SELFEMP	0.5667	0.6438
	0.0043	0.0057
AGE	0.2888	0.3348
	0.0308	0.0344
MARRIED	20.3453	20.3857
	0.0096	0.0147
PUBHIST	1.8819	0.3909
	0.0001	0.1077
VACTRACT	0.1626	0.2235
	0.2392	0.1740
FRM	0.3517	0.5839
	0.0135	0.0007
COSIGN	0.0950	20.1882
	0.7766	0.6572
LTV	3.4729	3.1875
	0.0001	0.0001
RACE	0.7400	0.3979
	0.0001	0.0246
GUIDELIN		23.6497
		0.0001
Concord*	82.7%	88.9%
Discord	16.9%	10.6%
Tied	0.5%	0.5%
Observations	2,736	2,734

*Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

Table 7. **Logit Regression of APPROVE: Stepwise Regression**

Variable	Model A: Full Stepwise Model	Model B: Stepwise without GUIDELIN
Intercept	21.4070 0.0022	24.4674 0.0001
RACE	0.5232 0.0021	0.9372 0.0001
FRM	0.5416 0.0015	0.3222 0.0198
LTV	2.3317 0.0001	2.7295 0.0001
MARRIED	20.3808 0.0146	20.3053 0.0177
MULTIFAM	0.6829 0.0008	0.4823 0.0038
FANNIE	20.6542 0.0008	21.3428 0.0001
SELFEMP	0.5926 0.0127	0.5410 0.0061
UNVERIFY	2.9822 0.0001	3.1945 0.0001
GUIDELIN	23.6262 0.0001	
Concord*	88.5%	81.0%
Discord	10.9%	18.5%
Tied	0.5%	0.5%
Observations	2,736	2,739

*Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

are both strongly significant; RACE makes the list, but with small magnitude. In the Zandi paradigm, evidence of a race effect is weak. All other coefficients carry the expected sign—except perhaps the coefficient on FRM, which suggests that fixed-rate mortgage applications are rejected more often than adjustable-rate mortgage (ARM) applications. This result is possibly due to preapplication steering (borderline cases are steered away from ARMs).[4] Model B replicates Model A but deletes GUIDELIN, thereby causing a large jump in the coefficient on RACE. In general, the effect of RACE on approval can be attributed largely to the greater likelihood that whites will meet lender credit guidelines.

The Boston Fed "Key Variables" and Stepwise Regression

One final robustness check of the results examines the Boston Fed's seven "key variables" (Munnell et al. 1992, 36). Model A in table 8 regresses the key variables on application disposition. Model B forces the first seven variables and includes any others that pass stepwise elimination. The results are strikingly similar to those from the stepwise regression shown in table 7. Again, the coefficient on RACE is substantially reduced when GUIDELIN and UNVERIFY are added.

Thus far, it seems clear that the most damaging evidence against the race effect is omitted-variable bias demonstrated by the GUIDELIN variable. The following section closely examines the relationship between GUIDELIN and RACE.

Race and Credit Guidelines Reexamined

The credit history questions asked of lenders in the follow-up Boston Fed survey are listed verbatim in figure 1. Question 40 produced the GUIDELIN variable that was crucial to the survey results. It asks whether the applicant's credit history meets the lender's loan policy guidelines for approval. Questions 42, 43, and 44, which closely follow the GUIDELIN question, are clearly preceded by the words "credit history." These three questions seem to disaggregate the overall credit history alluded to in question 40. We interpret this series of questions as follows: Questions 42, 43, and 44 record the facts about applicant credit history, while question 40 requires the lender to convert the facts into an assessment of creditworthiness. In particular, we feel that the answer to question 40 should be a direct function of the answers to questions 42, 43, and 44, although a lender might have different credit

4. Stuart Rosenthal drew our attention to the fact that loan-to-value ratio and instrument type are endogenous with respect to accept/reject decisions. He argues, for example, that a borrower applying for a loan with a 90 percent loan-to-value ratio may be rejected. That borrower may subsequently reapply with an 80 percent loan-to-value ratio and be accepted. Hence, the loan-to-value ratio and the accept/reject decision form a simultaneous system. Inclusion of the loan-to-value ratio directly in the accept/reject model leads to simultaneous bias. Rosenthal believes that a similar argument holds for all other terms of the loan contract affecting credit risk, including instrument type. We plan to investigate the issue of simultaneous bias in modeling lender and borrower loan decisions in our future work.

Table 8. **Logit Regression of APPROVE: Boston Fed "Key Variables"**

Variable	Model A: Seven Boston Fed "Key Variables"	Model B: Seven Boston Fed "Key Variables" plus Stepwise
Intercept	25.9140 0.0001	21.3314 0.0002
RACE	0.8594 0.0001	0.4573 0.0440
APPSEX	20.0348 0.8024	20.1364 0.5941
APTOTINC	0.0001 0.5569	0.0003 0.1421
LOANAMT	20.0007 0.5225	20.0011 0.3639
EXPDUMMY	0.4758 0.0003	0.2420 0.0052
CONSHIST	0.3750 0.0001	20.0958 0.3600
LTV	3.4325 0.0001	3.1414 0.0001
FANNIE		20.6786 0.0096
FRM		0.6311 0.0008
GUIDELIN		23.6227 0.0001
MARRIED		20.3907 0.0330
MULTIFAM		0.5447 0.0023
PUBHIST		0.5227 0.0074
SELFEMP		0.7818 0.0166
TIMESAPP		20.2937 0.0001

Table 8. **Logit Regression of APPROVE: Boston Fed "Key Variables"** *(continued)*

Variable	Model A: Seven Boston Fed "Key Variables"	Model B: Seven Boston Fed "Key Variables" plus Stepwise
UNVERIFY		3.1158 0.0001
Concord*	77.9%	89.8%
Discord	21.7%	9.8%
Tied	0.5%	0.4%
Observations	2,736	2,734

*Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

requirements for high loan-to-value loans or ARMs. In any case, lenders should impose identical credit history requirements on minorities and whites.

Model A in table 9 reports the logit regression of GUIDELIN on the three credit history variables and RACE. The results of this estimation are noteworthy. Overall, the model accurately predicts almost 90 percent of GUIDELIN assessments. Mortgage payment history, consumer payment history, and public record history all strongly determine whether an applicant meets the lender's credit history guidelines, but even after correcting for objective measures of credit history, the race or ethnicity of the applicant determines creditworthiness. This result probably provides stronger evidence of discrimination in the mortgage market than anything presented in the Boston Fed study. The GUIDELIN question asks lenders for a subjective interpretation of the values of three objective variables, but even this simple exercise is tainted by discrimination. A given set of values for these three variables meets loan policy guidelines if the applicant is white but not if the applicant is African American. It is difficult to propose any legitimate explanation for this phenomenon.

To check the robustness of our finding, we disaggregate the three objective credit history variables into series of dummy variables as did the Boston Fed study (Munnell et al. 1992, appendix table B2). For example, the consumer payment variable and mortgage payment variable can assume six and four values, respectively. Model B in table 9 presents the results from logit regression of GUIDELIN on the dummy variables and RACE (the comparison values are "no credit history" and

Figure 1. **Boston Fed Credit Guideline Operation**

B. Data Relating to Credit History

Column 39: List the number of commercial credit reports in the file
40: Did the applicants' credit history meet your loan policy guidelines for approval? (Y or N)
41: List the number of separate consumer credit lines on the credit report
42: Credit history – Mortgage payments (see instructions below)
43: Credit history – Consumer payments (see instructions below)
44: Credit history – Public records (see instructions below)

INSTRUCTIONS FOR COMPLETING COLUMNS #42–44

Enter the number that best describes the credit history (from the commercial credit report) of the applicant(s). Note that these columns should be completed *regardless* of the loan disposition or your answer to #40.

CREDIT HISTORY CODES—Mortgage Payments (Column 42):

0 – no mortgage payment history
1 – no late mortgage payments
2 – one or two late mortgage payments
3 – more than two late mortgage payments

CREDIT HISTORY CODES—Consumer Payments (Column 43):
Note: Consider consumer payment history for previous two years only.

0 – insufficient credit history or references for determination
1 – no "slow pay" or delinquent accounts, but sufficient references for determination
2 – one or two "slow pay" account(s) (each with one or two payments 30 days past due)
3 – more than two "slow pay" accounts (each with one or two payments 30 days past due); or one or two chronic "slow pay" account(s) (with three or more payments 30 days past due in any 12-month period)
4 – delinquent credit history (containing account(s) with a history of payments 60 days past due)
5 – serious delinquencies (containing account(s) with a history of payments 90 days past due)

CREDIT HISTORY CODES—Public Records (Column 44):

0 – no public record defaults
1 – bankruptcy
2 – bankruptcy *and* charge-offs
3 – one or two charge-off(s), public record(s), or collection action(s), totaling less than $300
4 – charge-off(s), public record(s), or collection action(s) totaling more than $300
5 – information not considered

Source: Munnell et al. 1992.

Table 9. **Logit Regression of GUIDELIN**

Variable	Model A: Continuous Objective Credit Variables	Model B: Dummy Objective Credit Variables	Model C: Stepwise Variables
Intercept	26.3061 0.0001	22.5281 0.0001	27.0472 0.0001
MORTHIST	0.7186 0.0001		0.6388 0.0003
CONSHIST	0.6481 0.0001		0.6910 0.0001
PUBHIST	2.0054 0.0001	1.9858 0.0001	1.9689 0.0001
GOODMORT		0.8219 0.0004	
OKMORT		1.4302 0.0016	
BADMORT		1.8720 0.0007	
GREATCON		23.3017 0.0001	
GOODCON		21.5506 0.0001	
OKCON		20.3108 0.3401	
BADCON		0.2712 0.3441	
AWFULCON		0.4779 0.0866	
FANNIE			20.7343 0.0276
GOTGIFT			20.4960 0.0320
GOTPMI			2.4133 0.0001
LTV			2.1204 0.0012
PRUNEMPL			0.0840 0.0465

Table 9. **Logit Regression of GUIDELIN** *(continued)*

Variable	Model A: Continuous Objective Credit Variables	Model B: Dummy Objective Credit Variables	Model C: Stepwise Variables
TERM			20.00403 0.0045
UNVERIFY			2.5066 0.0001
RACE	1.0329 0.0001	0.9438 0.0001	0.7745 0.0001
Concord*	89.4%	90.5%	93.8%
Discord	8.8%	7.2%	5.9%
Tied	1.8%	2.3%	0.3%
Observations	2,734	2,734	2,732

*Concord, Discord, and Tied are measures of association for assessing a model's predictability. The measures of association are based on the number of observations with different response values, the number of concordant pairs, and the number of discordant pairs.

"no mortgage payment history," respectively). Note that all coefficients increase with the progression from better to worse credit history. The strong positive coefficient on RACE is also noteworthy. Model C presents an additional check of the GUIDELIN-RACE relationship. The listed variables are those identified in a stepwise elimination regression. As expected, the three credit history variables enter. Loan-to-value ratio, housing expense-to-income ratio, and total expense-to-income ratio also enter, implying that a given credit history will not meet guidelines as these ratios increase. As expected, UNVERIFY enters as well. Even in this expanded model of GUIDELIN determination, 94 percent of assessments are accurately predicted, and the race of the applicant is significant.

Zandi correctly observed that the addition of GUIDELIN diminished the direct effect of RACE on approval. He failed to note, however, that the value of GUIDELIN, a subjective variable, is an insidious function of race. This data set probably contains better controls for the credit guideline decision than for the disposition decision. In particular, we have solid information on the three variables that represent credit history. Our results show that lenders collapse these three variables into one measure of credit history and use race as a filter. Yes, minorities fail to satisfy credit history requirements more frequently than whites, making the direct effect of race on disposition less relevant. Unfortunately, however, credit history guidelines are a function of race. The only conceivable explanation of this result, other than discrimination, is that minorities systematically apply to more stringent lenders. Future research that includes lender dummy variables will answer that final challenge. For now, however, GUIDELIN cannot be included in any specification that examines discrimination in the lending process.

Endowments or Discrimination?

Despite the protests of some observers, three general conclusions from the Boston Fed data seem immutable. First, whites are rejected less often than minorities. Second, whites are somewhat better qualified mortgage applicants than minorities by objective measures of credit risk. Third, whites are considered somewhat more creditworthy than minorities on the basis of race alone. In this section, we quantify these notions by using established econometric tools. In particular, the difference in acceptance rates is decomposed into endowment and discrimination effects. Zandi (1993) raised the decomposition issue in his *American Banker* article but relied on a methodology that prevented direct computation.

The logic behind the difference decomposition is that minorities have higher rejection rates because of different inherent characteristics and different treatment by lenders. The first aspect—inherent characteristics—is reflected in the values of such control variables as income, net worth, and credit history. As a group, minorities exhibit lower values than whites for these variables. The second reason for the higher rejection rates is disparate lender treatment as reflected in the estimated coefficients of the disposition model.

The estimated coefficients and sample means for the variables in the loan disposition model suggested by stepwise elimination are listed in table 10. White and minority subsample coefficients are estimated by fitting only the appropriate subsample of observations. Evaluating the white subsample coefficients at the white variable means yields the expected rejection rate for whites. Similarly, the expected rejection rate The total difference in expected rejection rates is further decomposed into endowment and discrimination components by determining the minority rejection rate if minorities were not the object of discrimination. The rejection rate is found by evaluating the *white* coefficients at the *minority* means, to predict the prospects of the average minority applicant if treated as white. With lender treatment held constant, the difference between this quantity and the predicted white rejection rate is attributable to different endowments. The difference between the

Table 10. **Decomposition of Differences in Expected Rejection Rates**

Variable	(1) White Coefficient	(2) Minority Coefficient	(3) White Mean	(4) Minority Mean
Intercept	29.3682	28.9888	1.0000	1.0000
AGE	0.4656	0.1136	0.4344	0.5152
CONSHIST	0.2804	0.3164	2.0000	2.7729
FRM	0.1819	0.7178	0.6851	0.6204
LTV	3.2870	1.0304	0.7365	0.8256
MARRIED	20.4692	0.0592	0.6116	0.5335
MORTHIST	0.2357	0.5688	1.0712	1.8917
MULTIFAM	0.6047	0.4830	0.0792	0.2744
PRUNEMPL	0.0843	0.0222	3.8305	3.6119
PUBHIST	1.5645	1.2001	0.0576	0.1463
SELFEMP	0.5103	0.3929	0.1171	0.0671
TOTTOINC	0.0710	0.1044	32.80003	4.8339
UNVERIFY	3.1290	3.4060	0.0379	0.1052

(5) p(reject): white means, white coefficients columns (1) * (3)	4.86%
(6) p(reject): minority means, minority coefficients columns (2) * (4)	22.45%
(7) p(reject): minority means, white coefficients columns (1) * (4)	14.27%
(8) p(reject): white means, minority coefficients columns (2) * (3)	9.50%
Total difference, expected minority reject rate less expected white rejection rate [(6)–(5)]	17.59%
Minorities treated as white, endowment effect [(7)–(5)]	9.42%
Minorities treated as white, discrimination effect [(6)–(7)]	8.18%
Whites treated as minority, endowment effect [(6)–(8)]	12.95%
Whites treated as minority, discrimination effect [(8)–(5)]	4.64%
Expected minority rejection rate (6)	22.45%
less rejection rate if treated as white (7)	14.27%
=	8.18%
divided by rejection rate if treated as white (7).	57.27%
Minorities are rejected 57% more often than expected.	

Table 10. **Decomposition of Differences in Expected Rejection Rates** *(continued)*

White rejection rate if treated as minority (8)	9.50%
less expected white rejection rate (5)	4.86%
=	4.64%
divided by rejection rate if treated as minority (8).	48.88%
Whites are rejected 49% less often than expected.	

fairly treated minority rejection rate and the predicted minority rejection rate is entirely attributable to differences in estimated coefficients for minorities is calculated by evaluating minority coefficients at minority means. The difference—22.45 percent less 4.86 percent, or 17.59 percent—is the total estimated difference between minority and white rejection rates.

with sample means held constant. As shown in table 10, the 17.59 percentage point difference in predicted rejection rates is about equally attributable to endowments and discrimination. Rephrased, the predicted rejection rate for minorities is 22.45 percent. If, however, minorities had received fair treatment, they would have suffered a rejection rate of only 14.27 percent. Thus, minorities were rejected 57 percent more often than expected, a figure comparable to the Boston Fed's estimate of 56 percent.

Just as the difference in predicted rejection rates was decomposed by evaluating minority means at white coefficients, parallel analysis examines the predicted rate of rejection for white applicants treated as minorities.[5] Table 10 contains the decomposition from this viewpoint and attributes a greater portion of the disparity to endowment differences. Still, whites are rejected 49 percent less often than expected, again because of favorable treatment in the lending process.

Discrimination and Mortgage Performance

Finally, several critics have questioned the contextual framework of the Boston Fed study. For example, Nobel laureate Gary Becker (1993) asserted that the study provides scant evidence to support the claim of racial discrimination. By analyzing average default rates for minorities and whites in the Boston area, Becker concluded that race is used for a legitimate, nondiscriminatory business purpose.

[5] Neumark (1988), however, argued that the white subsample coefficients are more appropriate for evaluating discrimination.

The logic behind the average default technique is simple. If minorities are the object of discrimination, a white applicant of given characteristics will be accepted while an equally creditworthy minority applicant will be denied. Since only the best minority applicants are accepted, the worst white applicant must be of lower quality than the worst minority applicant. Since Boston-area default rates are equal among whites and minorities, lenders must be properly evaluating the true default risk of whites and minorities. Thus, the reasoning follows, a positive coefficient on race in the rejection probability equation is permissible because it serves a rational business purpose.

The intuition behind Becker's arguments regarding the default rates of whites and minorities is analogous to arguments made about discrimination in baseball (e.g., do minority batters have higher batting averages than white batters?) (Van Order, Westin, and Zorn 1993). Although the intuition is simple, several problems plague the default or mortgage performance approach to analyzing racial discrimination in mortgage lending. First, discrimination at the accept/reject decision is still illegal regardless of whether applicants subject to discrimination ultimately receive loans, even if Becker-type arguments are valid. In addition, until the rational business purpose for using race in mortgage lending is empirically established, the discriminatory treatment of borrowers by racial or ethnic status will remain illegal.

Second, the Becker theory either is operationalized—often in terms of average default rates rather than marginal default rates—as required by the arguments of the theory or assumes implicitly that the distribution of loan profits provides the same mean profit for minorities and whites. In addition, the theory seems to imply that discrimination in mortgage lending occurs only at the margins. Discrimination implies that the marginal minority default rate will be lower than the average default rate. Unfortunately, marginal default rates are unobservable, and the average default rates often subjected to examination are inappropriate proxies. The equality of average default rates for minorities and whites, therefore, is irrelevant to the discussion of disparate treatment in the application process. Galster (1993) argued that minorities should be expected to exhibit a greater magnitude of default because of their weaker economic and financial characteristics compared with whites. Stated another way, a larger percentage of minority loans will typically be rejected for legitimate reasons, so the average expected profit should be lower for minorities. Since defaults are negatively correlated with profitability, minorities should experience higher default rates than whites—discrimination or no discrimination. In addition, there is no a priori reason to expect that discrimination in mortgage lending must be limited to the margins. It is conceivable for relatively good loans to be rejected because of discrimination. Hence, on average, default rates for minorities should be higher than those for whites in a world of racial discrimination.

Third, Becker's arguments do not allow for the likely costs associated with reapplication following the initial denial of loan requests. For example, suppose it is true that discrimination primarily affects marginally qualified applicants. Suppose also that applicants near the cusp of the accept/reject decision reapply several times to different lenders until they ultimately secure loans. Under these conditions, marginal minority borrowers might be forced to visit more lenders than comparable white borrowers. Additional visits to lenders, however, increase the cost of obtaining credit. Under this extreme scenario, even though default rates for minority and white borrowers would be similar—since all marginal borrowers obtain loans—the cost of securing credit would be greater for minority borrowers.

Finally, how reliable are the default data cited by Becker and others? The recently released default studies are not particularly convincing. Most of the studies are based on aggregate data. If poor quality mars the data or methods used to evaluate the data cited by Becker and others, the statements that attempt to infer the incidence of racial discrimination from default rate data would have to be viewed with caution.

Summary and Conclusions

Since its release in 1992, the Boston Fed report *Mortgage Lending in Boston: Interpreting HMDA Data* has been a source of controversy in the mortgage lending industry. Confusion over the study's scope and methods has contributed to the debate. For example, discrimination can enter the lending process at several identifiable stages. The Boston Fed study limited its focus to the application processing stage. Further, among the three distinct forms of discrimination—blatant discrimination, disparate treatment, and adverse impact—the Boston Fed investigated only disparate treatment. Proponents and critics of the study should clearly understand the limited research niche it fills. Gary Becker, Peter Brimelow, and Leslie Spencer, for example, noted that the Boston Fed study provided questionable evidence of adverse impact discrimination, but this type of discrimination was beyond the scope of the report. Consequently, these criticisms say nothing about the report's merit or findings. Even as it provides evidence for adverse impact discrimination, the average default rate approach that supports Becker-type arguments is suspect.

More pertinent are the criticisms of Stan Liebowitz and Mark Zandi. Liebowitz attributed the Boston Fed result to data errors. He claimed to find several obviously miscoded applications in the source data (e.g., loan-to-value ratios exceeding 5). Our analysis shows that the Boston Fed data do contain many miscoded or atypical observations. Using a systematic data-cleaning procedure, however, we reestimated the Boston Fed study with clean data only and found that the race effect on application disposition persisted.

Zandi reestimated the Boston Fed study and contended that omission of a variable assessing applicant credit risk was responsible for the race effect. Our analysis confirms that this credit variable is an important determinant of the race effect. Zandi failed to note, however, that the credit variable itself is affected by discrimination. When we compare objective measures of credit risk with the Boston Fed study's subjective assessment, we find that minorities receive systematically lower credit ratings. A white applicant with "slow pay" credit accounts, for example, is considered creditworthy, while a similar minority applicant is not. This result provides further statistical evidence of discrimination in the mortgage lending process.

Through a rigorous statistical analysis of mortgage lending patterns in the Boston area in 1990, the Boston Fed study clearly demonstrated disparate treatment of applicants during the application stage of the lending process. Our study confirms these results and refutes recent reports that attempted to discredit the original Boston Fed research. In fact, a close examination of the data available to us reveals an even stronger statistical case for discrimination than was originally reported. While we do not claim to have exhausted every possible approach for investigating the robustness of the Boston study and we plan to undertake further data and analytic work on this subject, the basic result of the Boston Fed study seems immutable: Boston-area lenders appeared to have statistically discriminated against minority applicants in 1990.

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Financial Services in Distressed Communities: Issues and Answers

Financial Services in Distressed Communities:
Framing the Issue, Finding Solutions
By James H. Carr and Jenny Schuetz

and

Predatory Lending: An Overview
By James H. Carr and Lopa Kolluri

August 2001

Executive Summary *

The American financial system is arguably the most sophisticated and efficient in the world. The power of our financial services industry derives from the complexity of the nation's financial intermediaries including commercial banks, savings institutions, mortgage banks, credit unions, investment banks, securities firms, insurance companies, specialized credit intermediaries, and a variety of specialized government and government-sponsored or -regulated financial institutions.

But this sophisticated financial services infrastructure differs markedly from the world of finance in lower-income and minority communities. There, the language of finance is increasingly pawnshops, check-cashing outlets, payday lenders, and rent-to-own stores. Largely unregulated in many states, the fees charged by these alternative financial services outlets are frequently excessive and their business practices often differ greatly from the asset-building and wealth-creation services provided by mainstream financial institutions.

In addition, excessive subprime, as well as predatory, lending tend to flourish in communities saturated with check cashers, pawnshops, and related financial services outlets. The heavy concentration of these practices in lower-income and minority communities further erodes the asset-building potential of financially vulnerable households. This concentrated negative impact on households translates into increased financial distress at a community level as households already living on the margin are forced to navigate a minefield of high-cost, unscrupulous, and often fraudulent financial services providers.

The following two articles focus on the financial services infrastructure that typically serves lower-income, minority, and distressed communities. They document how the failure to ensure efficient financial services markets in those areas exposes residents to wealth-stripping financial services activities and greatly contributes to their financial marginalization. The articles offer several policy recommendations to improve the delivery of lower-cost, asset-building financial services to the nation's most financially vulnerable consumers.

The first article, titled "Financial Services in Distressed Communities: Framing the Issue, Finding Solutions," by James H. Carr and Jenny Schuetz, examines the recent explosive growth of alternative financial services outlets in distressed communities and the corresponding growth of subprime and predatory lending in those same markets. Carr and Schuetz document the high costs for households relying primarily or exclusively on those lenders. Recognizing that fringe lenders have filled an important credit gap by developing products and services to meet the unique needs of lower-income consumers, the article cautions that those services, nevertheless, often come at staggering costs. Further, the article explains that because alternative financial services providers do not offer savings products, households that rely exclusively on them to meet their financial services needs have neither the incentive nor opportunity to save.

Carr and Schuetz also highlight the substantial costs to households exploited by excessive subprime and predatory lending. The article notes that while subprime lending is a critical source

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of credit for millions of families, minority households are disproportionately steered to higher-cost subprime lending. The extreme reliance on subprime lending by minority households raises the question of whether they are steered on the basis of their race or ethnicity rather than due to legitimate creditworthiness issues. The article documents that as much as 35 to 50 percent of the borrowers in the subprime market could have qualified for lower-cost prime market loans and provides examples of the extraordinary costs to households of being unfairly steered to subprime credit. The article notes that steering of borrowers to the subprime market contributes to confusion in the policy-making community in distinguishing between legitimate subprime and predatory lending.

Carr and Schuetz conclude with three policy recommendations to improve the financial services environments of distressed communities. They are: (1) Enhance data collection on finance services transactions and increase enforcement of fair lending, equal credit opportunity, and consumer protection laws and regulations; (2) Create greater competition for financial services in distressed communities by improving the range of available financial products and services and enhancing government's role as a facilitator and supporter of financial services innovation; and (3) Enhance and expand consumer outreach and financial education and awareness.

In the area of enhancing financial innovation, the recommendations include creation of partnerships between mainstream financial services providers and alternative financial services outlets that would leverage the strengths of both sets of institutions. Such partnerships would leverage the economies of scale that could be provided by mainstream firms while leveraging the customized products and outreach techniques perfected by fringe lenders.

The second article, "Predatory Lending: An Overview," by James H. Carr and Lopa Kolluri, examines more closely the issue of predatory lending. It notes that predatory lending represents some of the most abusive lending behavior in the financial services community and highlights the fact that predatory lending is not a simple issue of high-cost lending. Rather, Carr and Kolluri note that predatory lenders structure loans to force borrowers to default for the express purpose of extracting the equity homeowners have accumulated in their properties. But the article also notes that steering households to high-cost subprime loans on the basis of race/ethnicity or other personal characteristics is also a predatory practice that should be considered in the context of debates on predatory lending. A three-part definition for predatory lending is offered to explain how lenders utilize a variety of otherwise legitimate marketing techniques and loan terms to create fraudulent and financially destructive loans. The article concludes with a series of recommendations to directly address predatory lending.

Carr and Kolluri note that because predatory lending thrives in an environment where competition for financial services is limited or lacking, effectively eliminating predatory lending requires the same three-pronged approach recommended by Carr and Schuetz to enhance the efficiency of financial services generally in distressed communities. Carr and Kolluri further point out that as few as five to seven practices constitute the bulk of the most egregious predatory lending behavior and meaningfully addressing those practices would greatly reduce the most blatant forms of predatory lending.

Financial Services in Distressed Communities: Framing the Issue, Finding Solutions*

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Introduction

The American financial system is arguably the most sophisticated and efficient in the world. The power of the U.S. financial system comes from the complexity of financial intermediaries that include commercial banks, savings institutions, mortgage banks, investment banks, securities firms, insurance companies, specialized credit intermediaries, and a variety of specialized government and government-sponsored financial institutions.

But this sophisticated financial services infrastructure differs markedly from the world of finance in lower-income and minority communities (see figure 1, Bifurcated U.S. Financial System). There, the language of finance is increasingly pawnshops, check-cashing outlets, payday lenders, and rent-to-own stores. Largely unregulated in many states, the business practices of these financial services outlets differ greatly from the asset-building and wealth-creation services accessed by the majority of Americans.

Further, excessive subprime, as well as predatory, lending tend to flourish in communities saturated with check cashers, pawnshops, and related financial services outlets. Creating greater efficiency in, and competition for, financial services in distressed communities is the key to enabling lower-income and minority residents to maximize their asset-building capabilities and limit the negative influence of excessive high-cost and predatory financial services providers.

This article discusses the recent rapid growth of the alternative or fringe financial sector and highlights how its high-cost fee structure greatly undermines the ability of individual households to accumulate assets and build wealth. The article further notes that, to the extent that fringe financial services providers concentrate in, and are the primary financial services providers for, distressed lower-income and particularly minority communities, the neighborhoods in which they locate are also seriously disadvantaged. The article concludes with a series of recommendations to promote efficient financial markets in lower-income and minority communities. A companion article focuses explicitly on predatory lending (see "Predatory Lending: An Overview").

Figure 1. **Bifurcated U.S. Financial System**

Financial Services in Distressed Communities

As many as 12 million households in the United States either have no relationship with traditional financial institutions or depend on fringe lenders for financial services. These households are disproportionately poor and minority. Among lower-income families surveyed in a 1995 Federal Reserve Survey of Consumer Finances, 25 percent were unbanked, as well as one-third of African-American households and 29 percent of Hispanic households. Without banks, these households operate largely in a cash economy or resort to fringe banking services that routinely charge significantly higher fees for services than those assessed by mainstream financial institutions. The situation is particularly daunting for African-American households, 60 percent of which have zero or negative net financial assets, according to a report by the Corporation for Enterprise Development.

Lack of physical proximity to mainstream financial institutions is perhaps the most frequently cited reason for the disparity in financial services utilization by low-income and minority populations compared with wealthier households. A 1999 *Harvard Business Review* article, for example, cites extreme disparity in financial services options available to residents of two neighborhoods in Los Angeles—one in South Central and the other in Pacific Palisades. South Central has one depository institution for every 36,000 people, while Pacific Palisades has one for every 1,250 people.

Yet while physical proximity is important, it is not the only—and often not the most significant—barrier to the use of mainstream financial services among lower-income and minority households. There are a variety of complex reasons why many lower-income and minority households do not use traditional financial services even when they have access. Those reasons include unfamiliarity with banking and savings services, a belief by consumers that they do not write enough checks to justify an account, and lack of trust of the mainstream financial services providers. In addition, mainstream financial services can also be very expensive for households that do not have a relationship with those institutions, when customers cannot fulfill minimum balance requirements, or when poor management of an account results in bounced-check or related fees.

In fact, fringe lenders attribute their rapid growth to large, unmet consumer financial services needs among many lower-income households. According to the Financial Service Centers of America (FiSCA) (formerly the National Check Cashers Association) alternative sources of credit are filling an important credit gap for "individuals with limited financial means or who may lack the tangible assets to pledge in connection with traditional types of collateralized transactions..." FiSCA further asserts that alternative financial services providers are in higher demand than banks or credit unions in many markets because they provide a wider range of services and more flexible hours of operation tailored to meet the unique needs of their clients.

There is little debate that fringe lenders provide critical services to customers whose extremely low or unreliable incomes, limited tangible assets, or inability to manage credit make them unlikely candidates for mainstream financial services. But the explosive growth of these financial services storefronts over the past decade raises many critical policy issues. First, because fringe lenders do not provide savings accounts, households that rely exclusively on them lack both the incentive and option to save. Second, the heavy concentration of fringe lenders in minority communities means that those areas are disproportionately burdened with second-class financial services options. Finally, reliance on fringe lenders, even to the extent they provide needed financial services, routinely comes at a very high cost.

Consider these examples for check cashers, payday lenders, pawnshops, auto title lenders, and various other fringe financial activity:

- Check cashers—Although the average fee at a check cashing outlet for a government or payroll check ranges from 1.5 to 3 percent of its face value, fees can run as high as 20 percent for personal checks. At least 19 states regulate some aspects of check cashing services.

- Payday lenders—institutions that offer small consumer loans of $100 to $300—routinely charge 15 percent per two-week period. In addition to annualized interest rates of more than 400 percent, such loans encourage households to spend the next paycheck before it arrives, thus encouraging a dangerous cycle that can trap a household in permanent debt.

- Pawnshops offer small, short-term loans using personal items as collateral. State-imposed interest rates are capped as high as 25 percent monthly, which, annualized, can exceed 300 percent. Loopholes in some states allow "lease back" or "roll over" agreements that add fees, sometimes doubling the already high interest rate.

- The rent-to-own industry offers purchasing credit to consumers for a variety of merchandise, such as furniture and home electronics, for weekly or monthly payments that can be applied toward ownership. Leased items are typically priced at two to three times the standard retail amount. No equity builds up in the leased items until the final payment. According to a Federal Trade Commission survey, 60 to 70 percent of customers who initiate leases eventually purchase the items. The Association of Progressive Rental Organizations estimates that the percentage of customers who complete a purchase is less than 25 percent.

- Auto title lending is a variation on traditional pawnbroking. A person with clear title to a vehicle can borrow money from a lender by giving him or her power of attorney to transfer the title should the borrower default. Title loans are typically made for about 25 percent of the car's value. Interest rates and other service charges vary between 2.5 and 25 percent per month, depending on a state's pawnshop laws. Title loans are particularly dangerous for working families because defaults can result in the loss of the car and, consequently, the job, if there is no other way to get to work.

- Robert Manning in his book, *Credit Card Nation*, also describes direct marketing campaigns for high-interest "secured" credit cards that are marketed to customers who likely would not qualify for a standard-rate bank-issued credit card. In one example, he cites an offer for a $400 line of credit for which, in return for applying for the credit card, an unsuspecting consumer agrees to pay a variety of fees totaling $369. Such "offers" may be widely distributed, but the people most likely to accept the offer are the most financially vulnerable populations with the least financial sophistication and the fewest credit options.

Compensating for Risk

While the fees charged by fringe lenders are justified on the basis of the perceived high risk of their borrowers, most of these financial services providers have devised creative ways to reduce or protect themselves against borrower default on top of the high fees they charge. Payday lenders, for example, not only require proof of employment, income, and a personal checking account, but the borrower also must provide a postdated personal check. The rent-to-own industry allows no equity to be built up until the final payment, so a customer may meet all weekly payments and default near or at the end of the loan term, losing the item plus all previous cash payments. The retailer can then re-lease the item at the same weekly or monthly rate. Pawnshops provide cash loans in return for collateral left in the possession of the pawnbroker. And "cash leasing," a cross between payday loans and pawn loans, involves small, short-term cash advances that carry monthly interest charges of up to 30 percent, backed by an active checking account and "pledged" household items, such as a stereo, computer, or television. Some states are better than others in affording consumer protections in these types of transactions.

In fact, Progressive Policy Institute analyst Anne Kim notes that the two largest check-cashing companies in the United States cashed roughly $6.5 billion in checks last year. According to Kim, the majority of those checks were payroll or government benefit payments. The value of bad checks—that is, the checks for which the check cashers could not collect—totaled less than one-fourth of one percent of the total amount of checks cashed. The nation's two largest check cashers thus realized healthy profits charging on average 2.2 and 3.5 percent, respectively, of the face amount of the checks they cleared.

The Problem Is Growing

As table 1 illustrates, alternative financial services activity is big business. Fringe services engage in at least 280 million transactions each year for gross revenues of more than $168 billion that extract fees of at least $5.5 billion. According to Norman D'Amours, former chairman of the National Credit Union Administration, the number of unregulated and unlicensed financial services providers is growing nationwide, but the increase is exponential in low- and moderate-income and minority communities.

He notes that while the number of credit unions, banks, and thrifts has been steadily decreasing over the past five years in the United States, the number of check-cashing outlets has doubled. An April 2000 report by Dove Consulting for the U.S. Department of the Treasury reveals that about 11,000 check-cashing outlets in the United States cash more than 180 million checks annually, worth roughly $60 billion. D'Amours also estimates that there are between 12,000 and 14,000 pawnshops across the country, outnumbering credit unions and banks. Further, in 1996 there were 8,000 rent-to-own stores that served 3 million customers, according to a recent Federal Trade Commission survey. And in *Savings for the Poor*, Dr. Michael Stegman of the University of North Carolina, Chapel Hill, reported that payday lending grew nationally from 300 stores seven years ago to more than 8,000 in 1999.

Table 1. **Fringe Lending Is Real Money: Estimated Annual Transactions**

Service	Fee/Rate per Transaction	Volume of Transactions	Gross Revenues	Fee Total
Check Cashing	2–3 % payroll and government checks (can exceed 15% for personal)	180 million	$60 billion	$1.5 billion
Payday Loans	15–17% per 2 weeks 400% APR	55–69 million	$10–13.8 billion	$1.6–2.2 billion
Pawnshops	1.5–25% monthly 30-300% APR	42 million	$3.3 billion	N/A
Rent-to-Own	2–3 times retail	3 million	$4.7 billion	$2.35 billion
Auto Title Lenders	1.5–25% monthly 30–300% APR	N/A	N/A	N/A
Total	**N/A**	**280 million**	**$78 billion**	**$5.45 billion**

It Undermines Households and Communities

Even at the most modest levels, alternative financial services fees can greatly undermine the asset-building capacity of lower-income households. According to research cited by the Federal Reserve, fringe services for cash conversion and bill paying would cost an average $20,000-income household between $86 and $500 per year, while the same services at a bank would cost only $30 to $60 (assuming that low-cost banking services are available and the prospective customer is not disqualified for an account by lack of credit). Yet, $500 per year saved for a period of 10 years at a modest interest rate of only 4 percent would grow to more than $6,000. That amount would be sufficient for a down payment on a modestly priced home.

Moreover, the actual costs to many households using fringe banking would be even higher if those same households also resort to payday loans, pawnshops, rent-to-own retail, or auto title pawn loans. An example Manning offers in *Credit Card Nation* is of a $196 Magnavox TV that costs $9.99 a week for 78 weeks from a rent-to-own shop, for a total of $779. Compare it to buying the same television with a credit card at 22.8 percent interest from a national discount electronics store over the same time period for a total of $231. The difference in finance charge would be $548. Assuming a household relied on fringe lenders for only an additional $300 worth of services per year, the new total of $800 of potential savings would grow to nearly $10,000 over a 10-year period, again assuming a modest 4 percent rate of return.

Even if these households actually were able to save some of their earnings, their failure to access mainstream financial services institutions undermines their long-term asset accumulation. To illustrate, table 2 calculates the different investment vehicles. If, in 1989, a family had $3,000 in savings, but saved the money in a shoebox, 10 years later that $3,000 would be still be worth $3,000 in nominal dollars but only $2,233 when adjusted for inflation. However, the same sum invested in a 10-year Treasury note would have grown to more than $5,000 by 1999. Investment in an S&P index fund would have yielded $9,180 over that 10-year period. And if the family had, by prophetic insight, invested their savings in Microsoft Corporation in 1990, their wealth could have grown to a staggering $211,360 by 1999.

Table 2. **The Value of Saving $3,000***

Year	Shoebox	Treasury Note	S&P 500 Index Fund	Microsoft Stock
1989	$3,000	$3,000	$3,000	$3,000
1999	$3,000	$5,072	$9,180	$211,360

* In nominal dollars.

Excessive Subprime Home Mortgage Lending

As with fringe lending, subprime mortgage lending has also experienced tremendous growth in recent years. A recent U.S. Department of Housing and Urban Development (HUD) study indicates that between 1993 and 1998, the dollar volume of subprime loans grew sevenfold, from $20 billion to $150 billion, and the number of subprime refinance loans grew tenfold, from 80,000 loans to 790,000 loans. This growth in subprime lending compares to less than a 40 percent increase in prime lending for home purchases and a 2.5 percent increase in prime refinance loans.

HUD reports that subprime loans are heavily concentrated in lower-income and minority communities—the same communities that are the target for fringe financial outlets. HUD's analysis indicates that subprime loans are three times more prevalent in lower-income neighborhoods than in high-income areas, and five times more likely in black communities than in white neighborhoods. In fact, in black neighborhoods, high-cost subprime loans accounted for 51 percent of home loans in 1998, compared with 9 percent in white areas. Moreover, homeowners in high-income black communities are six times as likely to have a subprime loan as homeowners in high-income white neighborhoods. Estimates by Fannie Mae, Freddie Mac, and others conclude that many households in the subprime market could reasonably qualify for a prime market loan (see article on Predatory Lending in this report).

The Financial Impact of Excessive Subprime Lending

Subprime loans do not have to be predatory to seriously undermine the financial viability of households. Targeting or referring households to the subprime market in instances in which those loan applicants could reasonably have qualified for prime market loans greatly undermines the long-term asset-building potential of those households. Each additional interest point on a home mortgage totals tens of thousands of dollars on the total cost of a mortgage over the life of the loan. Subprime mortgages are routinely 3 to 4 percentage points or more higher than a comparable prime market loan. Yet, a mere 1 percentage point of additional interest can make a substantial financial impact over the life of a loan (see table 3).

Table 3. **Comparing Mortgage Payments for Different Interest Rates**

30-Year Fixed-Rate Loan

House Value	**$85,000**
Down Payment	**$4,250 (5%)**
Loan Amount	**$80,750**

Annual Interest Rate	Monthly Payment	Annual Payment	Annual Difference from 8%	Lifetime Difference from 8%
8%	592.51	7,110.18	N/A	N/A
9%	649.73	7,796.79	686.61	20,598.43
10%	708.64	8,503.67	1,393.49	41,804.69
11%	769.00	9,228.01	2,117.83	63,535.05
12%	830.60	9,967.26	2,857.08	85,712.32

Take the example of a home modestly priced at $85,000. Assuming a 5 percent down payment, the mortgage is slightly under $81,000. With a base interest rate of 8 percent on a 30-year loan, a loan 1 percentage point higher results in $687 more annually. Over the lifetime of this 9 percent loan, it would be a $21,000 difference. At 2 percentage points—a 10 percent interest rate—the difference from a prime loan of 8 percent would be $42,000, half the original loan amount. Now, take that same $687 a household could save each year by shaving off a percentage point on their mortgage and invest it at 6 percent. At the end of 30 years, that household would have $57,572 instead of having to pay $21,000 in additional interest. The 2-percentage-points savings of $1,393 per year, invested at 6 percent, would total $116,736 at the end of 30 years for the household. And if the subprime loan carried a 12 percent interest rate, the extra interest payment over the base 8 percent loan would be $85,712 over the life of the loan. Invested at 6 percent for 30 years, that $85,712 of additional payments would grow to $239,421 in savings over a 30-year period.

Reasons for Rapid Growth

Three trends in recent years appear to have strengthened the alternative financial services sector: 1) increasing consolidation into large, publicly held firms with standardized business outlets across the nation, 2) increasing involvement by mainstream financial institutions in fringe lending outlets, and 3) enhanced products and services and effective marketing schemes to capitalize on rising consumer debt and the disconnect between low-income households and the mainstream financial system.

Industry Restructuring

Restructuring within both the mainstream and fringe financial services industries are contributing to the growing significance of fringe financial storefronts in disenfranchised communities. Michael Stegman cites consolidation in the banking industry as one reason for the decline in the presence of traditional banks in neighborhoods of all income levels. In *Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor,* John Caskey suggests that banking deregulation and pressure for increased profits have led banks to charge for previously free services and close unprofitable branches (often in low-income and minority areas) as well as eliminate money-losing services, such as small-balance deposit accounts.

Over the same period, several fringe financial outlets, such as pawnshops, check cashers, and payday lenders, have engaged in major consolidations. In the check-cashing industry, for example, six firms owned at least 50 outlets each in 1991. By 1999, one of the largest of these establishments had grown to more than 1,000 company-owned stores with franchises in 30 states. Further, this company has expanded its traditional in-store check-cashing business to include bill payment services as well as automated check cashing using advanced function ATMs with user-friendly touch screen menus.

Pawnshops, too, have grown into national chains. Data from *Fringe Banking* report the existence of at least five large, publicly traded nationwide pawnbroking firms. The largest of these chains went public in 1987, and by 1999 had acquired 414 stores in the United States. The rent-to-own industry has shown similar trends of consolidation. The largest firm was founded in 1986, and by 1999 owned 2,300 stores across the nation, or roughly one-fourth of all rent-to-own stores.

Convergence of Fringe and Mainstream Lenders

Wall Street has also fueled the growth in fringe and subprime activity. A recent *Business Week* article notes, for example, that through securitization—that is, the practice of issuing securities based on a pool of mortgages that can be sold to investors—leading Wall Street firms resold $60 billion of subprime mortgage loans in 1999, up from $3 billion in 1995. Between 1995 and 1998, subprime loan note sales rose from $10 billion to $87 billion. Banks now control 5 of the nation's top 10 subprime lenders and 10 of the top 25 subprime lenders.

Effective Marketing and Customized Services

While many low-income households exhibit reluctance to use traditional banks, fringe financial services providers have well-developed marketing strategies to draw in and retain customers by focusing on the relationship between customers and staff. Pawnshops and rent-to-own stores emphasize treating customers with personal attention and encourage small weekly payments made in person, allowing the retailer to market additional products to existing customers. These types of businesses rely heavily on repeat customers, which they cite as a means of increasing transactions while reducing risk, as Caskey reports in *Lower Income Americans, Higher Cost Financial Services.*

Role of Financial Markets in Community Reinvestment

Creating efficient markets in distressed communities is essential to successful revitalization of those areas. Stated otherwise, building community wealth requires the building of individual wealth. Mainstream financial institutions are the engines of wealth creation and upward financial mobility in America. Improving access to, and utilization of, the mainstream engines of wealth creation would by itself promote significant community investment.

Each dollar that is spent on overpriced financial services by a lower-income household represents potentially important savings that could lead to wealth building. For example, the more than $5.45 billion in fringe financial services fees that are collected from financially vulnerable consumers each year is slightly less than the entire asset base of the more than 460 community development financial institutions (CDFIs) operating in the United States. It is also moderately less than the fiscal year 2000 HUD budget for Community Development Block Grants plus all HOPE VI and Empowerment Zone/Enterprise Community funding.

Moreover, the fees represent an annual funding stream. If only a portion, perhaps 20 percent, of those dollars lost each year to fringe financial services could be captured and redirected to housing, that would represent more than $1 billion for home-buyer assistance or housing rehabilitation in many of the most distressed communities in the nation. And, that funding stream would not require any additional taxpayer contributions. Add to that sum the hundreds of millions of dollars unnecessarily paid each year, by households unfairly and unnecessarily steered into high-cost subprime loans, and it is immediately clear how better organizing the financial markets in distressed communities and connecting households to the engines of wealth creation can provide a major boost to the community revitalization process.

Flowing to a broader range of consumer goods and services, that money could encourage the opening of new business based on market demand for locally desired products or services. Helping to create wealth could reduce the need for complex tax-related government subsidies that encourage businesses to relocate to distressed communities that have no economic rationale for being there other than to benefit from untargeted and questionable tax subsidies. If channeled into savings, money lost to check cashers and similar high-cost services could offer financial institutions and community residents enormous wealth-generating potential.

Fixing the Problem

Enhancing financial services options for lower-income and minority households and communities will require action in three areas:

1. Improving the availability of data on financial services transactions and aggressively enforcing fair lending, equal credit opportunity, and consumer protection laws and regulations.

2. Enhancing availability of products and services designed to meet the unique needs of lower-income and lower-wealth customers.

3. Offering consumer financial education and outreach programs.

Collecting Additional Data and Enforcing Laws

An important missing tool to address the issue of market failure in distressed communities is a robust set of data that could more easily enable policy makers, regulatory agency personnel, researchers, nonprofit community activists, and other interested parties to pinpoint critical areas and issues for examination and possible action. Enhancing data collection is always controversial. But it is simply not possible to resolve a problem that cannot be identified and examined. When the federal government first sought to include borrower race/ethnicity information in the Home Mortgage Disclosure Act database, many argued that added information would be useless because it would answer only *who* was accepted or rejected for mortgage credit but not *why*. Yet that data exposed major and critical areas for concern throughout the mortgage lending industry related to lending to traditionally underserved borrower groups. The net result has been explosive growth in affordable lending to lower-income and minority households over the past decade.

Because alternative financial services providers are regulated at the state level, with widely varying regulatory oversight, a single national reporting requirement could greatly enhance the ability of regulators, community groups, and research institutions to examine the practices of these firms. Data elements might include fee schedules, collateral requirements, number of customers served, and revenue and earnings statements.

The goal of greater regulation with respect to fringe lenders should not be to eliminate those sources of credit. In moderation, they provide important access to credit for a variety of consumers. Rather, enhanced regulation should ensure that to the extent those services are provided, they are offered at costs that more reasonably reflect the real risks presented by consumers. Interest rates, for example, that when annualized can exceed 300 percent or more, are hard to justify under any circumstance. Further, the targeting of high-cost financial services on the basis of personal characteristics such as race or ethnicity, rather than on the basis of income or creditworthiness, should be closely monitored and effectively addressed.

For subprime loans, additional information might include key loan terms such as the inclusion of credit life insurance, balloon payments, prepayment penalties, and related major loan characteristics. Further, interest rates, points, processing fees, and closing costs would also be critical. This data could highlight areas for further investigation and allow for a more aggressive enforcement of fair housing, equal credit opportunity, and a variety of consumer protection laws.

To the greatest extent possible, reporting requirements for similar financial transactions should be the same for the greatest number of institutions possible. Dissimilar reporting requirements across institutions that perform similar services create opportunities for abuse by institutions that are not covered. At the same time, institutions that are covered may be discouraged from attempting to enter emerging markets with new or innovative products. Further, because data collection can be very costly, care should be taken to ensure that any new reporting requirements do not overwhelm financial institutions with requests for insignificant and extraneous information.

Further, an explicit focus on how equal credit opportunity and consumer protection laws are violated in distressed communities would provide financially vulnerable households with the kind of support offered to middle-income and wealthy households in vibrant communities. Each year, millions of dollars are spent on financial system regulation through agencies such as the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Department of the Treasury, and Federal Reserve System, to name a few. But federal institutions can do relatively little to protect the financial interests of households operating in a cash economy or relying on fringe financial services providers whose activities are not covered by those key federal financial regulators.

Enhancing Products to Serve Lower-Income Households

Efforts to promote a wider range of financial products and services for low-income and minority households can be divided into three categories: 1) efforts to connect households receiving government benefits to low-cost access to those funds through electronic transfer accounts (ETAs) and related initiatives; 2) enhanced utilization of technology, such as sophisticated ATMs and the Internet; and 3) innovative products and partnerships designed to meet the unique needs of lower-income, lower-wealth households.

Government Initiatives. The Debt Collection and Improvement Act of 1996 is one of several promising initiatives launched by the federal government to decrease processing costs, reduce fraud, and provide a lower-cost alternative for benefit recipients than sending them paper checks that must be cashed, usually for a fee. The law mandated that, by 1999, all federal benefit payments would be delivered electronically—a measure that is expected to save the federal government an estimated $100 million annually on processing and delivering payments. Since the legislation went into effect, Congress has mandated that states convert food stamp programs to electronic payment by 2002, using point-of-sale (POS) terminals at participating retailers. Additionally, more than 40 states have voluntarily decided to add their emergency cash assistance programs to the plastic food stamp cards so that welfare benefits will be accessible at ATMs and POS networks.

These laws create even more opportunities to link low-income families and people living in underserved areas to banks and other savings institutions. Michael Stegman, in his forthcoming article, "Banking the Unbanked," says the electronic delivery of government benefits "promotes financial inclusion" and recognizes that "economic opportunity cannot thrive where access is denied." In fact, an estimated 3 million of the roughly 12 million unbanked individuals in the United States receive federal government benefits—a large market that has gone largely untapped.

Expanding Use of Technology. A Ford Foundation white paper, "Financial Technology and the Lower-Income Consumer" by Steve Davidson et al., notes that new types of ATM and card-based technology have the potential for "turning the unbanked to the self-banked" while lowering costs and increasing access and convenience to financial services and products. The report provides several examples: Umbrella Bank in Illinois plans to put ATM-equipped kiosks in lower-income housing developments; FirstTel is gearing up for similar services in HUD housing in Florida; and Banco Popular offers an all-electronic account to customers without a traditional bank account.

Similar to the federal government's ETAs is a U.S. Treasury Department pilot initiative that uses ATMs to limit the reliance on fringe lenders and check cashers in traditionally underserved markets. Treasury is piloting a program to put ATMs in post offices to distribute Social Security payments, federal retirement payments, and other government benefits. Consumers use a debit card or credit card to access their benefits with no extra fees. The ATMs would provide safe and convenient access to banking services in traditionally underserved areas. The project, in partnership with the U.S. Postal Service and Key Bank of Cleveland, which owns and operates the ATMs, is testing the use of the free-of-charge ATMs at three urban locations in Baltimore and three rural locations outside Tallahassee, Florida.

Efforts to lower the cost of banking by using technologial advances should be encouraged among the private sector as well, since an estimated half of the country's private sector employees do not participate in direct deposit. Comptroller of the Currency John D. Hawke Jr. recently told the National Community Reinvestment Coalition that expanding the structure of the direct deposit account to make it more appealing to the unbanked is critical to bringing them into the mainstream banking system. Creating these connections—and adding functions such as transfer of funds to other countries at a lower cost than wire transfer fees—can create links between banks and lower-income residents.

Innovative Products and Services. Mainstream financial services providers can learn from the considerable finesse demonstrated by alternative financial services providers in marketing, packaging, and bundling services. One example is bundling services such as check cashing, money orders, money wiring, utility and cable bill payment, and related services (see the summary of John Caskey's proposed solution following this article). Mainstream financial institutions can take a lesson from and form partnerships with fringe service providers, creating efficient operating structures that lower costs and then pass along savings to clients.

Innovative programs that have recently been introduced or are being test-marketed by institutions such as community development credit unions (CDCUs) and CDFIs should be encouraged and expanded. Woodstock Institute's *Reinvestment Alert No. 16* provides two examples of CDCUs that are offering alternative payday loan products to counter the often-excessive fees charged by fringe payday lenders. The Faith Community United Credit Union in Cleveland and the Louisiana-based ASI Federal Credit Union offer affordable alternatives to their members, and their experiences can show how other mainstream credit unions and financial services providers can establish similar consumer loan products. Both offer interest rates of 17 to 18 percent, with $15 to $30 processing fees and timely repayment requirements. Credit counseling is offered with the service, and a savings plan can be integrated into the loan.

Davidson et al. also provide examples of how some mainstream financial services providers are expanding their reach to lower-income consumers by lowering the cost of those services to help "transition" these customers to mainstream markets. Union Bank of California has created a division called Cash & Save that offers check-cashing services at a lower-than-average 1.0 percent to 1.5 percent fee on payroll checks issued by area employers. Customers are permitted to open Union Bank savings accounts at Cash & Save outlets. Another company, Directo Inc., is serving lower-income customers—many of whom were denied bank accounts—with a payroll debit card, allowing employees to access their pay electronically through an ATM. Directo also has an innovative wire service/ATM feature that enables customers to wire money to foreign bank accounts that can then be accessed through an ATM. The fees are much lower than those for most wire services.

New partnerships between fringe lenders and mainstream financial services providers can also prove to be highly beneficial to residents of distressed communities and the financial institutions that serve them. By moving away from an exploitative model and toward a model that lays the foundation for a long-term, mutually beneficial relationship, mainstream financial institutions can help to build the assets of lower-income consumers that can lead to more valuable and substantial relationships over time.

In *Banking the Unbanked,* Stegman cites the Chicago Community Reinvestment Act Coalition and Bank One as an example of this type of partnership. The organizations teamed up to increase lending, service, and investments in lower-income communities in the Chicago region. They are also piloting a program to promote deposit services to unbanked customers. This pilot, the "Alternative Banking Program," offers a safe, convenient, and inexpensive alternative to check-cashing services and conducts financial literacy workshops to demonstrate the cost savings of using alternatives to check cashers.

The incentive to reform the financial services environment characterized by high-cost and inefficient financial services providers is compelling for policy experts interested in helping to promote the building of wealth among lower-income and minority households. The extraordinary sums of money involved in excessive fringe and subprime lending clearly demonstrate the fact that there is substantial potential for lower- and moderate-income households to build their financial assets. Further, recent research by Hogarth and O'Donnell in the *Journal of Consumer Policy* shows that when low- to moderate-income households are brought into institutions with a transaction account, there is a high probability of moving them "in and up" into other product lines.

Improving Financial Education and Outreach

Even if there is improved enforcement of laws, it is very important to educate consumers about the types of institutions, products, and services they should use, and ones they should avoid. Many lower-income households have limited financial savvy and do not know the most basic aspects of household budgeting. Well-conceived, -designed, and -delivered consumer education programs can be instrumental in helping households more effectively mange their finances.

In addition, consumers need to know how to identify potentially fraudulent or otherwise questionable lenders. They need to know, for example, that when they see ads that read: "No credit, no job, no problem," they should respond with "No thanks!" Financially vulnerable households need help understanding that substantial wealth can be built from relatively small amounts of money. They need support to best understand how to properly and effectively evaluate the financial services options available to them and how to select the options that best meet their needs.

Having said that, caution needs to be exercised with respect to our expectations on the ability of financial education to aid borrowers facing predatory lenders. Households with limited education are little match for sophisticated criminals intent on defrauding a household of their wealth. Loan documents are challenging and complex even for borrowers with masters degrees in business.

Mortgage loan contracts can involve 30 or more separate documents written in the legal prose and not intended to be understood by a lay person. Expecting a poorly educated borrower to defend himself or herself in this type of situation is unrealistic. For borrower education to be most effective, it will need to include education prior to selecting a lender as well as third party review at the time of closing.

Conclusion

Improving the financial services environment for lower-income and minority households is imperative to enabling them to fully benefit from the wealth-building opportunities available to most Americans. With regard specifically to minority households, it is useful to keep in mind that discrimination has played a significant role in creating many of the distressed markets heavily populated by fringe, excessive subprime, and predatory lenders—and that for many years government policies directly supported and even enforced many of the most discriminatory actions. As a result of that history, government has an important role to play in helping eliminate the legacies of those discriminatory actions. Principal among them are the inefficient markets in distressed communities. Improving the markets can be accomplished by supporting financial institutions to reposition themselves to be more effective in meeting the financial services needs of residents of underserved communities.

Rather than acting solely as a policeman—enforcing laws and penalizing institutions that fail to perform—government should work with financial institutions to provide them with the flexibility to test programs or with the funding to pilot innovative financial services approaches that are too expensive for private financial institutions to pursue on their own.

The federal government is constantly engaged in the credit markets to ensure the efficient functioning of those markets as they pertain to middle- and upper-income households. In fact, even today, most households benefit from a substantial infrastructure of government agencies that work to perfect the operation of market mechanisms to ensure the most efficient delivery of financial services possible. But because most of the financial institutions supported or regulated by this infrastructure do not directly serve unbanked households, this elaborate infrastructure does little to promote the financial well-being of the residents of distressed communities.

Greater information and enforcement of relevant laws, combined with increased financial sophistication on the part of consumers, could go a long way toward eliminating in the near term some of the most egregious and abusive financial services practices in struggling, lower-income and minority communities. By combining the private market's innovation with publicly supported initiatives to understand and address market failure, the full range of financial services that serve the majority of Americans can be made accessible in all communities.

Strengthening Financial Services

Five Key Elements in Bridging the Banking Gap[1]

In a paper recently presented at a Federal Reserve System conference on *Changing Financial Markets and Community Development*, John P. Caskey outlined a five-point strategy to bring into the financial mainstream the "unbanked" who, without any type of deposit account, are typically customers of check-cashing outlets (CCOs). He suggests that specially bundled financial programs would help this population build savings and improve credit-risk profiles, qualifying them for lower-cost services and eliminating a common source of stress.

1. Open specialized bank branch "outlets" that provide CCO services.

Banks could provide a range of financial services to unbanked communities by creating bank "outlets" for check cashing. By locating in places convenient to large numbers of low- and moderate-income households that tend to use CCOs, these outlets could initiate banking relationships and build trust among the unbanked. Additional products and services that could be offered include money orders, stamps and envelopes, international and domestic cash wire transfers, phone cards, bus tokens and transit passes, and payment of utility and phone bills. By charging lower fees for check-cashing services than CCOs and offering discounted rates for frequent customers, bank outlets could encourage repeat business, enabling many to "graduate" to banks. The outlets could also work with customers to build savings and address credit problems.

2. Offer "starter" bank accounts with low minimum-balance requirements that cannot be overdrawn, and include access to low-cost money orders for making long-distance payments.

To encourage the unbanked to become traditional bank customers, their accounts could be tailored to their unique situations. Low-cost, low–minimum balance checking and savings accounts could be offered with nontraditional features, such as discounted money orders, stamped envelopes, convenient processing of utility bills, and electronic deposit of wages and government transfers. By blocking the account from being overdrawn, CCO customers can avoid the high costs of bouncing checks that might have dissuaded them from having traditional accounts. ATM and debit-card access could also be given, along with the service of making long-distance payments.

3. *Create accounts specifically designed to build savings.*

"Savings-building" accounts that allow individuals to pledge to save a fixed amount in small increments over a specified time period, usually a year, could also assist the unbanked. Contributions would coincide with receipt of regular income such as a paycheck and, if possible, would be automatically debited. Caskey suggests separating these accounts from a regular checking or savings account to keep a psychological distinction between the two. He also

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[1] Material in this section © John P. Caskey. Used with permission.

suggests imposing a penalty for early closure of the account and for failure to make specified deposits at regular intervals.

4. *Offer deposit-secured emergency loans to individuals whose credit histories make them ineligible for traditional mainstream credit.*

With credit-scoring and other cost-saving technologies, bank outlets could find it more feasible to make unsecured non-revolving loans of less than $1,000 to customers with good credit records. This would allow them to compete with payday lenders and pawnbrokers to offer smaller loans often not practical at larger banks because of high risk factors and administrative costs. For customers with impaired credit histories, outlets could offer deposit-secured credit cards, or loans made against the balance of a savings-building account. In addition, outlets could partner with community-based organizations (CBOs) to establish philanthropic deposit accounts to provide collateral for loans to lower-income households without financial savings.

5. *Seek community-based partners and offer financial literacy programs.*

Banks can benefit in many ways by forming partnerships with carefully chosen nonprofit CBOs. A well-connected CBO can help overcome distrust between community residents and banks. Also, CBOs benefit from increased financial services in the neighborhood, and can initiate and promote financial literacy initiatives.

Caskey also offered two case studies of these strategies:

"Cash & Save" Outlets of Union Bank of California

Union Bank of California began opening "Cash & Save" outlets in 1993 in Los Angeles and San Diego offering check-cashing and banking services. By 2000, there were 12 stores, the most successful of which were stand-alone outlets in large discount stores that catered to middle- and lower-middle-income shoppers. "Check-cashing" is prominently advertised and the hours of operation include evenings and weekends. In addition to traditional banking services, the Cash & Save outlets offer a full range of commercial check-cashing services. A first-time check-cashing customer pays a $3 fee to become a Cash & Save "member" with a digital photo, signature, and employment information on file.

To encourage repeat business, discounts are offered, including a $10 annual "Money Order Plan" that allows six "free" money orders a month and a discounted 1 percent check-cashing fee for the year. Other services include cashing of government checks and paychecks for nondepositors, originating domestic and international wire transfers, handling the payment of utility bills, selling prepaid phone cards, faxing and photocopying, and in some locations selling bus tokens and passes. Basic checking accounts have low minimum-balance requirements. Among nontraditional accounts is a deposit account similar to an Electronic Transfer Account that receives electronic deposits of government benefits payments with a passbook interest rate. Maintenance fees are waived, but all cash withdrawals carry a 1 percent fee. Cash & Save also offers two savings plans: The "Nest Egg" account requires a commitment to deposit at least $25 a month for one year after a $10 initial deposit, and the "Combo" account combines the Nest Egg account with the Money Order Plan. Cash & Save outlets formed partnerships with CBOs to offer personal financial management seminars. The CBOs host the seminars and the banks publicize them. Union Bank reports that about 40 percent of its regular check-cashing customers use at least one traditional bank product within a few years.

"Over-the-Rhine" branch of Cincinnati Central Credit Union

The Cincinnati Central Credit Union (CCCU), realizing the lack of depository financial institutions in the Over-the-Rhine neighborhood, formed a partnership with a local nonprofit organization based there called SmartMoney Community Services. SmartMoney raised the capital to acquire and equip a storefront credit union branch and then provided subsidized office space. The partnership is mutually beneficial: SmartMoney provides one-on-one financial counseling sessions and helps build trust between the community and the CCCU, and the credit union provides the community with convenient, professional depository and credit services. Services include low-cost, low–minimum balance checking and savings accounts, and a small-scale individual development account program.

The branch also sells low-cost money orders, postage stamps, envelopes, and bus passes. To provide small loans to residents with impaired credit histories, the "Smart Loan" program was designed. SmartMoney collected donations from churches and individuals to use as collateral for Smart Loans, with the maximum loan amount being $3,000. SmartMoney requires that recipients enroll in its Smart Change budget counseling course to repair credit records and build savings. CCCU reports that the branch, which is largely self-supporting, has successfully met residents' needs for convenient financial services and support.

Case Study on Neighborhood Trust Federal Credit Union

Neighborhood Trust Federal Credit Union (NTFCU) in New York City is one of the fastest-growing community development credit unions in the United States. Opened in 1997, it has accumulated $5 million in assets, about double the amount in deposits in most neighborhood credit unions, according to the *New York Times*. Based in an abandoned Chemical Bank branch in the Port Authority Terminal on Fort Washington Avenue and 178th Street, the nonprofit credit union provides services to low-income residents of the Washington Heights and West Harlem communities, where check-cashing outlets and pawnshops are on nearly every corner and predatory lenders proliferate. An estimated 70 percent of NTFCU customers have never had a bank account.

Background/Structure

The idea of creating a nonprofit organization to provide financial and educational services for community development was conceived in 1994 by New York City school teachers Mark Levine and Luis De Los Santos. Recognizing the disparities of service in the Washington Heights community, Levine, a graduate of the Kennedy School at Harvard, conducted a population survey that revealed a desperate need for affordable financial services. He enlisted friends to help him conduct research to determine how to create a community-owned and -run community credit union.

Three years later, the NTFCU was born. A daughter organization of the nonprofit Credit Where Credit is Due organization—which provides outreach, education, and training on financial management, banking services, and homeownership—NTFCU now has a staff of 12 and 3,000 members, each of whom is a shareholder.

Population Served

The two communities served by NTFCU have a total population of about 500,000 with a median household annual income of $10,000 to $12,000. In Washington Heights, 80 percent of the population is Dominican and in West Harlem it is 55 percent African American and Latino. A large proportion of the local businesses are home-based child care, beauty salons, grocery stores and convenience stores, and eateries. Most of the credit union's customers have never used mainstream financial institutions. Instead, they were typically served by pawnshops, check cashers, and predatory lenders.

Services Provided

NTFCU provides a number of financial services, including:

- Personal and business banking: Customers can open a no–minimum balance checking account with $100 and have no limit on the number of checks that can be written for a monthly service fee of $5. Savings accounts require $50 minimums. The credit union also offers ATM cards.

- Lending services in the form of personal loans, securitized credit, and mortgage lending: Personal loans ($500 to $10,000) are offered for personal needs or to start or build micro-businesses. Interest rates are higher on personal loans than for business development. Repayment periods vary by loan and borrower profiles, but generally do not exceed four years. At the time of this writing, the loan portfolio consisted of 700 loans totaling $1.9 million, with a repayment rate of 97 percent. Default rates of 3 percent are consistent with commercial banks serving higher-income populations. Securitized and partially securitized credit cards are also offered. These are basically prepaid credit cards. Mortgage lending is primarily for cooperative housing purchases, normally not exceeding $150,000. Although the majority of owner-occupied housing stock in upper Manhattan is cooperative housing, these mortgages are often viewed as risky loans for commercial banks because they are considered nontraditional.

- Education through financial literacy programs. The Credit Where Credit Is Due (CWCID) organization, the Neighborhood Trust's mother organization, conducts four different educational and outreach programs.

1. The *Personal Financial Literacy Program* focuses on developing basic accounting skills to open and use bank accounts, write checks, draft monthly budgets, save for college, and understand concepts of stock market investment. Graduates of this program can use the pro bono services of the investment company, First Investor.

2. The *Enterprise Training Program* series coaches entrepreneurs on business concepts, how to prepare business plans and budgets, access capital, handle accounting and bookkeeping, and better understand the basics of business law and employee management. After completion of the eight-class series, entrepreneurs are entitled to one hour of free consultation with the CWCID education program manager, as well as free consultations with the law firm of Chadbourn and Parke.

3. The *Youth Education Program* or *School Banking* teaches local fourth and fifth graders to use banking services and to save for their futures. Participants open bank accounts and can make deposits with as little as one cent. Withdrawals require parental consent. The program operates in local schools and includes lessons in basic math as applied to banking. More than $23,000 has been saved by the 750 participants.

4. The *Home Ownership Training Program* teaches community members how to obtain a home mortgage loan, assess one's financial capacity to repay it, calculate the terms of an affordable mortgage, and assess the value of a house. Because the majority of housing in the area is cooperative housing, the program also offers specific information about what cooperatives are and about cooperative lending.

Strategies for Success

The credit union's success is attributed to its ability to fine-tune its services to community needs, and its commitment to local economic development. The survey conducted in the beginning of CWCID's project helped identify these needs. The organization is also in a constant mode of self-evaluation and regularly asks clients to fill out evaluation questionnaires. Another strength is Neighborhood Trust's sound business practices and modeling of commercial banking operations, combined with a balance between its commercial approach and nonprofit developmental agenda. Finally, successful fund raising to cover a variety of support activities has also added to the ultimate success of Neighborhood Trust.

Individual Development Accounts

Individual development accounts (IDAs) are matched savings accounts designed to help low-wealth families or individuals build assets. Participants can use the money saved through these accounts to buy a house, develop a business, or increase job skills through education and training.

Similar to other defined contribution plans, such as 401(k)s, IDAs offer a monetary incentive for participation for every dollar saved. Individuals make regular savings deposits in their IDAs that are then matched by funds from the sponsoring bank, foundation, other charitable organization, or local government.

IDA programs often include personal finance literacy counseling and training on such issues as homeownership, household budgeting, record keeping, and long-term economic planning.

Although the main goal of the program is to increase wealth, the accounts also provide opportunities for banks to attract new customers by increasing the comfort level of participants with financial institutions.

Several foundations, community organizations, elected representatives, and government officials have provided crucial support for IDA programs. Both the Corporation for Enterprise Development and the Center for Social Development at the University of Washington at St. Louis have played central roles in the implementation of a national IDA pilot demonstration, research on the effectiveness of IDAs, proliferation of federal and state IDA legislation, and the development and dissemination of program development materials. As a result, a proposed national IDA tax credit, called the Savings for Working Families Act, is expected to come before Congress for a vote this year.

The national demonstration has achieved the goal of proving that low-income and low-wealth individuals can save when given the proper incentives and educational tools. Over a three-year period, the 2,000-plus demonstration participants deposited more than $1.3 million. The success of the national demonstration has generated tremendous interest in and support for IDA programs at the federal, state, and local levels. In considering further initiatives, however, it is important to keep in mind that these early IDA initiatives have been relatively costly to set up. Services such as outreach and consumer education can be costly.

Community Development Financial Institutions

Definition, Structure, and Population Served	Mission	Strengths
Community Development Financial Institutions (CDFIs)		
CDFIs are private-sector financial intermediaries with community development as their primary mission. They are bridge institutions that link unconventional borrowers and conventional financial institutions. There are 6 basic types of CDFIs: 1) community development credit unions, 2) community development banks, 3) community development loan funds, 4) microenterprise funds, 5) community development corporation-based lenders and investors, and 6) community development venture funds. CDFIs target their efforts to distinct geographic	CDFIs bring private-sector capital to bear on problems that have historically required public sector solutions. They all have community development as their primary mission and carry out that mission by: 1) financing businesses and community facilities, job creation and development, and affordable housing in low- and moderate-income communities; 2) providing technical assistance to assist "unbankable" customers; 3) demonstrating that poor urban and rural areas can be profitable markets; 4) helping banks target their	The strength of CDFIs is their flexibility to adapt lending guidelines to the needs of borrowers; to accept unconventional collateral for loans; and to provide education, training, and assistance to potential borrowers. CDFIs attract private investment, they don't substitute for it. They rely on capital-led strategies to address

areas that are economically distressed and/or to distinct demographic populations that are underserved. Some CDFIs, for example, target their efforts to a particular urban, rural, or reservation community. Others lend to particular groups of people (minorities, women, low-income families) or offer specific types of credit products not readily available in the conventional market.	community reinvestment funding; and 5) bringing innovative and trailblazing products and services to disinvested areas. CDFIs make possible loans and investments in community development that conventional financial institutions would consider unbankable.	economic and social problems, and seek to establish capital relationships within their markets that seed sustainability.
CDFI Fund		
The CDFI Fund was established by the U.S. government to facilitate the creation of and capitalize a national network of financial institutions that is dedicated to community development and is committed to serving and improving low-income and low-wealth communities. CDFI Fund supports these organizations with an aim to make the most effective use of limited federal resources. It uses relatively small amounts of federal money to leverage significant amounts of private and nonfederal dollars, promotes private entrepreneurship, and encourages self-help and self-sufficiency.	The Fund bolsters economic development by investing in and assisting CDFIs. By investing in institutions, not just projects, the Fund helps CDFIs better respond to their markets by increasing their ability to manage risk, enhance capacity, and be flexible in their financing. The CDFI Fund provides the following types of assistance: equity investments, credit union shares, loans, grants, and technical assistance (directly, through grants, or by contract with organizations with expertise in community development finance). The Fund supports the following uses of financial assistance: commercial facilities that promote revitalization, community stability, or job creation or retention; businesses that provide jobs for, that are owned by, or that enhance availability of products and services to low-income people; community facilities; basic financial services; housing for low-income people; other businesses and activities deemed appropriate by the Fund; and technical assistance for capacity building, training, and development of programs, investments, or loans.	The CDFI Fund is innovative, investment-oriented, and businesslike in approaching its funding. Recognizing that there are diverse organizational levels, the Fund has established different windows for participants. In addition to the "Core CDFI Program," the Fund has implemented an "Intermediary Program" through which organizations in need of assistance can participate through CDFI intermediaries, and a "Technical Assistance Program" that offers financial support to CDFIs working to build their organizational capacity. Current Initiatives: Core Program—provides financial and technical assistance to CDFIs; Intermediary Program—provides financial assistance to CDFI intermediaries (CDFIs that finance other CDFIs); Bank Enterprise Award Program—provides financial assistance to CDFI and non-CDFI depository institutions; Certification—non-monetary classification recognizing that CDFIs meet Fund eligibility requirements; Microenterprise Awards—non-monetary award program recognizing excellence in microenterprise development; Technical Assistance Component will provide financial assistance to training and technical assistance providers that work with CDFIs; Secondary Market Initiative—financial support to enhance CDFI liquidity.

Case Study of a CDFI: First Bank of the Americas

First Bank of the Americas (FBA) in Chicago is an FDIC-insured bank designated by the U.S. Treasury as a community development financial institution. Since its founding in 1997, FBA has served the predominately Mexican-American communities of Pilsen, Back of the Yards, and Little Village. In a speech in early 2000 to the Chicago Board of Alderman, First Bank of the Americas President and CEO David Voss described the bank's mission of providing reasonably priced financial services to the surrounding community where high-cost fringe bankers do brisk business in "lifeline banking transactions" of check cashing, bill payment, and money transfer.

During a five-month period between September 1999 and February 2000, FBA refinanced more than 150 high-rate mortgages, home equity loans, and consumer loans at market interest rates. Voss estimated that FBA's refinancing will save community members more than $4 million over the next five years.

To overcome neighborhood residents' distrust of traditional financial institutions, FBA, with some outside funding, has launched a community outreach and education campaign. It conducts monthly financial literacy seminars and provides information on local Hispanic TV and radio stations. FBA also has established "school banks" at two schools, Maria Saucedo Scholastic Academy and Cristo Rey High School. The banks, staffed and managed by students, offer savings accounts to students and school staff, serving a dual function of teaching children personal financial management and introducing them to the workings of a bank.

Microfinance for Enterprise Initiatives of Low- and Moderate-Income and Other Disadvantaged Communities

Microfinance is the extension of small loans to small enterpreneurs and households that are too poor to qualify for traditional bank loans or lack assets for collateral. These loans are typically used for income generation, enterprise development, and, in some instances, for community needs such as health and education. Typically microfinance, also called microcredit, loans have a short repayment period and have terms and conditions suited to the local conditions of the community.

The concept of microfinance is not new. Informal systems of credit have existed in societies for centuries, long before modern, commercial banking came into the picture. Many of the current microfinance practices, made popular in developing countries, derive from community-based mutual credit transactions based on trust and peer-based non-collateral borrowing and repayment.

Microcredit in the United States

Microcredit can be an effective program to help empower financially disenfranchised populations, enabling those without access to lending institutions to start small businesses at bank interest rates. In the last five years a surge of interest has spread across the United States to broaden access to credit to lower-income Americans.

In the United States, microlending is centered in community-based banks, credit unions, community loan funds, and other local CDFIs. These institutions provide loans to businesses or households that have one or more of the following characteristics: (1) operate in low- and moderate-income and other disadvantaged communities, (2) are a start-up business or have annual revenues below a specific benchmark, (3) have owners who personally create their product or deliver the service, (4) have fewer than 25 employees, and (5) have a local customer base. The principal amounts of microcredit loans may be as little as $300 or as much as $25,000.

Interest rates are comparable to commercial lending rates and loan repayment rates often exceed those in the commercial sector.

Effective Strategies

According to the OCC study of microcredit practices in the United States, microlending institutions have several common strategies in small business finance. They 1) commit resources, including expert staff, and actively solicit small business customers; 2) learn about small business needs and offer tailored products and services; 3) provide small business customers with easy access; 4) establish streamlined processing for timely credit decisions; 5) offer special handling for flexible loan underwriting; 6) consider partnerships to provide options for small business finance, such as guarantees and credit enhancements, technical assistance, and gap financing; and 7) establish systems to track loan performance and profit.

Microfinance Challenges

Microlending institutions in the United States, such as CDFIs and mainstream banks, face a number of challenges and barriers in providing credit to small businesses in traditionally underserved markets. These include incompatibility of traditional credit evaluation techniques adopted in the banking sector with a need for human subjective review in the decision-making process. It also requires working effectively with government and community-based partners to provide credit enhancements, technical assistance, and other resources. In addition, microcredit providers are often working with a community with information deficits. Many would-be entrepreneurs and small-business owners are unaware of the financial and technical support available to them, and they often have social and language barriers as well. Participation in government programs and with other community development organizations also requires extra time: While banks can make decisions on microcredit loans within three days, loans that involve guarantees from the U.S. Small Business Administration or funds from government agencies often may take much longer.

Rutgers University Research on Organizations as Leaders in Expanding Homeownership

With support from the Fannie Mae Foundation, a team of researchers led by David Listokin and Elvin K. Wyly of Rutgers University conducted case studies of organizations recognized by their peers as leaders in expanding homeownership opportunities for historically underserved households and communities. The case studies describe the efforts of small and large lenders, nonprofit community-based organizations, and lending consortia. The researchers document strategies used by these organizations in the areas of institutional management, attracting and qualifying mortgage applicants, and retaining new homeowners.

The case studies reveal a diverse array of strategies designed to address market imperfections related to information, discrimination, and limited household financial resources. These strategies expand homeownership opportunities, and indicate that a broad spectrum of actors in the housing finance system view historically underserved households and communities as viable markets, not regulatory burdens.

Challenges remain, however, in efforts to use housing finance to promote community development and household wealth accumulation. These challenges reflect inherent tensions between the industry trend toward standardized, efficient business practices and the customized, often expensive programs needed to address multiple obstacles to homeownership and community development faced by underserved households and communities. They also reflect a historically unequal distribution of risks and rewards associated with homeownership in America.

Predatory Lending: An Overview*

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Introduction

Predatory lending has become one of the most critical policy issues facing the financial services industry, particularly mortgage lending. Nearly every federal financial services regulatory agency has publicly denounced predatory lending and called for more effective regulation to address it. Legislation has been proposed in Congress and several states to combat predatory lending, and trade associations and individual financial institutions have declared their concerns. Also, the Federal Reserve Board has proposed a rule to require lenders to report annual percentage rates for all loans, a measure that could help identify predatory lenders.

Despite broad consensus to take action, efforts to end predatory lending have been modest at best. One reason for the slow response is the lack of consensus on what constitutes illegal predatory lending. While there is significant agreement on the key loan terms and lender behavior that generally constitute predatory lending, there is little political consensus at the national level within the housing finance community about how best to address the various areas of concern. Without national consensus on how most effectively to address key predatory lending practices, significant progress in this arena is not likely in the near term.

Predatory loans are characterized by excessively high interest rates or fees, and abusive or unnecessary provisions that do not benefit the borrower, including balloon payments or single-premium credit life insurance, large prepayment penalties, and underwriting that ignores a borrower's repayment ability. Yet, although high interest rates or fees are common characteristics of predatory loans, high-cost loans are not necessarily predatory. And depending on the unique characteristics of an individual loan and specific borrower, loan provisions that may be predatory in one instance, such as a prepayment penalty, may be reasonable and legitimate under others. For this reason, regulatory agencies and other institutions are cautious about instituting broad-based and sweeping regulations that could undermine legitimate sources of financing for credit-impaired households.

Further complicating efforts to stop predatory lending is the fact that there is little, if any, publicly available data regarding loan terms, such as interest rates, origination points, processing or closing fees, and special provisions such as balloon payments, credit life insurance, and prepayment restrictions. Without information on loan terms by borrower and neighborhood race/ethnicity and income, there is no way to effectively monitor or identify questionable lending patterns for further examination. Needless to say, a problem that cannot be identified and examined cannot be eliminated.

As mentioned in the accompanying article (see "Financial Services in Distressed Communities: Framing the Issue"), predatory lending generally does not occur in a vacuum. Rather, it breeds in an environment characterized by little competition for traditional financial services. Specifically, a community flush with "fringe lenders"—check cashing outlets, pawnshops, rent-to-own stores, title lenders, and similar operations—as well as excessive subprime lending, is the environment in which predatory lending activities often flourish.

This article provides a working definition of predatory lending and highlights some of the most common characteristics of predatory loans. It distinguishes predatory lending from subprime lending, and highlights the legitimate role that subprime lending plays for households with demonstrated credit problems. The article further points out, however, that despite a clear technical distinction between legitimate subprime lending and predatory lending, there exists a huge gray area between the two, in the form of excessive subprime lending. The article concludes with a series of recommendations and considerations for further action to limit both predatory and excessive subprime lending.

Defining the Problem

A clear definition of predatory lending is difficult due to the complexity of determining the appropriate level of fees for a given level of risk. Generally speaking, three features—alone or in combination—define predatory lending practices. Those features include targeted marketing to households on the basis of their race, ethnicity, age or gender or other personal characteristics unrelated to creditworthiness; unreasonable and unjustifiable loan terms; and outright fraudulent behavior that maximizes the destructive financial impact on consumers of inappropriate marketing strategies and loan provisions. Although a loan involving any one of these tactics might legally be considered predatory, most predatory lenders use some combination of all three to extract the greatest profit and, as a consequence, cause the greatest financial harm to the borrower.

Fraudulent Target Marketing

Predatory lenders use sophisticated technology and numerous sources of publicly available data to identify potential customers. They market their products to customers they identify as financially unsophisticated or vulnerable, and therefore most likely to accept highly unfavorable loan terms. In particular, predatory lenders look for people with limited education who are not adept in financial matters and lack the financial sophistication to scrutinize loans. Such lenders often prey on households that have limited incomes but significant equity in their homes. The elderly are a primary target for predatory lenders.

Marketing techniques include placing "cold calls" to potential borrowers, direct mailings, telephone and door-to-door solicitation, and television commercials. As with many other loan features, these practices by themselves are not predatory. Target marketing is used extensively by all types of mainstream businesses to identify potential customers and customize products to meet their particular needs. Predatory lenders use target marketing not to meet the needs of their customers, but rather to identify households most vulnerable to the lenders' aggressive or fraudulent behavior.

Predatory lenders' advertisements claim that easy and affordable home equity loans are a quick way for consumers to pay down credit card debt, take a desired vacation, or pay off other expenses, and still have lower monthly mortgage payments. Predatory lending also often involves fraudulent home improvement scams targeted to elderly homeowners because they are more likely than younger people to live in older homes that need repair, are less likely to undertake the repairs themselves, and may not have the cash to pay for someone else to perform them. Because these homeowners have built up substantial equity in their homes, they are particularly at risk of losing a major share, if not all, of their equity. Predatory lenders also make loans to homeowners who are mentally incapacitated and do not understand the nature of the mortgage transaction or papers to be signed.

Abusive Loan Terms

The second characteristic of a predatory loan is the set of abusive terms it contains. Predatory loan terms are structured to extract the greatest possible return to the lender. For equity stripping purposes, they are also routinely designed to preclude a borrower's ability to repay the loan. The loan itself may be unnecessarily large, even in excess of a 100 percent loan-to-value ratio. As long as the amount of the loan exceeds the fair market value of the home, it is difficult for the owner to refinance the mortgage or to sell the house to pay off the loan. Negative amortization loans are structured so that interest is not amortized over the life of the loan and the monthly payment is insufficient to pay off the accrued interest. The principal balance therefore increases each month and, at the end of the loan term, the borrower may owe more than the originally borrowed amount.

Aside from the loan itself—typically offered at very high interest rates—loan terms often include inflated and padded costs, such as excessive closing or appraisal charges, high origination and other administrative fees, and exorbitant prepayment penalties that trap lower-income borrowers into the subprime market. While prepayment fees are rarely charged in the prime market—some 2 percent of mortgages carry them—they are included in 80 percent of subprime mortgages, according to the Detroit Alliance for Fair Banking. And, unlike in the prime market, where prepayment fees are a tradeoff for lower interest rates, subprime mortgage holders rarely, if ever, get anything for the added fees, which can cost as much as a 6 percent penalty for early payoff. Consumers are locked into the subprime market even if they demonstrate improving creditworthiness, and are doubly hurt because they are not free to take advantage of lower interest rates as can prime market customers.

There may also be insertion of pre-dispute, mandatory, binding arbitration clauses in contractual documents. Such clauses are not necessarily offensive by themselves. When combined with other predatory loan provisions, however, they can greatly inhibit a borrower from receiving relief from highly unfavorable and unreasonable loan terms and conditions. Other typical predatory loan features include balloon payments that effectively force borrowers to refinance their loans at even higher rates later. Predatory loan terms also commonly feature single-premium credit life insurance that the lender requires as an up-front, lump-sum payment that the borrower must finance. Thus the borrower ends up paying additional interest—on top of the cost of overpriced and often unnecessary insurance. Maintenance provisions may increase the interest rate of a loan as a result of a 30- or 60-day late payment.

Fraudulent Lender Behavior

Fraudulent behavior is the third identifying characteristic of a predatory loan. It refers to illegal management by the lender of the loan transaction to extract the maximum value for the lender. Fraudulent behavior might include: 1) failing to explain the terms of the loan or providing obscure information, 2) using high-pressure tactics to force a prospective borrower to continue through the loan application process in cases in which the customer would prefer to discontinue the process, 3) omitting explanations of credit life insurance or balloon payments, and 4) discouraging borrowers from exploring lower-cost options.

One common tactic is to offer a short-term loan and quote a seemingly reasonable rate, without explaining that the "reasonable" rate becomes astronomical when translated into the annual percentage rate. "Flipping," or repeated refinancing, is another powerful tool of a predatory lender. The lender might offer to refinance a loan on the justification that the borrower can obtain a lower interest rate. But upon signing the new loan documents, the borrower finds out either that the interest rate is not lower or higher processing fees more than overwhelm any offset in interest rates. Or, a balloon payment provision in the original loan might make refinancing unavoidable.

Initiating loans without considering the borrower's ability to repay or structuring loans with payments that a borrower cannot afford can effectively strip the equity from a homeowner. And encouraging borrowers to consolidate consumer debts into a home equity loan with a higher interest rate than the underlying consumer credit debt—thereby also increasing the size of the loan—is a standard predatory lending practice. Further, predatory lenders may refuse to provide modest home equity loans and, instead, use high-pressure tactics to persuade borrowers to fully refinance their homes—again, usually at interest rates that exceed the underlying mortgage.

Other fraudulent behavior includes adding cosigners whom the lender knows have no intention of contributing to the payments, forging loan documents, and using abusive and high-pressure collection practices, such as harassing phone calls, letters, and threats. The combination of abusive loan terms and aggressive and fraudulent lender behavior that characterizes predatory lending illustrates how a loan can financially destroy an individual even in instances in which the loan's interest rate may not be alarmingly high. Because of the many tools in the arsenal of a predatory lender, a request for a relatively modest loan can be transformed into a major financial crisis for an unsuspecting borrower.

A real-life example is useful in understanding how predatory lenders operate: ABC television's "Prime Time Live" in April 1997 featured the story of an elderly man in poor health who could not read or write. The man initially sought a small loan to buy food. Eventually the lender converted his request into a $50,000 home-equity loan. The loan was flipped just 17 days after signing, even before the first payment was due. Subsequently, in less than four years, the lender flipped the loan 11 times, attaching a 10 percent finance fee each time. The lender foreclosed on the house after the man could not make his loan payments. In this case, the man sued and his loans were forgiven. This was a very unusual ending to a predatory lending story—most victims are unable to obtain successful or satisfactory legal redress.

Finally, it is worth noting that some practices of other real estate professionals, such as mortgage brokers and home improvement contractors, could reinforce and further promote predatory lending. Home improvement contractors, for example, sometimes target inner-city neighborhoods where houses are older and often in need of renovation, and where households are cash-poor but have accumulated significant equity in their properties. In these instances, contractors may steer their customers to predatory lenders for loans to pay for the home improvements. Brokers are an important part of the infrastructure of predatory lenders. Checking property deeds and other public records and spending time in a community, brokers identify homeowners who have substantial equity in their properties and encourage those households to refinance with a predatory lender who, in turn, provides the broker with a substantial referral fee. Elderly, black, widowed women are frequent targets.

Predatory Lending as Subset of Subprime Lending

Predatory lending is a subset of subprime lending. The difference between the two is important. By definition, subprime lending is the provision of loans to households that have demonstrated an inability or unwillingness to properly manage credit. By definition, the subprime market is the credit source of last resort for households with poor credit histories, insufficient documentation of requisite financial resources or other important loan application information, and other loan application shortcomings that would limit a prospective borrower's ability to secure credit from the prime market.

Subprime loans carry higher interest rates than prime loans with the justification that borrowers with higher risk factors should pay more to offset their perceived greater risk to the financial institution advancing the loan. Subprime loan rates are also higher, according to Ken Temkin of the Urban Institute, because underwriting guidelines in the subprime market are not standardized across the industry. The lack of standardization causes variation in interest rates offered by different lenders and makes it difficult for borrowers to "shop" for the most favorable rates.

Despite this clear conceptual distinction between predatory lending and legitimate subprime lending, the reality of subprime and predatory lending is much murkier. A loan does not have to be loaded with an excessive number of egregious provisions for it to unfairly undermine the financial solvency of a family. For example, steering minority households to the subprime market on the basis of race/ethnicity, rather than because of a demonstrated inability to properly manage credit, may be a violation of the Fair Housing Act and Equal Credit Opportunity Act—although it is not necessarily an act of "predatory lending."

In fact, even one percentage point unjustifiably added to a mortgage can add substantially to a household's financial burden and greatly undermine its asset-building capabilities. Over the 30-year life of an $81,000 home mortgage, one additional percentage point could add nearly $21,000 to the cost for the home buyer—not including the additional higher processing fees subprime loans typically carry. Note that the typical subprime loan is 300 to 400 basis points higher than a comparable prime market loan.

Concentration in Low-Income and Minority Neighborhoods

Just as fringe-lending activity is increasing, the subprime market has experienced exponential growth in lower-income minority communities. A recent study published by the U.S. Department of Housing and Urban Development (HUD) based on 1998 Home Mortgage Disclosure Act (HMDA) data uncovered striking racial disparities in the subprime market. The report finds that subprime loans are three times more likely in low-income neighborhoods than in high-income areas, and five times more likely in black neighborhoods than in white neighborhoods. In predominantly black communities, high-cost subprime lending accounted for 51 percent of home loans in 1998, compared with only 9 percent in predominantly white areas.

HUD further notes that homeowners in high-income black neighborhoods are six times as likely as homeowners in upper-income white neighborhoods, and twice as likely as homeowners in low-income white neighborhoods, to have subprime loans. Thirty-nine percent of homeowners in upper-income black neighborhoods had subprime loans, compared with 6 percent of homeowners in upper-income white neighborhoods and 18 percent for homeowners living in low-income white neighborhoods.

Does Risk Fully Explain the Size of the Subprime Market?

As noted above, the rationale for disproportionately high levels of subprime lending to lower-income and minority households is that those borrowers represent substantially greater risk than borrowers in the prime mortgage market. Unfortunately, there is little available public data on the credit quality of households that would allow for an examination of the reasonableness of the growth of subprime lending to lower-income minority households. Data that are available, however, do not support the recent explosive growth of this segment of the mortgage market.

First, several financial institutions in the past decade have confirmed that lower-income status is not synonymous with higher credit risk. Stated otherwise, lower-income consumers who receive mainstream credit perform roughly the same as middle- and upper-income households receiving similar credit. As a result, the much greater level of subprime lending to lower-income households relative to higher-income households is not immediately justified by available information on credit quality of these two groups. Second, although black households have been shown in studies to have greater credit problems than non-Hispanic white households, the level of subprime lending to black households and communities far exceeds the measured level of credit problems experienced by those households.

According to a 1999 Freddie Mac study, black households have roughly twice the credit problems of non-Hispanic white households. Yet HUD's data show that blacks rely on subprime refinance lending roughly four times as much for their mortgage credit. Credit quality alone therefore does not fully explain the extreme reliance of black households on the subprime market. Further research by Freddie Mac reports that as much as 35 percent of borrowers in the subprime market could qualify for prime market loans. Fannie Mae estimates that number closer to 50 percent.

If these estimates are accurate, it represents potentially hundreds of millions of dollars wasted each year by the very households that can least afford it.

Credit History Versus Creditworthiness

Although creditworthiness is the measure by which financial institutions determine the type of loan most appropriate for a particular borrower, there is substantial confusion between creditworthiness and credit history. Creditworthiness or credit risk is the measurement of the borrower's ability and willingness to repay a loan. Credit history is the financial transactions data on which a borrower's creditworthiness is determined. Stated otherwise, creditworthiness is the interpretation of an individual's credit history. An evaluation about creditworthiness of a borrower requires, among other things, judgments about the reliability and comparability of the underlying financial transactions data. There are a number of reasons why an individual's credit history may not accurately reflect his or her actual creditworthiness.

Confusion about credit history and creditworthiness inappropriately reinforces the idea that lower-income, and particularly minority, communities are largely bad credit risk environments. Several problems arise from interpreting creditworthiness from existing credit history data for minority households and comparing the data with that for non-Hispanic white households. First, low-income minorities are more likely to be financially unsophisticated, and thus may not attempt to correct poor credit histories before applying for a loan. Two borrowers may have similar credit behavior, but if one has taken steps to improve his or her credit records before applying for a loan, that borrower will be deemed more creditworthy. In fact, many households may be completely unaware of the need to maintain a good credit history, and the role that documentation plays in determining their access to credit.

A related issue is coaching of borrowers at the time of application for loans. Proper counseling at the time of loan application may enable a household to improve its credit score, but there may be substantial differences in the ways in which households receive such coaching along racial and ethnic lines. Third, comparing credit histories of households that have access to and use mainstream financial institutions with individuals that rely primarily on fringe banking services could result in biased assessments of creditworthiness across racial and ethnic groups.

Federal mortgage data, as well as the behavior of fringe and predatory lenders, suggest that minority households are more likely to have used finance companies and other fringe financial services whose terms and practices are more costly and harsh. In some cases, consumers may even have used predatory lending institutions that intentionally structure loans for default. In some instances, loan terms may be so oppressive and unreasonable that repayment is simply unrealistic. Or, some households may have used fringe lenders who might aggressively report even modest credit blemishes in an effort to hold onto their customers by ensuring they remain unattractive to mainstream lending institutions.

Finally, some households may default intentionally because they recognize, albeit after the fact, that the loan terms they have accepted are egregious and unfair if not outright fraudulent. In these instances, financially vulnerable households are penalized with additional credit blemishes for recognizing and acting to defend themselves from unscrupulous or fraudulent lenders.

Unfortunately for underserved households, data that might provide more accurate assessments of borrower creditworthiness are not readily available and therefore not generally used in sophisticated models of credit risk. The result is continued disparate evaluations of credit risk for lower-income, and particularly minority, households and consequently, lower homeownership rates than might be possible.

Recommendations and Solutions

Predatory lending is an outlying consequence of the inefficient financial markets that exist in many lower-income and minority communities. Predatory lending practices thrive in an environment where competition for financial services is limited or lacking, and where excessive marketing of subprime loans and fringe financial services are occurring. For this reason, effectively limiting predatory lending requires the same three-pronged approach recommended to reduce excessive fringe financial services in lower-income, minority, and distressed communities: 1) enhanced enforcement of the relevant federal and state lending and consumer protection laws, 2) increased prime market lending, and 3) improved borrower education and awareness of financial services options and opportunities (see "Financial Services in Distressed Communities").

Laws that specifically relate to predatory lending and whose greater enforcement must play a key role in eliminating predatory lending include the Fair Housing and Equal Credit Opportunities Acts, the Real Estate Settlement Procedures Act, and the Homeowner's Equity Protection Act. Some predatory lending practices also might violate various federal and state consumer protection laws, such as the Truth in Lending Act. Together, these laws provide a formidable regulatory infrastructure to make important strides in removing predatory lenders from the nation's most vulnerable and distressed communities. Together, these laws cover practically every conceivable predatory lending arrangement. (For a more detailed discussion of possible legal strategies to fight predatory lending, see Engel and McCoy 2001.)

Yet, the strength of these federal laws can, nevertheless, be a weakness. Because so many different laws could pertain to various predatory lending practices, determining which law or laws may have been violated in any particular case can be complicated, time-consuming, and costly. Simplifying federal law to target predatory lending directly would greatly enhance the ability of lower-income households and their advocates to combat unfair and illegal lending behavior. Further, outlawing abusive practices would act as a preventive measure and would avoid the need for consumers to be harmed before there could be legal redress.

The North Carolina nonprofit Coalition for Responsible Lending, for example, points out that a handful of provisions account for the overwhelming majority of the most abusive predatory lending activities. The coalition recommends new legislation that focuses on seven loan terms and practices including: 1) credit insurance; 2) excessive fees charged to borrowers; 3) prepayment fees that do not benefit the borrower; 4) mortgage broker abuses including yield-spread premiums; 5) steering of borrowers to subprime loans on the basis of race/ethnicity, age, or gender; 6) mandatory arbitration clauses that restrict the rights of the borrower; and 7) loan flipping or repeated refinancings that do not benefit the borrower.

Many states have recently enacted or have begun to debate streamlining their state statutes to focus directly on predatory lending. The state of North Carolina enacted a comprehensive predatory lending law in July 1999. The North Carolina law defines two types of loans—"home loans" and "high-cost home loans." For all home loans, the law prohibits lending abuses such as requiring credit life, disability, or unemployment insurance, and loan flipping. With regard to high-cost home loans, it imposes expanded protections against excessive balloon payments, high interest rates and fees, negative amortization, and predatory home improvement contractors. In addition, loan counseling is required and a borrower's ability to repay must be taken into consideration.

Using the North Carolina model, the states of New York, Illinois, South Carolina, Minnesota, West Virginia, Utah, Maryland, and California are all considering predatory lending legislation. Another example of local action is Washington, DC's, new "Predatory Lending Protections and Mortgage Foreclosure Improvements Act of 2000" that provides additional protections for District residents who might find themselves at risk of losing their homes through foreclosure as a result of corrupt lending practices. Among other features, this law attacks predatory activity by defining a subset of loans that might be predatory and providing homeowners with a quick judicial review prior to a foreclosure sale. Philadelphia is another city that has recently enacted a predatory lending law.

Perhaps the most comprehensive federal examination of predatory lending performed to date was pursued jointly by the U.S. Department of the Treasury and HUD. Their report, "Curbing Predatory Home Mortgage Lending," included extensive discussion of predatory lending tactics and a wide range of recommendations to limit fraudulent lending behavior (see the full report at www.huduser.org/publications/hsgfin/curbing.html). The study highlighted and discussed practices ranging from loan flipping, targeting minority and low-income borrowers, and lending to borrowers based on the value of their home rather than the ability to repay a loan. Expanding borrowers' access to the prime market by awarding banks and thrifts Community Reinvestment Act credit and amending many existing laws were among the recommended solutions. Additionally, the study revealed that the Federal Housing Administration is developing tools to help borrowers who have been victimized by predatory lenders to avoid foreclosure, retain their homes with a reasonable level of debt, and, if necessary, repair their credit.

The National Community Reinvestment Coalition has outlined a multipart strategy to address predatory lending. Among its recommendations are for the Federal Reserve Board to use its existing authority to prohibit unfair and deceptive mortgage lending practices, to step up its oversight of subprime lenders, and to improve data disclosure to more effectively track subprime and predatory lending.

Conclusion

The issue of predatory lending is, for good reason, an issue of national concern. Yet, while there is strong consensus to act, there is enormous inertia in taking definitive action that might impact lending of any type. Part of the failure to aggressively address predatory lending is based on a legitimate concern that price controls and blanket prohibitions of individual loan features could negatively impact market segments in unintended ways.

Moreover, as this article and the previous one on *Financial Markets in Distressed Communities* highlights, predatory lending is merely the extreme end of a spectrum of abusive, unscrupulous, and costly financial services practices that dominate lower-income and minority communities. Placing caps on certain practices and eliminating certain other behaviors would go a long way to removing some of the most destructive wealth-stripping activities from the mortgage markets in distressed communities. But limitations, restrictions, and caps on various financial services practices are not sufficient to address the broader issue of market failure that plagues these communities. That broader challenge requires positive action and initiative. Lower-income and minority communities need high-quality, low-cost financial services tailored to their low-income and low-wealth circumstances. Further, those households need access to savings vehicles that would enable them to build their assets to the greatest extent possible.

Assisting households to better understand how to make informed choices about the financial services and providers they choose is an important aspect of a comprehensive anti–predatory lending program. At the same time, however, there are real limits on the extent to which consumer financial education can help vulnerable households who are the focus of fraudulent professionals.

Mortgage loan documents can consist of dozens of provisions written in extremely complex, confusing, and technical legal language. Predatory lenders target lower-income and minority borrowers with limited education and vulnerable elderly consumers specifically because they cannot reasonably protect themselves. To expect that financially vulnerable consumers can reasonably review, understand, and challenge specific provisions in the dozens of legal documents that are routinely involved in the mortgage lending process is a highly unreasonable expectation.

Despite the inability to achieve consensus on the perfect response to predatory lending, some immediate intervention is needed and should be forthcoming at a national level. Failure to successfully remove predatory lenders from the financial services markets could, over a relatively short time, undermine much of the success that has been achieved over the past decade in enhancing the number of historically underserved households that are now homeowners. And it could further exacerbate the tenuous financial positions of many vulnerable, lower-income, elderly homeowners, many of whom reside in older, inner-city, and distressed communities.

Principles for Responsible Lending[1]
Coalition for Responsible Lending

Homeownership not only supplies families with shelter, it also provides a way to build wealth and economic security. Unfortunately, too many American homeowners are losing their homes, as well as the wealth they spent a lifetime building, because of harmful home equity lending practices. Some lenders target elderly and poor or uneducated borrowers to strip the equity from their homes, which traps borrowers in bad loans and creates a high risk of foreclosure. Subprime lending has increased 1,000% in the last five years, and abusive lending is up commensurately.

Seven principles should govern attempts to eliminate predatory lending and protect family wealth:

- Prohibit the financing of up-front credit insurance for all loans.
- Limit fees charged borrowers, direct and indirect, to 3% of the loan amount.
- Prohibit back-end prepayment penalties on subprime loans, since they act in an anti-competitive manner by keeping lenders from remedying abusive situations.
- Take sufficient steps to address mortgage broker abuses on purchased loans, including prohibiting yield-spread premiums.
- Address steering by making sure that borrowers receive the lowest-cost loan they qualify for.
- Avoid mandatory arbitration clauses in any home loans.
- Prohibit "flipping" of borrowers through repeated fee-loaded refinancings.

1. Credit insurance premiums should not be financed into the loan up-front in a lump-sum payment. One type of credit insurance, credit life, is paid by the borrower to repay the lender should the borrower die. The product can be useful when paid for on a monthly basis. When it is paid for up-front, however, it does nothing more than strip equity from homeowners, which is why Fannie Mae and Freddie Mac have both agreed not to purchase any loan that includes financed credit insurance. Conventional loans almost never include, much less finance, credit insurance.

2. The borrower should not be charged fees greater than 3% of the loan amount (4% for FHA or VA loans). Points and fees (as defined by HOEPA) that exceed this amount (not including third party fees like appraisals or attorney fees) take more equity from borrowers than the cost or risk of subprime lending can justify. By contrast, conventional borrowers generally pay at most a 1% origination fee.

3. Subprime loans (defined as interest rates above conventional) should not include prepayment penalties, for the following reasons:

    - Prepayment penalties trap borrowers in high-rate loans, which too often leads to foreclosure. The subprime sector serves an important role for borrowers who encounter temporary credit problems that keep them from receiving low-rate conventional loans. This sector should provide borrowers a bridge to conventional financing as soon as the

[1] "Principles for Responsible Lending" are from the Coalition for Responsible Lending and are used with permission. For more information, see www.responsiblelending.org.

borrower is ready to make the transition, though prepayment penalties are designed to prevent this from happening. Why should any borrower be penalized for doing just what they are supposed to do—namely, pay off a debt?

- Prepayment penalties are hidden, deferred fees that strip significant equity from over half of subprime borrowers. Prepayment penalties of 5% are common. For a $150,000 loan, this fee is $7,500, more than the total net wealth built up over a lifetime for the median African American family. According to Lehman Brothers' prepayment assumptions, over half of subprime borrowers will be forced to prepay their loans—and pay the 4% to 5% in penalties—during the typical five-year lock-out period. And borrowers in predominantly African-American neighborhoods are five times more likely to be subject to wealth-stripping prepayment penalties than borrowers in white neighborhoods. Prepayment penalties are therefore merely deferred fees that investors fully expect to receive and borrowers never expect to pay.

- Borrower choice cannot explain the prevalence of prepayment penalties in subprime loans. Only 2% of borrowers accept prepayment penalties in the competitive conventional market, while, according to Duff and Phelps, 80% in subprime do.

4. Lenders should take sufficient steps to address mortgage broker abuses, including prohibiting yield-spread premiums. Brokers originate over half of all mortgage loans and a relatively small number of brokers are responsible for a large percentage of predatory loans. Lenders should identif—and avoid—these brokers through comprehensive due diligence. In addition, lenders should refuse to pay "yield-spread premiums"—fees lenders rebate to brokers in exchange for placing a borrower in a higher interest rate than the borrower qualifies for. These lender kickbacks violate fair lending principles since they provide brokers with a direct economic incentive to steer black borrowers into costly loans.

5. To address steering, lenders should make sure that borrowers get the lowest-cost loan they qualify for. As Fannie Mae and Freddie Mac have shown, subprime lenders charge prime borrowers who meet conventional underwriting standards higher rates than necessary. This is particularly troubling for lenders with prime affiliates–the very same "A" borrower who would receive the lender's lowest-rate loan from its prime affiliate pays substantially more from the subprime affiliate. HUD has shown that steering has a racial impact since borrowers in African-American neighborhoods are five times more likely to get a loan from a subprime lender–and therefore pay extra–than borrowers in white neighborhoods. A minority borrower with the same credit profile as a white borrower simply should not pay more for the same loan. Therefore, lenders should either:

   - offer "A" borrowers loans with "A" rates, or
   - refer such borrowers to an affiliated or outside lender that offers these rates.

6. Lenders should not impose mandatory arbitration clauses in any home loans. Increasingly, lenders are placing pre-dispute, mandatory binding arbitration clauses in their loan contracts. These clauses insulate unfair and deceptive practices from effective review and relegate consumers to a forum where they cannot obtain injunctive relief against wrongful practices, proceed on behalf of a class, or obtain punitive damages. Arbitration can also involve costly

fees, be required to take place at a distant site, or designate a pro-lender arbitrator. Arbitration will always take time the consumer may not have if they are facing foreclosure. Such clauses are unfair to borrowers, who generally do not understand what rights they are giving up; if an informed consumer thinks that arbitration is a helpful step in resolving a dispute with a lender, the consumer and lender should be permitted to agree to arbitration then.

7. Lenders should prohibit "flipping" of borrowers through repeated fee-loaded refinancings. One of the worst practices is for lenders to refinance subprime loans over and over, taking out home equity wealth in the form of high fees each time, without providing the borrower with a net tangible benefit. Some lenders originate balloon or adjustable rate mortgages only to inform the borrowers of this fact soon after closing to convince them to get a new loan that will pay off the entire balance at a fixed rate. Others require borrowers to refinance in order to catch up if the loan goes delinquent.

Combating Predatory Lending Practices

Federal Banking Regulatory Agencies Call for Greater Oversight

The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision in January issued a directive that strengthens the examination and supervision of institutions with significant subprime lending programs.

The "expanded guidance" decree specifies borrower characteristics that indicate an institution is targeting the subprime lending market, clarifies the standards to use when evaluating loss allowances, and identifies potentially predatory lending practices that safety and soundness examiners will criticize, among other features.

The expanded guidance is expected to help banks and thrifts engaging in subprime lending activities be more aware of the banking agencies' expectations regarding risk management processes.

Responses to Predatory Lending by the U.S. Department of Housing and Urban Development (HUD) and U.S. Treasury Department

A joint U.S. Department of Housing and Urban Development and U.S. Treasury Department Task Force on Predatory Lending has conducted five field forums around the country and, based on its findings, proposed a four-point plan to address predatory lending practices. The plan is detailed in the report, "Curbing Predatory Home Mortgage Lending," summarized below. The full report is available at: www.huduser.org/publications/hsgfin/curbing.html.

1. Provide improved disclosures to borrowers and enhance consumer literacy. Require creditors to recommend that high-cost loan applicants seek home mortgage counseling, disclose credit scores on request, and provide better information on loan costs and terms.

2. Prohibit damaging or unfair lending practices. Loan flipping and lending to borrowers without regard to their ability to repay should be prohibited, and brokers and lenders should be required to provide greater documentation of loan and payment history.

3. Restrict abusive terms and conditions on high-cost loans, including balloon payments, prepayment penalties, and the financing of points and fees; prohibit mandatory arbitration agreements on high-cost loans; and ban single-premium credit life insurance.

4. Use Community Reinvestment Act (CRA) credit to create a positive incentive structure for banks and thrifts. Grant CRA credit to institutions that promote borrowers from the subprime to prime mortgage market, and deny CRA credit to institutions that originate or purchase loans that violate applicable lending laws.

Proposals by the Federal Reserve Board to Strengthen Predatory Lending Prohibitions

The Federal Reserve Board has proposed amending two of its regulations to crack down on predatory lending:

The first proposal is to require additional disclosure of mortgage applications and loans under the Home Mortgage Disclosure Act (HMDA). The revision, which would mandate reporting of requests for mortgage preapprovals and home-equity lines of credit, is designed to track the level, trend, and underwriting characteristics of high-cost mortgage loans. It would help identify institutions engaged in subprime lending, make high-volume nondepository lenders subject to HMDA reporting requirements, and simplify the definition for "refinance" and "home improvement loan" to ensure more complete and consistent data.

The second proposed amendment broadens the scope of loans subject to the Home Ownership and Equity Protection Act (HOEPA) of 1994 by adjusting price triggers that determine coverage under the act. Interest rate triggers would be lowered by two percentage points (from 10 points to 8 points above current Treasury bill rates), and the fee-based triggers would include optional insurance premiums and similar credit protection products paid at closing.

The proposed amendment also prohibits certain practices, such as repeated refinancing of HOEPA-regulated loans over a short time when transactions are not in the borrower's interest, and making loans without verification of a consumer's repayment ability.

It is important to note that HOEPA still does not cover all home equity lenders and all home equity loans, and there are loopholes that allow room for abuse.

Calls for Additional Federal Action

The National Community Reinvestment Coalition (NCRC) has made several recommendations for additional federal anti–predatory lending action.

It recommends calling for federal banking regulations to increase their oversight of subprime lenders during CRA exams and accompanying fair-lending reviews. The NCRC suggests that regulatory agencies issue an interagency advisory letter saying that predatory lending will not receive credit under CRA exams and will be penalized through lower CRA ratings and fair lending referrals to the Department of Justice. It calls for the Federal Reserve Board to use its authority to conduct regular fair lending reviews of subprime affiliates of bank holding companies, as recommended by the General Accounting Office.

Secondly, the NCRC has called for Congress to pass more comprehensive anti–predatory lending legislation.

The NCRC is a national community reinvestment and fair lending trade association of more than 700 community-based organizations and local public agencies dedicated to increasing access to credit and capital for traditionally underserved urban and rural areas.

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Mukasey Declines to Create a U.S. Task Force to Investigate Mortgage Fraud

By ERIC LICHTBLAU
Published: June 6, 2008

WASHINGTON — Attorney General Michael B. Mukasey rejected on Thursday the idea of creating a national task force to combat the country's mortgage fraud crisis, calling the problem a localized one akin to "white-collar street crimes."

Mr. Mukasey made clear that he saw the mortgage fraud problem at the root of the nation's housing crisis as a serious one. But he said he was confident that the Justice Department's current approach — using local prosecutors' offices around the country to oversee separate F.B.I. investigations — was adequate.

Since he took over as attorney general last November, Mr. Mukasey has grappled with how best to deal with the law enforcement side of the growing housing crisis. He said in March, for instance, that the Justice Department was still struggling to determine whether there was a "larger criminal story" behind the housing crisis.

He gave his most definitive answer on Thursday in a briefing for reporters, saying that he did not think that the kind of national task force created at the Justice Department in 2002 to investigate the collapse of Enron was "the proper response" to the current crisis.

Some critics have called for the same sort of broad federal law enforcement response seen in the Enron case and a wave of other corporate scandals earlier this decade, or in the collapse of the savings and loan industry in the 1980s and 1990s.

"This is disappointing," Representative Barney Frank, the Massachusetts Democrat who leads the House financial services committee, said in an interview about Mr. Mukasey's remarks.

Calling the mortgage crisis, "worse than Enron," Mr. Frank said. "Enron didn't cause a worldwide recession. This has more innocent victims."

Mr. Frank noted that a $2.4 billion bill to prevent mortgage foreclosure, which has already passed the House, includes a provision backed by Republicans to provide an additional $300 million for law enforcement officials to fight mortgage fraud. He questioned how that money could be spent without a more centralized effort.

But administration officials maintain that they are aggressively investigating fraud allegations growing out of the housing crisis, with or without a national task force to

coordinate the effort.

The Federal Bureau of Investigation is investigating 19 major corporate fraud cases related to the mortgage crisis. The targets of most of those investigations have not been disclosed. In addition, the F.B.I. has 1,380 small mortgage fraud investigations now open in field offices around the country, a sharp increase over previous years, officials said.

Christopher J. Dodd, the Connecticut Democrat who leads the Senate banking committee, said Mr. Mukasey's comments suggested that the administration "vastly underestimates the scope of this problem."

Mr. Dodd said in a statement that "millions of borrowers were lured into mortgages they could not afford by unscrupulous lenders and brokers, resulting in a housing crisis that has affected neighborhoods across America. The administration ought to be aggressively pursuing the perpetrators of these abusive practices."

John C. Coffee, a professor at Columbia Law School who specializes in corporate law, said that so far, the office of the New York attorney general, Andrew M. Cuomo, appeared to have adopted a more aggressive approach to investigating possible mortgage fraud by major Wall Street firms than have his federal counterparts.

"One area the attorney general should be concerned about is securities fraud at the core of our investment banking system," Professor Coffee said. "The allegation that deserves attention is that these firms were knowingly packaging these securities with the knowledge that the quality of the collateral had materially deteriorated without disclosing that change."

The practice, he added, appears to reflect "a systemic problem, with the red lights blinking."

Mr. Mukasey, in his comments to reporters, acknowledged that particular markets had problems at almost every stage of the housing process. Mortgage holders were not told the true terms of their loans, homes were overvalued, and investment firms put together mortgage-backed securities packages in ways that inflated their true value.

"That has happened over and over again," Mr. Mukasey said of the problems. "Someone that I met with characterized it as white-collar street crime."

But the attorney general said local jurisdictions were in the best position to investigate, and he noted several major prosecutions had already been brought in federal court in the Eastern District of New York.

"There will be more and we will prosecute it, where we see it," he said. "There's always more we can do. That said, I don't see what you call the Enron-type task force. This isn't that type of phenomena."

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How HUD's mortgage policy fed the crisis

Agency labeled risky loans 'affordable' and finance firms bought them up

By Carol D. Leonnig
washingtonpost.com
updated 11:34 p.m. ET, Mon., June. 9, 2008

In 2004, as regulators warned that subprime lenders were saddling borrowers with mortgages they could not afford, the U.S. Department of Housing and Urban Development helped fuel more of that risky lending.

Eager to put more low-income and minority families into their own homes, the agency required that two government-chartered mortgage finance firms purchase far more "affordable" loans made to these borrowers. HUD stuck with an outdated policy that allowed Freddie Mac and Fannie Mae to count billions of dollars they invested in subprime loans as a public good that would foster affordable housing.

Housing experts and some congressional leaders now view those decisions as mistakes that contributed to an escalation of subprime lending that is now roiling the U.S. economy.

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The agency neglected to examine whether borrowers could make the payments on the loans that Freddie and Fannie classified as affordable. From 2004 to 2006, the two purchased $434 billion in securities backed by subprime loans, creating a market for more such lending. Subprime loans are targeted toward borrowers with poor credit, and they generally carry higher interest rates than conventional loans.

Low-income borrowers paying the price

Today, 3 million to 4 million families are expected to lose their homes to foreclosure because they cannot afford their high-interest subprime loans. Lower-income and minority home buyers — those who were supposed to benefit from HUD's actions — are falling into default at a rate at least three times that of other borrowers.

"For HUD to be indifferent as to whether these loans were hurting people or helping them is really an abject failure to regulate," said Michael Barr, a University of Michigan law professor who is advising Congress. "It was just irresponsible."

Congress is expected to vote before its Fourth of July recess on legislation that would strip HUD of its regulatory authority over Fannie and Freddie and give it to a stronger regulator.

Fannie and Freddie finance about 40 percent of all U.S. mortgages, with $5.3 trillion in outstanding debt. Owned by private shareholders but chartered by Congress, they are exempt from state and local taxes and receive an estimated $6.5 billion-a-year federal subsidy because they can borrow money more cheaply than other investors. In return, they are expected to serve "public purposes," including helping to make home buying more affordable.

'Trying to do a good thing'

HUD officials dispute allegations that the agency encouraged abusive lending and sloppy underwriting standards that became the hallmark of the subprime industry. Spokesman Brian Sullivan said the agency and Congress wanted to increase homeownership among underserved families and could not have predicted that subprime lending would dominate the market so quickly.

"Congress and HUD policy folks were trying to do a good thing," he said, "and it worked."

Since HUD became their regulator in 1992, Fannie and Freddie each year are supposed to buy a portion of "affordable" mortgages made to underserved borrowers. Every four years, HUD reviews the goals to adapt to market changes.

In 1995, President Bill Clinton's HUD agreed to let Fannie and Freddie get affordable-housing credit for buying subprime securities that included loans to low-income borrowers. The idea was that subprime lending benefited many borrowers who did not qualify for conventional loans. HUD expected that Freddie and Fannie would impose their high lending standards on subprime lenders.

Banks typically back prime loans with customers' deposits. But subprime lenders often rely on money from Wall Street investors, who buy packages of loans as investments called mortgage-backed securities.

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Lenders slash prices to dump foreclosed homes

Foreclosure rates began to soar

In 2000, as HUD revisited its affordable-housing goals, the housing market had shifted. With escalating home prices, subprime loans were more popular. Consumer advocates warned that lenders were trapping borrowers with low "teaser" interest rates and ignoring borrowers' qualifications.

HUD restricted Freddie and Fannie, saying it would not credit them for loans they purchased that had abusively high costs or that were granted without regard to the borrower's ability to repay. Freddie and Fannie adopted policies not to buy some high-cost loans.

That year, Freddie bought $18.6 billion in subprime loans; Fannie did not disclose its number.

In 2001, HUD researchers warned of high foreclosure rates among subprime loans.

"Given the very high concentration of these loans in low-income and African American neighborhoods, the growth in subprime lending and resulting very high levels of foreclosure is a real cause for concern," an agency report said.

But by 2004, when HUD next revised the goals, Freddie and Fannie's purchases of subprime-backed securities had risen tenfold. Foreclosure rates also were rising.

That year, President Bush's HUD ratcheted up the main affordable-housing goal over the next four years, from 50 percent to 56 percent. John C. Weicher, then an assistant HUD secretary, said the institutions lagged behind even the private market and "must do more."

CONTINUED: Investors zeroed in on targeted markets

1 | 2 | Next >

RESIDENTIAL SEGREGATION AND HOUSING DISCRIMINATION IN THE UNITED STATES

Violations of the International Convention on the Elimination of All Forms of Racial Discrimination

A Response to the 2007 Periodic Report of the United States of America

Submitted by U.S. Housing Scholars and Research and Advocacy Organizations

A Report to the U.N. Committee on the Elimination of Racial Discrimination, January 2008

Prepared by:

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RESIDENTIAL SEGREGATION AND HOUSING DISCRIMINATION IN THE UNITED STATES

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Executive Summary

Residential segregation is an insidious and persistent fact of American life. Discrimination on the basis of race, while on the decline according to some estimates, continues to pervade nearly every aspect of the housing market in the United States. This shadow report evaluates the current state of housing discrimination and segregation and the United States government's failure to fulfill its obligations related to housing under the International Convention on the Elimination of All Forms of Racial Discrimination ("CERD").

Historically, policies and practices of the United States government, as well as state and local governments, have helped to create highly segregated residential patterns across the United States. Today, many of the government's programs and policies continue to perpetuate segregation and concentrate poverty in communities of color, albeit without the explicit design of earlier programs. For example, family public housing is highly segregated and predominantly located in areas of concentrated poverty. Similarly, since 2001, the federal government has implemented policy changes and budget cuts that have restricted affordable housing choice and mobility for participants in the Section 8 Housing Choice Voucher Program. In addition, the Low Income Housing Tax Credit provides an incentive to develop affordable housing primarily in poor and predominately minority neighborhoods, which often perpetuates residential segregation. These federal programs are augmented by state and local government policies that contribute to residential segregation—including exclusionary zoning rules and school attendance boundaries.

Nor has the United States government adequately responded to private acts of housing discrimination. African Americans and Latinos frequently encounter discrimination when attempting to rent or purchase a home, or when attempting to secure funding or insurance for a home purchase. Despite its illegality, the practice of "steering," in which real estate agents direct people toward homes in buildings or neighborhoods in which their presence will not disturb the prevailing racial pattern, is becoming more, rather than less, common. In addition, people of color are more likely than whites with similar borrower characteristics to be victims of predatory lending, to receive higher cost loans, and to lose their homes to foreclosure. Because home equity is the largest pool of wealth for most families in the United States, disparities in homeownership are a major component of persistent racial inequality.

CERD imposes on the United States government an obligation to ensure that all people enjoy the rights to housing and to own property, without distinction as to race. It requires the United States government to cease discriminatory actions, including those that are discriminatory in effect regardless of intent, and to take affirmative steps to remedy past discrimination and eradicate segregation. This report contains a number of recommendations—addressed specifically to the Department of Housing and Urban Development, the Department of Justice, the United States Congress, the Internal Revenue Service, and state and local governments—to assist the United States government in complying with its obligations under CERD.

Table of Contents

I. Overview

Obligations Related to Housing Under CERD

I. The United States government's obligations with respect to housing under CERD are similar to its duties under the Fair Housing Act (the "FHA" or "Act"),[1] as well as the closely linked Equal Credit Opportunity Act.[2] The FHA requires the federal government and all agencies and grantees involved in federally funded housing to "affirmatively further" fair housing.[3] It, most centrally, requires that the United States Department of Housing and Urban Development ("HUD") enforce the terms of the FHA as they relate to discrimination in private housing transactions and in credit markets in conjunction with the United States Department of Justice ("DOJ").[4] The Act also directs the federal government to take affirmative steps to remedy private discrimination, to avoid governmental policies that perpetuate segregation, and to reverse historical patterns of segregation and discrimination.[5] Analogously, under CERD, the United States has accepted the following obligations:

- To ensure the compliance of "all public authorities and public institutions, national and local" with the obligation not to engage in racial discrimination.[6]
- To "review governmental, national and local policies, and to amend, rescind or nullify any laws and regulations which," regardless of intent, "have the effect of creating or perpetuating racial discrimination wherever it exists."[7]
- To "particularly condemn racial segregation" and "undertake to prevent, prohibit and eradicate all practices of this nature in territories under their jurisdiction."[8] In 1995, the Committee on the Elimination of Racial Discrimination issued a detailed interpretation of Article 3 explaining that the duty to eradicate segregation includes not only the obligation to cease active discrimination, but also the obligation to take affirmative steps to eliminate the lingering effects of past discrimination.[9] It recognized that, although conditions of complete or partial racial segregation may in some countries have been created by governmental policies, a condition of partial segregation may also arise as an intended or unintended consequence of the actions of private persons.

[1] 42 U.S.C. §§ 3601-3631 (2000).
[2] 15 U.S.C. §§ 1691-1691f, § 1691 (1991) (prohibiting discrimination on the basis of race and other characteristics "with respect to any aspect of a credit transaction").
[3] 42 U.S.C. § 3608(d).
[4] Exec. Order No. 12,892, 3 C.F.R. 849 (1995); *see also* 42 U.S.C. § 3608 ("The authority and responsibility for administering this Act shall be in the Secretary of Housing and Urban Development."); 15 U.S.C. § 1691e(k) (providing for notification to HUD of Equal Credit Opportunity Act complaints raising potential FHA violations).
[5] 42 U.S.C. § 3608(d).
[6] International Convention on the Elimination of All Forms of Racial Discrimination art. 2 § (1)(a), Dec. 21, 1965, 660 U.N.T.S. 195 [hereinafter CERD].
[7] *Id.* at art. 2 § (1)(c).
[8] *Id.* at art. 3.
[9] U.N. Comm. on the Elimination of Racial Discrimination, Aug. 18, 1995, General Recommendation 19, Racial segregation and apartheid (Forty-seventh session, 1995), ¶ 140, U.N. Doc. A/50/18, *reprinted in* Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, U.N. Doc. HRI\GEN\1\Rev.6 at 208 (2003), *available at* http://www1.umn.edu/humanrts/gencomm/genrexix.htm.

- To "undertake to prohibit and to eliminate racial discrimination in all its forms and to guarantee the right of everyone, without distinction as to race, colour, or national or ethnic origin, to equality before the law, notably in the enjoyment of" the right to housing, and the right to own property alone as well as in association with others.[10]

The Current State of Housing Segregation in the United States

2. Given the persistence and prevalence of housing segregation throughout the United States, it is evident that, despite this Committee's expressed concern "about persistent disparities in the enjoyment of, in particular, the right to adequate housing,"[11] the United States has not satisfactorily complied with its obligations under CERD. According to the most recent estimates from the United States Census Bureau, Latinos constitute 14.8% of the United States population, while the non-Latino population is 66.4% white, 13.4% African American, 4.9% Asian, 1.5% American Indian or Alaska Native, and 0.34% Native Hawaiian and other Pacific Islander.[12] However, "[t]he average white person in metropolitan America lives in a neighborhood that is 80% white and only 7% black."[13] In stark contrast, "[a] typical black individual lives in a neighborhood that is only 33% white and as much as 51% black,"[14] making African Americans the most residentially segregated group in the United States.[15]

3. For African Americans and Latinos, relatively high incomes are no protection against segregation, as "[d]isparities between neighborhoods for blacks and Hispanics with incomes above $60,000 are almost as large as the overall disparities, and they increased more substantially in the [1990s]."[16]

[10] CERD, *supra* note 6, art. 5 §§ (d)(v), (e)(iii).
[11] U.N. Comm. on the Elimination of Racial Discrimination, Aug. 14, 2001, Concluding observations of the Committee on the Elimination of Racial Discrimination: United States of America (Fifty-ninth session, 2001), ¶ 398, U.N. Doc. A/56/18, *available at* http://www1.umn.edu/humanrts/country/usa2001.html.
[12] U.S. Census Bureau, Annual Estimates of the Population by Sex, Race, and Hispanic or Latino Origin for the United States: April 1, 2000 to July 1, 2006 (2006), *available at* http://www.census.gov/popest/national/asrh/NC-EST2006-srh.html; *see also* Press Release, U.S. Census Bureau, Minority Population Tops 100 Million (May 17, 2007), *available at* http://www.census.gov/Press-Release/www/releases/archives/population/010048.html.
[13] John Logan, Lewis Mumford Ctr. for Comparative Urban & Reg'l Research, Ethnic Diversity Grows, Neighborhood Integration Lags Behind 1 (2001), *available at* http://www.s4.brown.edu/cen2000/WholePop/WPreport/MumfordReport.pdf.
[14] *Id.*
[15] John Iceland et al., U.S. Census Bureau, Racial and Ethnic Residential Segregation in the United States: 1980-2000, at 95 (2002).
[16] Logan, *supra* note 13, at 1.

4. Segregation has a plurality of causes, including private discrimination, historical and current government policies, income differentials, and preference.[17] Although housing discrimination against African Americans and residential segregation improved slightly between 1980 and 2000,[18] racial steering[19] continues at high levels, and racial isolation within America's cities[20] and schools[21] increased during that same period.

[17] Preference is frequently cited as a primary cause of segregation. However, this simplifies the reality of housing choice in the United States. Housing choices are made against the backdrop of a racially and economically segregated market, and many people, whether due to economics, discrimination, or other factors, have little to no meaningful choice in terms of where they live. White people in the United States have often chosen to live in white enclaves for a number of different reasons, some explicitly discriminatory and others not, *see generally* KEVIN M. KRUSE, WHITE FLIGHT: ATLANTA AND THE MAKING OF MODERN CONSERVATISM (2005), and have defended those homogeneous neighborhoods vigorously. *See, e.g.*, THOMAS J. SUGRUE, THE ORIGINS OF THE URBAN CRISIS: RACE AND INEQUALITY IN POSTWAR DETROIT 210 (1996) ("In reaction to the economic and racial transformation of the city, Detroit's whites began fashioning a politics of defensive localism that focused on threats to property and neighborhood.") Even for people of color with the economic means to choose where to live, a decision to live in a neighborhood that is composed predominantly of people of color is often difficult; such a neighborhood "feels familiar, relaxed, and doesn't require any conscious effort to exist," but often "bear[s] burdens and costs that predominantly white [communities] do not," such as inadequate public schools. SHERYLL CASHIN, THE FAILURES OF INTEGRATION: HOW RACE AND CLASS ARE UNDERMINING THE AMERICAN DREAM 130, 135 (2004).
[18] *See* John Iceland, *Racial and Ethnic Segregation and the Role of Socio-economic Status*, *in* FRAGILE RIGHTS WITHIN CITIES: GOVERNMENT, HOUSING AND FAIRNESS 107, 117 (John M. Goering ed., 2007).
[19] Steering is the practice of "directing prospective home buyers interested in equivalent properties to different areas according to their race." Gladstone, Realtors v. Village of Bellwood, 441 U.S. 91, 94 (1979).
[20] *See* NANCY MCARDLE & GUY STUART, CIVIL RIGHTS PROJECT, RACE, PLACE & SEGREGATION: REDRAWING THE COLOR LINE IN OUR NATION'S METROS (2002) (collection of four housing studies on changing racial demographics in Boston, Massachusetts, Chicago, Illinois, and San Diego, California from 1990 through 2000), *available at* http://www.civilrightsproject.ucla.edu/research/metro/three_metros.php.
[21] *See* ERICA FRANKENBERG ET AL., CIVIL RIGHTS PROJECT, A MULTIRACIAL SOCIETY WITH SEGREGATED SCHOOLS: ARE WE LOSING THE DREAM 6 (2003).

II. Government Policies Contribute to and Promote Residential Segregation

5. Historically, the government's policies and practices have helped to create and perpetuate the highly racially segregated residential patterns that exist today.[22] As the United States admitted in its 2000 Periodic Report, "[f]or many years, the federal government itself was responsible for promoting racial discrimination in housing and residential segregation."[23] Beginning in 1934, the federal government, through the Federal Housing Administration's ("Administration") mortgage insurance programs, transformed the American housing market from one that was effectively inaccessible to people outside the upper-middle and upper classes to a broadbased one—but for whites only.[24] The Administration, in combination with New Deal-era selective credit programs, had a huge impact on the American housing market, functioning to insure private lenders against loss, standardize appraisal practices, and popularize the use of long-term, amortized mortgages.[25] These programs were also explicitly discriminatory and denied benefits in accordance with race-based rules.[26]

6. African Americans were also systematically excluded from GI Bill loan programs, which were administered through the Veterans Administration ("VA") and guaranteed mortgages for five million homes throughout the United States, because banks refused to approve loans for African Americans.[27] Both the VA and the Administration "endorsed the use of race-restrictive covenants until 1950" and explicitly refused to underwrite loans that would "introduc[e] 'incompatible' racial groups into white residential enclaves."[28] Financing almost half of all suburban homes in the 1950s and 1960s, the Administration and VA employed racially discriminatory programs to facilitate the development of the suburbs.[29]

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[22] *See* DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS 20 (1993).

[23] *Initial Report of the United States of America to the United Nations Committee on the Elimination of Racial Discrimination*, at 49, delivered to the U.N. Committee on the Elimination of Racial Discrimination (Sept. 2000), available at http://www.ushrnetwork.org/pubs/CERD.USA.pdf [hereinafter *Initial Report*].

[24] KENNETH T. JACKSON, CRABGRASS FRONTIER 190-218 (1985); IRA KATZNELSON, WHEN AFFIRMATIVE ACTION WAS WHITE 115-41 (2005).

[25] *See* JACKSON, *supra* note 24, at 204; David M.P. Freund, *Marketing the Free Market: State Intervention and the Politics of Prosperity in Metropolitan America*, *in* THE NEW SUBURBAN HISTORY 11, 16 (Kevin M. Kruse & Thomas J. Sugrue eds., 2006).

[26] *See* JACKSON, *supra* note 24, at 207-09. For example, the Administration's Underwriting Manual described the "risks posed by the commingling of 'inharmonious racial groups.'" Arnold R. Hirsch, *"Containment" on the Home Front: Race and Federal Housing Policy from the New Deal to the Cold War*, 26 J. URB. HIST. 158, 162 (2000); CASHIN, *supra* note 17, at 111 (noting underwriting manual "maintained that it was 'necessary that properties shall continue to be occupied by the same social and racial classes'" and "instructed appraisers to predict 'the probability of the location being invaded by . . . incompatible racial and social groups'").

[27] *See* KATZNELSON, *supra* note 24, at 115, 139-40.

[28] Freund, *supra* note 25, at 16.

[29] JACKSON, *supra* note 24, at 215.

7. The failure of the federal government to take seriously its obligation to affirmatively further fair housing has meant that inaction and limited enforcement of Title VI and Section 109 statutory obligations[30] result in static patterns of racial segregation. Women of color are disproportionately harmed[31] by segregation in government-subsidized housing because, across all HUD programs, 79% of households are headed by women, 42% are headed by women with children, and 58% of residents are people of color.[32] The following are examples of programs and practices that continue to perpetuate residential segregation.

Public Housing

8. Public housing policies have contributed significantly to the establishment and entrenchment of residential segregation and concentrated poverty throughout the United States. Most public housing built from the 1950s to the 1970s was comprised of large, densely populated "projects," often consisting of high-rise buildings located in poor, racially segregated communities.[33] Housing authorities often yielded to public and political pressure not to locate public housing or its tenants in white neighborhoods.[34] In addition, the demographics of cities and public housing have changed, with fewer whites and more African Americans living in public housing.[35]

9. The federal government and individual housing authorities played an active and deliberate role in concentrating poverty in racially segregated public housing. Many cities established separate public housing for African American and white residents, whether explicitly or not.[36] In 1989, a court found the "primary purpose of [Dallas's] public housing program was to prevent blacks from moving into white areas of th[e] city," and that the city deliberately took actions designed to create and maintain segregation through its public housing.[37] Similarly, Chicago public housing officials ad-

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[30] Title VI of the Civil Rights Act of 1964 and Section 109 of title I of the Housing and Community Development Act of 1974 both prohibit discrimination in any program or activity funded in whole or in part with federal financial assistance. *See* 42 U.S.C. § 2000d; 42 U.S.C. § 5309(a). The statutes also provide the government with authority to review and require compliance. *See* 42 U.S.C. § 2000d-1; 42 U.S.C. §§ 5309(b), (c).

[31] *See* U.N. Comm. on the Elimination of Racial Discrimination, Mar. 20, 2000, General Recommendation 25, Gender Related Dimensions of Racial Discrimination (Fifty-sixth session, 2000), U.N. Doc. A/55/18, *reprinted in* Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, U.N. Doc. HRI/GEN/1/Rev.6 at 214 (2003), *available at* http://www1.umn.edu/humanrts/gencomm/genrexxv.htm.

[32] *See* Office of Policy Dev. & Research, U.S. Dep't of Hous. & Urban Dev., Dataset: A Picture of Subsidized Households–2000, *available at* http://www.huduser.org/picture2000/index.html.

[33] Rod Solomon, Brookings Inst., Public Housing Reform and Voucher Success: Progress and Challenges 2 (2005). *See generally* Robert Gray & Steven Tursky, *Location and Racial/Ethnic Occupancy Patterns for HUD-Subsidized Family Housing in Ten Metropolitan Areas*, *in* Housing Desegregation and Federal Policy 235 (John M. Goering ed., 1986).

[34] *See, e.g.*, Walker v. HUD, 734 F. Supp. 1289, 1294 (N.D. Tex. 1989); Gautreaux v. Chicago Hous. Auth., 296 F. Supp. 907, 913-14 (N.D. Ill. 1969).

[35] *See, e.g.*, Thompson v. HUD, 348 F. Supp. 2d 398, 406 (D. Md. 2005); *Walker*, 734 F. Supp. at 1296; *Gautreaux*, 296 F. Supp. at 909.

[36] *See, e.g.*, NAACP v. HUD, 817 F.2d 149, 151 (1st Cir. 1987) (Boston); *Thompson*, 348 F. Supp. 2d at 406 (Baltimore); *Walker*, 734 F. Supp. at 1294, 1296 (Dallas); *Gautreaux*, 296 F. Supp. at 909 (Chicago). For a discussion of the development of segregated public housing in Chicago as an example, see generally Arnold R. Hirsch, Making the Second Ghetto: Race and Housing in Chicago 1940-1960 (1983).

[37] *Walker*, 734 F. Supp. at 1293.

mitted to a policy of racial segregation and the imposition of racial quotas in its housing projects.[38] Not until 1985 were "[e]fforts to desegregate the nation's public housing stock . . . extended to the entire nation."[39]

10. HUD has admitted to constructing public housing in already segregated neighborhoods, and to being "part of the problem" and "complicit in creating isolated, segregated, large-scale public housing."[40] The agency had long employed a deliberate policy of locating public housing residents in neighborhoods where their presence would not disturb the prevailing racial pattern.[41] Indeed, HUD, along with a number of individual local housing authorities, persistently resisted integration, and their policies regarding site selection, tenant selection, and tenant assignment ensured the continuation of racially identifiable public housing in racially concentrated neighborhoods.[42]

11. Today, public housing remains highly segregated and is located largely in areas of concentrated poverty. People of color constitute 69% of public housing residents; 46% are African American and 20% are Hispanic.[43] Public housing projects are located in census tracts in which, on average, people of color constitute 58% of the population and 29% of the population is below the poverty level.[44] Only 8% of households living in public housing have yearly incomes above $20,000.[45] The levels of segregation for African Americans are even worse in family public housing; in 1990, 55% of the African American households in family projects were in census tracts with populations that were more than 70% African American.[46]

12. Racial discrimination and segregation in public housing affects women to a greater degree than men. According to HUD data from 2000, 77% of households living in public housing are headed by women, and 40% are headed by women with children.[47] Girls living in public housing also face specific risks because of their sex that are often more prevalent in areas of high poverty concentration, including harassment, domestic violence, sexual assault, pressure to become sexually active at a young age, and fear of victimization and exploitation.[48]

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[38] *Gautreaux*, 296 F. Supp. at 909.
[39] John M. Goering, *Introduction*, *in* HOUSING DESEGREGATION AND FEDERAL POLICY, *supra* note 33, at 192.
[40] *See, e.g.*, *Thompson*, 348 F. Supp. 2d at 467.
[41] *Id.* at 468.
[42] *Id.* at 469 (quoting HUD official's admission); *Walker*, 734 F. Supp. at 1299-1300 (noting Dallas' thirty-year illegal assignment of tenants); *Gautreaux*, 296 F. Supp. at 909, 912-13 (noting discriminatory racial quotas and site selection procedures).
[43] Office of Policy Dev. & Research, *supra* note 32.
[44] *Id.*
[45] *Id.*
[46] JOHN GOERING ET AL., U.S. DEP'T OF HOUS. & URBAN DEV., THE LOCATION AND RACIAL COMPOSITION OF PUBLIC HOUSING IN THE UNITED STATES 20, 21 tbl.7 (1994).
[47] Office of Policy Dev. & Research, *supra* note 32.
[48] Susan J. Popkin et al., *Girls in the 'Hood: Evidence on the Impact of Safety*, POVERTY & RACE, Sept.-Oct. 2006.

The Section 8 Housing Choice Voucher Program

13. The Section 8 Housing Choice Voucher Program is a tenant-based rental voucher program administered by HUD, under which local public housing authorities ("PHAs") issue more than 1.4 million housing vouchers nationwide to income-qualified households, who then find privately-owned housing units to rent.[49] Large numbers of Section 8 program participants, as well as those eligible for Section 8 assistance, are people of color. In 2000, 61% of Section 8 voucher holders were people of color; 41% of voucher holders were African American and 16% were Hispanic.[50] Although intended to increase mobility and affordable housing choices for very low-income households, the Section 8 program, as administered, does not affirmatively promote the mobility of program participants.

14. Voucher holders frequently encounter difficulty moving to more affluent neighborhoods, where landlords often refuse to rent to Section 8 voucher-holders.[51] Discrimination against Section 8 recipients is illegal in many states and cities,[52] but landlords need not accept any particular individual rental applicant, and a study of Section 8 voucher-holders' experiences in Chicago found that "discrimination against Section 8 holders appears to be disturbingly common."[53] This discrimination disproportionately harms women of color, because 84% of households using Section 8 vouchers are headed by women, and 56% are headed by women with children.[54]

15. The Section 8 program has the potential to help ameliorate residential segregation.[55] However, re-

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[49] U.S. Dep't of Hous. & Urban Dev., About the Housing Choice Vouchers Program, http://www.hud.gov/offices/pih/programs/hcv/about/index.cfm; *see also* DEBORAH J. DEVINE ET AL., U.S. DEP'T OF HOUS. & URBAN DEV., HOUSING CHOICE VOUCHER LOCATION PATTERNS: IMPLICATIONS FOR PARTICIPANTS AND NEIGHBORHOOD WELFARE 90, 120 n.65 (2003), *available at* http://www.huduser.org/Publications/pdf/Location_Paper.pdf.
[50] Office of Policy Dev. & Research, *supra* note 32.
[51] SUSAN J. POPKIN & MARY K. CUNNINGHAM, URBAN INST., CHAC SECTION 8 PROGRAM: BARRIERS TO SUCCESSFUL LEASING UP 4-5 (1999) (citing STEPHEN D. KENNEDY & MERYL FINKEL, U.S. DEP'T OF HOUS. & URBAN DEV., SECTION 8 RENTAL VOUCHER AND RENTAL CERTIFICATE UTILIZATION STUDY: FINAL REPORT (1994)).
[52] Examples of jurisdictions that prohibit discrimination against Section 8 voucher recipients include: Connecticut, CONN. GEN. STAT. ANN. § 46a-64c; Massachusetts, MASS. GEN LAWS ANN. ch. 151B, § 4(10); New Jersey, *see* Franklin Tower One v. N.M., 725 A.2d 1104, 1114 (N.J. 1999); Washington, D.C., D.C. Code Ann. § 1-2502; and Chicago, Illinois, CHI., ILL. FAIR HOUS. ORDINANCE § 5-08-030. Despite having the country's largest Section 8 program, New York City does not prohibit discrimination against Section 8 voucher holders. *See* Manny Fernandez, *Bias Is Seen as Landlords Bar Vouchers*, N.Y. TIMES, Oct. 30, 2007.
[53] POPKIN & CUNNINGHAM, *supra* note 51, at 23; *see also* Fernandez, *supra* note 52 (describing discrimination against voucher recipients in New York City).
[54] Office of Policy Dev. & Research, *supra* note 32.
[55] For example, the Section 8 program offers the possibility of implementing a nationwide, comprehensive mobility program. Alex Polikoff, *A Vision for the Future: Bringing Gautreaux to Scale*, *in* KEEPING THE PROMISE: PRESERVING AND ENHANCING HOUSING MOBILITY IN THE SECTION 8 HOUSING CHOICE RESEARCH PROGRAM 137, 141 (Philip Tegeler et al. eds., 2005) (proposing a nationwide "*Gautreaux*-type" program). The Gautreaux Assisted Housing Program, a judicially mandated program that resulted from the United States Supreme Court's *Gautreaux* decision, Hills v. Gautreaux, 425 U.S. 284 (1976), provided public housing-eligible families with Section 8 vouchers to pay for private rental apartments in neighborhoods in which no more than 30 percent of the residents were African American. *See* Gautreaux v. Landrieu, 523 F. Supp. 665 (N.D. Ill. 1981) (HUD consent decree). Participants received assistance finding housing and counseling. *Id.* Between 1976 and 1998, the Gautreaux Assisted Housing Program helped more than 25,000 voluntary participants move to more than 100 communities throughout the Chicago metropolitan area that offered them improved life opportunities. Polikoff, *supra*, at 144. The Gautreaux Program came to an end in 1998, after HUD satisfied its court-ordered obligation to provide desegregated housing opportunities to 7,100 families. Business and Professional People for the Public Interest, Public Housing Transformation: What is *Gautreaux*?, http://www.bpichicago.org/pht/gautreaux.html.

cent policy changes have prevented Section 8 from achieving this potential and have set back gains attributable to the program. In 2002, the federal government eliminated funding for housing mobility programs, which provided counseling to voucher recipients seeking to move into lower-poverty areas.[56] In 2003, HUD began to restrict housing choice by limiting the standards that permitted families to use Section 8 vouchers to move into lower-poverty areas with higher rents.[57] In 2004, HUD retroactively cut voucher funding, which encouraged some PHAs to adopt policies that further prevented families from moving to higher-rent areas.[58] At the same time, it limited the mobility of Section 8 voucher recipients by permitting PHAs to restrict the portability of vouchers across jurisdictions if that portability would result in financial harm to the PHA.[59]

The Low Income Housing Tax Credit

16. The implementation of the Low Income Housing Tax Credit ("LIHTC")[60] is another example of an important government program that perpetuates existing patterns of residential segregation. The LIHTC provides federal tax credits to investors who acquire, rehabilitate, or construct affordable rental property targeted to low-income tenants.[61] Indeed, the LIHTC has been the "principal mechanism for supporting the production of new and rehabilitated rental housing for low-income households" since it began in 1987.[62] Since 1999, the LIHTC has supported the development of 100,000 units of affordable housing per year.[63]

17. LIHTC developments must comply with federal rules, but no explicit fair housing standards govern the administration of the tax credit.[64] Generally, HUD site and neighborhood guidelines prohibit building new low-income housing in racially and economically isolated neighborhoods.[65] Yet, these rules, which were created to prevent racial segregation in HUD-administered programs, have not been formally applied in the administration of the LIHTC.[66] Instead, the LIHTC actually provides an incentive to develop affordable housing in "qualified census tracts," which are often the poorest

[56] Philip Tegeler, *New Directions for U.S. Housing Policy: The Unmet Potential of Two Large Housing Programs*, *in* THE EROSION OF RIGHTS: DECLINING CIVIL RIGHTS ENFORCEMENT UNDER THE BUSH ADMINISTRATION 98 (William L. Taylor et al. eds., 2007), *available at* http://www.cccr.org/downloads/civil_rights2.pdf.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] 26 U.S.C. § 42 (2005). The LIHTC was created by the Tax Reform Act of 1986, P.L. No. 99-514, 100 Stat. 2085 (1986).
[61] CARISSA CLIMACO ET AL., ABT ASSOCS., UPDATING THE LOW-INCOME HOUSING TAX CREDIT (LIHTC) DATABASE: PROJECTS PLACED IN SERVICE THROUGH 2003, at 2 (2006) (hereinafter ABT REPORT 2003). The LIHTC produced an estimated 1.5 rental housing units between the start of the program in 1987 and 2005, surpassing the size of the public housing program. *Id.*
[62] *Id.* at 1.
[63] *Id.* at ii.
[64] *Id.* at 2.
[65] *See* 24 C.F.R. §§ 983.6(b)(3)(iii), (iv).
[66] Philip D. Tegeler, *The Persistence of Segregation in Government Housing Programs*, *in* THE GEOGRAPHY OF OPPORTUNITY: RACE AND HOUSING CHOICE IN METROPOLITAN AMERICA 197, 198 (Xavier de Souza Briggs ed., 2005).

census tracts in a jurisdiction.[67] Accordingly, the LIHTC is not being implemented to "affirmatively further" fair housing.[68]

18. The LIHTC has replicated the public housing trend of concentrating developments in highly segregated, poor neighborhoods throughout the United States.[69] A recent report indicates that "[o]nly a few states place more than half their LIHTC family housing in census tracts with minority population rates less than half the rate for the metropolitan area."[70] In addition, 33.1% of LIHTC units in central city locations are in neighborhoods of concentrated poverty, compared with only 20.8% of rental units overall.[71]

Zoning

19. Zoning is another government practice that impacts many jurisdictions and neighborhoods in the United States. Zoning power delegated by state governments gives local governments indirect control over who may live within their boundaries[72] and has often been used to exclude people of color and the poor and to perpetuate segregation.[73] There is a "long-known connection between low-density-only zoning and racial exclusion,"[74] and many municipalities have low-density-only zoning that tends to exclude African Americans and Latinos from either certain neighborhoods or entire municipalities by effectively reducing the rental housing available.[75]

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[67] 26 U.S.C. § 42(d)(5)(c)(ii)(I) (2005). The LIHTC provides incentives for developments proposed in neighborhoods where at least 50% of the households have incomes below 60% of the area's median family incomes, which are the neighborhoods most likely to have a high concentration of low-income people of color. LANCE FREEMAN, CTR. ON URBAN & METRO. POLICY, SITING AFFORDABLE HOUSING: LOCATION AND NEIGHBORHOOD TRENDS OF LOW INCOME HOUSING TAX CREDIT DEVELOPMENTS IN THE 1990s, at 4 (2004), *available at* http://www.brookings.edu/urban/pubs/20040405_Freeman.pdf; *see, e.g.*, Greater Milwaukee Human Rights Coalition, *Shadow Report of the Greater Milwaukee Human Rights Coalition Concerning Compliance with the International Convention on the Elimination of all forms of Racial Discrimination*, at ¶ 52, delivered to the U.N. Committee on the Elimination of Racial Discrimination (2007) [hereinafter *Greater Milwaukee Human Rights Coalition Shadow Report*] (noting that criteria for awarding tax credits of "local support" put forth by the agency which administers the LIHTC program in Wisconsin serves to encourage community discrimination against minority and low-income populations).

[68] Florence Roisman, *Mandates Unsatisfied: The Low Income Housing Tax Credit and the Civil Rights Laws*, 52 U. MIAMI L. REV. 1011, 1029 (1998).

[69] *See* Myron Orfield, *Racial Integration and Community Revitalization: Applying the Fair Housing Act to the Low Income Housing Tax Credit*, 59 VAND. L. REV. 1747, 1781 (2005) (noting LIHTC units are "more likely than other rental units to be located in census tracts where more than 60 percent of households would qualify to live in a tax credit unit").

[70] JILL KHADDURI ET AL., ABT ASSOCS., ARE STATES USING THE LOW INCOME HOUSING TAX CREDIT TO ENABLE FAMILIES WITH CHILDREN TO LIVE IN LOW POVERTY AND RACIALLY INTEGRATED NEIGHBORHOODS? 22 (2006). The LIHTC statute requires that each state's plan give preference to "projects serving the lowest income tenants . . . for the longest period of time." 26 U.S.C. § 42(m)(1)(B)(ii) (2002).

[71] ABT REPORT 2003, *supra* note 51, at 2.

[72] Rolf Pendall, *Local Land Use Regulation and the Chain of Exclusion*, 66 J. AM. PLANNING ASS'N 125, 140 (2000).

[73] ROLF PENDALL ET AL., FROM TRADITIONAL TO REFORMED: A REVIEW OF THE LAND USE REGULATIONS IN THE NATION'S 50 LARGEST METROPOLITAN AREAS 3 (2006) (noting that zoning has long been used to separate people by race and by class); *see, e.g.*, Village of Arlington Heights v. Metro. Hous. Dev. Corp., 429 U.S. 252 (1977) (upholding zoning ordinance that barred construction of multi-family housing, effectively barring African American families from moving to neighborhood); Buchanan v. Warley, 245 U.S. 60 (1917) (striking down ordinance that barred sale of lot to person of color if majority of residences on lot's block were occupied by whites).

[74] Pendall, *supra* note 72, at 135.

[75] PENDALL ET AL., *supra* note 73, at 6, 12-14; Pendall, *supra* note 72.

20. In other contexts, particularly in Southern states, as small towns expand their borders, they frequently exclude long-standing communities of color at the towns' fringes.[76] Such exclusion creates minority enclaves with inferior or no access to basic public services such as water, sewer, or police protection that are enjoyed by white residents.[77] In more egregious cases, even when towns exercise regulatory power over these enclaves, residents frequently are not town citizens and cannot vote in municipal elections.[78] In a similar effort to exclude immigrants, many municipalities have recently enacted zoning ordinances that prohibit members of extended families from living together.[79]

21. The Fair Housing Act has long prohibited zoning rules that have the effect of discriminating on the basis of race without a legitimate nondiscriminatory justification.[80] However, court challenges to exclusionary zoning practices are restricted because individuals have standing to challenge the practices only if there is a substantial probability they could live in the municipality if not for the challenged practice.[81]

22. Inclusionary zoning has been an important tool for creating more affordable housing opportunities in many jurisdictions.[82] The opposite of exclusionary zoning, inclusionary zoning ordinances go "beyond voluntary incentives and requir[] that a small percentage of units (typically 10 percent) in every market rate housing development be kept affordable to moderate-income families."[83]

23. Some state governments have successfully required municipalities to provide more fair housing opportunities than they otherwise would. For example, in New Jersey, each municipality must provide

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[76] Charles S. Aiken, *Race as a Factor in Municipal Underbounding*, 77 ANNALS ASS'N AM. GEOGRAPHERS 564, 564-79 (1987) (first use of term "municipal underbounding" to describe pattern of African American communities left outside of borders of small Southern towns); Daniel T. Lichter et al., *Municipal Underbounding? Annexation and Racial Exclusion in Southern Small Towns*, RURAL SOC. 72 (forthcoming 2007) (finding white communities are less likely to annex African American communities, regardless of size).

[77] *See, e.g.*, James Dao, *Ohio Town's Water at Last Runs Past a Color Line*, N.Y. TIMES, Feb. 17, 2004, at A2 (describing Zanesville, Ohio's denial of water to an African American community for more than fifty years, even though community existed less than one mile from public water lines and city provided water to surrounding neighborhoods); Lee Romney, *Poor Neighborhoods Left Behind*, L.A. TIMES, Sept. 18, 2005, at B1 (describing exclusion of four Latino neighborhoods from the city of Modesto, California).

[78] *See* U.N.C. CTR. FOR CIVIL RIGHTS, INVISIBLE FENCES: MUNICIPAL UNDERBOUNDING IN SOUTHERN MOORE COUNTY (2006), *available at* http://www.law.unc.edu/documents/civilrights/briefs/invisiblefencesreport.pdf (documenting history of three African American communities outside city limits but within extraterritorial jurisdiction of three cities in Moore County, North Carolina); Shaila Dewan, *In County Made Rich by Golf, Some Enclaves Are Left Behind*, N.Y. TIMES, June 7, 2005, at A1.

[79] *See, e.g.*, Nick Miroff, *Culpeper Officials Targeting Illegal Immigrants*, WASH. POST, Sept. 21, 2006.

[80] *See* 42 U.S.C. § 3604(a); *see also* Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926 (2d Cir.), *aff'd*, 488 U.S. 15 (1988) (per curiam); Resident Advisory Bd. v. Rizzo, 564 F.2d 126 (3d Cir. 1977); United States v. City of Black Jack, 508 F.2d 1179 (8th Cir. 1974).

[81] *See Arlington Heights*, 429 U.S. at 252; Simon v. E. Ky. Welfare Rights Org. (EKWRO), 426 U.S. 26 (1976); Warth v. Seldin, 422 U.S. 490 (1975).

[82] *See* Nat'l Hous. Conference, *Inclusionary Zoning: Lessons Learned in Massachusetts*, NHC AFFORDABLE HOUS. POL'Y REV., Jan. 2002, at 26-28 (describing inclusionary development policy in Boston, Massachusetts); Robert W. Burchell & Catherine C. Galley, *Inclusionary Zoning: Pros and Cons*, NHC AFFORDABLE HOUS. POL'Y REV., Oct. 2000, at 3, 4 (discussing successful inclusionary zoning programs in numerous localities, including Montgomery County, Maryland).

[83] Nat'l Hous. Conference, *supra* note 82, at 1-2.

for its "fair share of the present and prospective regional need" for low-income housing.[84] Nevertheless, segregation persists, partly because New Jersey's wealthy suburbs are allowed to evade the low-income housing requirement by paying poorer urban areas to build or rehabilitate that housing through regional contribution agreements.[85]

The Link Between School Segregation and Residential Segregation

24. Just as segregated housing patterns often lead to segregated schools, integration in schools can, in turn, lead to greater residential integration. As a result, integrated schools are an important tool for mitigating residential segregation.[86] Unfortunately, a recent decision of the United States Supreme Court which struck down two modest voluntary school integration plans[87] limits the ability of local school boards to take race into account in assigning individual students in an attempt to integrate public schools.

25. School desegregation programs have had a positive impact on residential integration.[88] During the 1970s, cities that had undergone metropolitan school desegregation experienced "markedly greater rates" of housing desegregation than did other cities.[89] Between 1970 and 1990, residential integration occurred at twice the national average in communities with metropolitan school desegregation programs.[90] A recent study of fifteen metropolitan regions shows that comprehensive school desegregation programs are strongly correlated with stable residential integration.[91] Even the United States Supreme Court has noted that the location of schools may influence patterns of residential development in metropolitan areas and have an important impact on the composition of inner-city neighborhoods.[92]

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[84] S. Burlington County NAACP v. Mt. Laurel, 33 A.2d 713, 724 (N.J. 1975).
[85] DAVID L. KIRP ET AL., OUR TOWN: RACE, HOUSING, AND THE SOUL OF SUBURBIA 161 (1995). *See generally id.* at 112-64. Regional contribution agreements are governed by statute. N.J. Stat. Ann. § 52:27D-312.
[86] Gary Orfield, *Metropolitan School Desegregation: Impacts on Metropolitan Society*, *in* IN PURSUIT OF A DREAM DEFERRED: LINKING HOUSING AND EDUCATION POLICY 135 (john a. powell et al. eds., 2001); *see also* Erica Frankenberg, *The Impact of School Segregation on Residential Housing Patterns: Mobile, Alabama, and Charlotte, North Carolina*, *in* SCHOOL RESEGREGATION: MUST THE SOUTH TURN BACK? 164, 180 (John Charles Boger & Gary Orfield eds., 2005).
[87] Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1, 551 U.S. ___, 127 S. Ct. 2738 (2007). In his dissent, Justice Breyer notes the correlation between school segregation and residential segregation. He maintains that there is an "interest in continuing to combat the remnants of segregation caused in whole or in part by these school-related policies" where such policies "have often affected not only schools, but also housing patterns, employment practices, economic conditions, and social attitudes." *Id.* at 2920 (Breyer, J., dissenting).
[88] *See* DIANA PEARCE, CTR. FOR NAT'L POL'Y REV., BREAKING DOWN BARRIERS: NEW EVIDENCE ON THE IMPACT OF METROPOLITAN SCHOOL DESEGREGATION ON HOUSING PATTERNS 3 (1980) (citing evidence of increased housing integration in places with metropolitan desegregation programs).
[89] *Id.* at 26-27.
[90] Frankenberg, *supra* note 86, at 180; G. Orfield, *Metropolitan School Desegregation*, *supra* note 86, at 135.
[91] INST. ON RACE & POVERTY, MINORITY SUBURBANIZATION, STABLE INTEGRATION, AND ECONOMIC OPPORTUNITY IN FIFTEEN METROPOLITAN REGIONS 27-29 (2006), *available at* http://www.irpumn.org/uls/resources/projects/Minority_Suburbanization_full_report_032406.pdf; *see also* PEARCE, *supra* note 88, at 51-52 (finding school desegregation supports stable, integrated communities by increasing available housing opportunities and associating benefits with integrated neighborhoods).
[92] *See* Swann v. Charlotte-Mecklenburg Bd. of Educ., 402 U.S. 1, 20-21 (1971).

26. However, levels of school segregation are severe in the United States, particularly for low-income African Americans. In 2002-2003, only 28% of all white public school students (K-12) attended high-poverty schools (defined as schools where 40% or more of the students were eligible for free or reduced price lunches—a proxy for poverty).[93] In contrast, 71% of all African American public school students and 73% of all Latino public school students attended high-poverty schools during the same period.[94] Meanwhile, 1.4 million African American students (1 of every 6) and nearly 1 million Latino students (1 of every 9) attend schools where 99% to 100% of the students are people of color.[95]

27. Meaningful school integration, where all children in a school district attend integrated schools no matter where they live, eliminates an incentive for whites to move to white enclaves.[96] Fully integrated schools open all areas of a community to parents, who can live anywhere in the district and know that their children will not be racially isolated in any school they attend.[97]

28. Recognizing the importance of schools in many real estate decisions, advertisements for homes in districts with segregated schools list the names of schools, if they are predominantly white, from two to ten times more frequently than do advertisements for homes in districts with integrated schools.[98] In districts with truly integrated schools, home advertisements mention schools much less often and focus instead on things like the distance to offices, stores, and recreational facilities.[99] By including white school names in advertisements, real estate agents subtly reinforce the notion that the ability to attend segregated schools is an important—and desirable—feature of property.[100] The separate administration of school and housing desegregation and enforcement decisions severely limits the ability of national, state, and local officials to address this conjoined problem.

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[93] GARY ORFIELD & CHUNGMEI LEE, CIVIL RIGHTS PROJECT, WHY SEGREGATION MATTERS: POVERTY AND EDUCATIONAL INEQUALITY 19, tbl.7 (2005).
[94] *Id.* We also note that these figures exclude millions of private school students, who are disproportionately white. The most recent data from the U.S. Department of Education shows that, of 5,122,772 private school students nationwide, 76.2% are non-Hispanic whites, even though non-Hispanic whites comprise only 59% of children in the United States. *See* U.S. DEP'T OF EDUC., CHARACTERISTICS OF PRIVATE SCHOOLS IN THE UNITED STATES: RESULTS FROM THE 2003-2004 PRIVATE SCHOOL UNIVERSE STUDY 13 tbl.7, 19 tbl.13 (2006); CHILD TRENDS DATABANK, RACIAL AND ETHNIC COMPOSITION OF THE CHILD POPULATION 5 (2006).
[95] ORFIELD & LEE, *supra* note 93, at 12-13.
[96] Frankenberg, *supra* note 86, at 180; PEARCE, *supra* note 88, at 41; *see also* CASHIN, *supra* note 17, at 169 ("Parenthood contributes to white separatism. . . . The most risk-free alternative in a society that is not fundamentally committed to bringing every child or every person along is to opt for those neighborhoods and schools that offer the best opportunities one can afford. Unfortunately those places tend to be the most homogeneous—indeed, the whitest and wealthiest of places.")
[97] Frankenberg, *supra* note 86, at 180; PEARCE, *supra* note 88, at 4, 40-41.
[98] G. Orfield, *Metropolitan School Desegregation*, *supra* note 86, at 135; PEARCE, *supra* note 88, at 9, 14-18.
[99] G. Orfield, *Metropolitan School Desegregation*, *supra* note 86, at 135; PEARCE, *supra* note 88, at 12, 14.
[100] PEARCE, *supra* note 88, at 18.

III. The United States Government Has Not Responded Adequately to Private Acts of Discrimination

29. The United States government's response to racial discrimination by private actors has been severely inadequate. Studies, including those performed by and on behalf of HUD, show that African Americans and Latinos frequently encounter discrimination when searching for housing at all stages: upon entering a realtor's office they receive inferior service, they are told fewer homes are available, and they are shown fewer homes than whites are.[101] HUD's Housing Discrimination Study 2000 ("HDS 2000"),[102] which is referenced in the United States' Report,[103] is the most recent comprehensive study of housing discrimination in the United States. It indicates that housing discrimination remains a serious problem for people of color, with some illegal discriminatory practices actually on the upswing. Despite some evidence of declines for African Americans, the levels of unequal treatment remain high.

Steering

30. Steering by real estate agents is a common discriminatory practice, impacting both whites and people of color at all income levels.[104] The United States Supreme Court has defined steering as a "practice by which real estate brokers and agents preserve and encourage patterns of racial segregation in available housing by steering members of racial and ethnic groups to buildings occupied primarily by members of such racial and ethnic groups and away from buildings and neighborhoods inhab-

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[101] *See generally* JOHN YINGER, CLOSED DOORS, OPPORTUNITIES LOST 19-48 (1995).
[102] HDS 2000 was conducted in three phases, measuring discrimination against African Americans and Latinos, Asians and Pacific Islanders, and Native Americans. *See* MARGERY AUSTIN TURNER ET AL., URBAN INST., DISCRIMINATION IN METROPOLITAN HOUSING MARKETS: NATIONAL RESULTS FROM PHASE I HDS 2000 (2002) (African Americans and Latinos); MARGERY AUSTIN TURNER ET AL., URBAN INST., DISCRIMINATION IN METROPOLITAN HOUSING MARKETS: NATIONAL RESULTS FROM PHASE II HDS 2000 (2002) (Asians and Pacific Islanders); MARGERY AUSTIN TURNER ET AL., URBAN INST., DISCRIMINATION IN METROPOLITAN HOUSING MARKETS: NATIONAL RESULTS FROM PHASE III HDS 2000 (2003) (Native Americans).
[103] *Periodic Report of the United States of America to the U.N. Committee on the Elimination of Racial Discrimination Concerning the International Convention on the Elimination of All Forms of Racial Discrimination*, ¶ 65, delivered to the U.N. Committee on the Elimination of Racial Discrimination (Apr. 2007), *available at* http://www1.umn.edu/humanrts/CERD2007.html [hereinafter *Periodic Report*].
[104] *See, e.g.*, NAT'L FAIR HOUS. ALLIANCE, HOUSING SEGREGATION BACKGROUND REPORT: LONG ISLAND, NEW YORK (2006); NAT'L FAIR HOUS. ALLIANCE, HOUSING SEGREGATION BACKGROUND REPORT: WESTCHESTER, NEW YORK (2006), *available at* http://www.nationalfairhousing.org; George Galster & Erin Godfrey, *By Words and Deeds: Racial Steering by Real Estate Agents in the U.S. in 2000*, 71 J. AM. PLAN. ASS'N 251, 260 (2005). For example, in 2007, the Metropolitan Milwaukee Fair Housing Council, Inc. filed a housing discrimination lawsuit against a local owner of apartment buildings after African American testers were consistently told that there were no apartments available and white testers were informed that there were available units. *Greater Milwaukee Human Rights Coalition Shadow Report*, *supra* note 67, at ¶ 57.

ited primarily by members of other races or groups."[105] Even though steering violates the Fair Housing Act,[106] it continues to be a major form of unfair, unequal treatment that training of realtors has not eliminated.[107] As a result of steering, people of color buying homes are directed to disproportionately African American and/or Latino neighborhoods, and white homebuyers are directed to disproportionately white neighborhoods, thus reinforcing segregation.[108]

31. Steering remains a stubbornly persistent practice—evidenced in 12% to 15% of tests[109]—that has increased since 1989.[110] HDS 2000 concluded that, overall, "[w]hite homebuyers were significantly more likely than comparable blacks to be recommended and shown homes in more predominantly white neighborhoods."[111] Even the interactions of real estate agents with people of color and whites tend to be very different. As some scholars have explained, "agents typically accept the initial request as an accurate portrayal of a white's preferences but adjust the initial request made by a black to conform to their preconceptions. In the case of houses with visible problems, agents refuse to accept the initial request as a sign that whites want such a house, but have no trouble making this inference for blacks."[112]

32. Some examples of steering by real estate agents reported in HDS 2000 include the following statements, which also demonstrate the agents' awareness that their actions are illegal:
    - "[Area] has a questionable ethnic mix that you might not like. I could probably lose my license for saying this!"
    - "[The area] is different from here, it's multicultural. . . . I'm not allowed to steer you, but there are some areas that you wouldn't want to live in."
    - "There are a lot of Latinos living there. . . . I'm not supposed to be telling you that, but you have a daughter and I like you."
    - "It's against the law for me to be saying so, but I could steer you toward some neighborhoods and away from some others."

[105] Havens Realty Corp. v. Coleman, 455 U.S. 363, 366 n.1 (1982).
[106] *See* 42 U.S.C. § 3604(a) (prohibiting practices that "otherwise make unavailable" housing on basis of race); *see also* *Havens Realty Corp.*, 455 U.S. at 370; *Gladstone*, 441 U.S. at 115 n.32; Robert G. Schwemm, Housing Discrimination Law and Litigation § 13:5 (2006).
[107] *See* Turner et al., HDS 2000 Phase I, *supra* note 102, at 6-10; Galster & Godfrey, *supra* note 104, at 260.
[108] Yinger, *supra* note 101, at 51-61.
[109] "Testing" is a process in which two applicants, generally one white and one a person of color, with similar qualifications apply for the same residence in order to determine whether either applicant receives differential treatment. Memorandum from Carolyn Y. Peoples, Assistant Secretary for Fair Housing and Equal Opportunity to All FHEO Field Office Staff and Office of Enforcement and Programs Staff (Apr. 10, 2003), *available at* http://www.hud.gov/offices/fheo/library/testing.pdf.
[110] Turner et al., HDS 2000 Phase I, *supra* note 102, at 6-16.
[111] *Id.* at 3-11.
[112] Jan Ondrich et al., *Now You See It, Now You Don't: Why Do Real Estate Agents Withhold Available Houses from Black Customers?*, 85 Rev. of Econ. & Stat. 854, 872 (2003); see also Bo Zhao et al., *Why Do Real Estate Brokers Continue to Discriminate? Evidence from the 2000 Housing Discrimination Study*, 59 J. Urb. Econ. 394 (2006).

- "I would not send you to this area. I'm not supposed to say this but I'm probably old enough to be your father." When tester asked why, the agent said tentatively, "Because it's primarily an ethnic neighborhood and I wouldn't send you there."[113]

33. HDS 2000 indicated that in home sales markets, whites consistently received favored treatment over African Americans 17% of the time, and over Latinos approximately 20% of the time.[114] Non-racial explanations for these patterns of differential treatment were explored and rejected.[115] In addition, HDS 2000 found that discrimination against Latinos seeking rentals had increased since 1989.[116]

Discriminatory and Predatory Lending in the Mortgage Industry

34. African Americans and Latinos have the lowest homeownership rates in the United States—less than 50%, as compared to 76% for whites.[117] Home equity is the largest pool of wealth for most American families, so disparities in homeownership are a major component of persistent racial inequality.[118] These discrepancies are due in large measure to the significant problem of mortgage lending discrimination, with private lenders denying mortgages to potential African American and Latino homebuyers at disproportionate rates.[119] Some studies indicate that large differences in mortgage rejection rates based on race occur because "[l]oan officers were far more likely to overlook flaws in the credit scores of white applicants or to arrange creative financing for them than they were in the case of black applicants."[120]

35. More pointedly, a HUD study that used testers posing as first-time homebuyers in Chicago and Los Angeles indicated that African American and Latino homebuyers faced "a significant risk of receiving less favorable treatment than comparable whites" when visiting mainstream mortgage lending institutions to make pre-application inquiries.[121] Among the most serious forms of discrimination discerned by the study were differential estimates of home price and total loan amount based on race.[122]

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[113] *See* Galster & Godfrey, *supra* note 104, at 262. Similar forms of discrimination occur in the rental market. *See* Seok Joon Choi et al., *Do Rental Agents Discriminate Against Minority Customers? Evidence from the 2000 Housing Discrimination Study*, 14 J. HOUSING ECON. 1 (2005).
[114] TURNER ET AL., HDS 2000 PHASE I, *supra* note 102, at 4-7, 4-12.
[115] *Id.* at 5-1 to 5-16.
[116] *Id.* at iii-iv.
[117] Delvin Davis, *Here Today, Gone Tomorrow: The Impact of Subprime Foreclosures on African-American and Latino Communities*, POVERTY & RACE, May-June 2007, at 1, 12.
[118] Despite some narrowing of income disparities in recent years, large disparities in wealth remain between whites and African Americans. *See generally* THOMAS SHAPIRO, THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY (2003).
[119] STEPHEN ROSS & JOHN YINGER, THE COLOR OF CREDIT 5-8 (2003); *see, e.g.*, *Greater Milwaukee Human Rights Coalition Shadow Report*, *supra* note 67, at ¶ 59 (noting that Milwaukee has the largest mortgage loan denial rate disparity of the 50 largest metropolitan areas in the United States, non-Hispanic whites in Milwaukee County experienced a 56.3% loan denial rate in 2006, while non-Hispanic blacks experienced a 53.1% loan denial rate).
[120] MELVIN L. OLIVER & THOMAS M. SHAPIRO, BLACK WEALTH/WHITE WEALTH 139 (1995).
[121] MARGERY AUSTIN TURNER ET AL., URBAN INST., ALL OTHER THINGS BEING EQUAL: A PAIRED TESTING STUDY OF MORTGAGE LENDING INSTITUTIONS iii (2002).
[122] *Id.* at 37.

36. Furthermore, disparities in the homeowners insurance available to people of color contribute to more declinations of coverage among homebuyers of color and limit opportunities for integration. Neighborhoods composed predominantly of people of color are often excluded from the best homeowners insurance coverage.[123] As a federal appellate court explained, procuring insurance is critical to the home purchasing process: "No insurance, no loan; no loan, no house; lack of insurance thus makes housing unavailable."[124] Examples of insurance discrimination include providing inattentive service to customers of color, offering policies with different terms to members of different racial groups, requiring inspections only in non-white neighborhoods, and requiring credit checks only from people of color.[125]

37. When people of color obtain loans, they are more likely than whites to receive higher cost loans and subprime loans.[126] In 2006, 53.7% of African Americans, 46.6% of Latinos, and only 17.7% of whites received high-priced loans.[127] In areas where the population is no more than 20% white, 46.6% of borrowers received high-priced loans, compared to only 21.7% of borrowers in communities where whites made up at least 90% of the population.[128] After controlling for various borrower characteristics, such as income and loan amount, these racial gaps are reduced but still statistically significant,[129] with people of color tending to receive the most expensive subprime loans.[130] These disparities are actually worse at higher income levels.[131]

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[123] *See* Shanna L. Smith & Cathy Cloud, *Documenting Discrimination by Homeowners Insurance Companies Through Testing*, *in* INSURANCE REDLINING 97-117 (Gregory D. Squires ed., 1997).
[124] NAACP v. Am. Family Mut. Ins. Co., 978 F.2d 287, 297 (7th Cir. 1992).
[125] *See* Gregory D. Squires, *Racial Profiling, Insurance Style: Insurance Redlining and the Uneven Development of Metropolitan Areas*, 26 J. URB. AFF. 391, 393 (2003).
[126] Subprime lending is the practice of making loans to borrowers who do not qualify for market interest rates because of their credit history; such loans are made on less favorable terms than are standard for prime loans. Allen Fishbein & Harold Bunce, *Subprime Market Growth and Predatory Lending*, *in* HOUSING POLICY IN THE NEW MILLENNIUM: CONFERENCE PROCEEDINGS 273 (U.S. Dep't of Hous. & Urban Dev. ed., 2001), *available at* http://www.huduser.org/Publications/pdf/brd/13Fishbein.pdf.
[127] Robert B. Avery et al., *The 2006 HMDA Data*, FED. RES. BULL. (forthcoming 2007) (manuscript at 1, 39, 68 tbl.11), *available at* http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06draft.pdf.
[128] *Id.* at 39, 72 tbl.14.
[129] Avery et al., *supra* note 127, at 39; *see also* WILLIAM C. APGAR, JR. & CHRISTOPHER E. HERBERT, ABT ASSOCS., SUBPRIME LENDING AND ALTERNATIVE FINANCIAL SERVICES PROVIDERS: A LITERATURE REVIEW AND EMPIRICAL ANALYSIS vi, 113-16 (2005), *available at* http://www.abtassociates.com/reports/final_abt_subprime_Feb_17.pdf (citing multiple studies showing higher incidence of subprime lending in minority neighborhoods, even after controlling for neighborhood credit scores); Vikas Bajaj & Ford Fessenden, *What's Behind the Race Gap?*, N.Y. TIMES, Nov. 4, 2007 (reporting that, in 2006, African Americans were 2.3 times more likely, and Hispanics twice as likely, to receive high-cost loans than whites, even after adjusting for loan amount and borrower income).
[130] Overall, people of color are over 30% more likely to receive a higher-rate subprime loan than are similarly-situated white borrowers. DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES 3, 8-9, 19 (2006), *available at* http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf (examining more than 177,000 subprime loans); *see also* ANTHONY PENNINGTON-CROSS ET AL., RESEARCH INST. FOR HOUS. AM., CREDIT RISK AND MORTGAGE LENDING: WHO USES SUBPRIME AND WHY? 13, 16 (2000), *available at* http://www.housingamerica.org/Publications/46519_RIHA00-03.pdf.
[131] ASS'N OF CMTY. ORGS. FOR REFORM NOW (ACORN), FORECLOSURE EXPOSURE: A STUDY OF RACIAL AND INCOME DISPARITIES IN HOME MORTGAGE LENDING IN 172 AMERICAN CITIES 1 (2007), *available at* http://acorn.org/fileadmin/HMDA/2007/HMDAreport2007.pdf; *see also* Fishbein & Bunce, *supra* note 126, at 275; CALVIN BRADFORD, CTR. FOR CMTY. CHANGE, RISK OR RACE? RACIAL DISPARITIES IN THE SUBPRIME REFINANCE MARKET 3-8 (May 2002), *available at* http://www.knowledgeplex.org/kp/report/report/relfiles/ccc_0729_risk.pdf (finding that racial disparities within subprime refinance market increase with borrower income).

38. Predatory lenders are particularly active in communities of color,[132] and intentionally seek out borrowers who cannot meet the terms of their loans, leading to default and foreclosure.[133] Predatory lenders also steer borrowers who could qualify for standard loans towards subprime loans with less favorable terms, sometimes by applying pricing criteria and discretionary charges inconsistently across racial lines.[134] Since 2005, more than half of all borrowers issued subprime loans could have qualified for lower-cost mortgages on more favorable terms.[135] These practices persist even though the targeting of neighborhoods of color with loans featuring unfair terms constitutes a violation of the Fair Housing Act.[136]

39. Beyond the substantial impact on individual borrowers,[137] predatory subprime lending results in significant costs to communities of color. Subprime loans are more likely then prime loans to end in foreclosure, and subprime foreclosures have been disproportionately concentrated in low-income and predominantly African American neighborhoods.[138] Foreclosures depress property values[139] and can result in vacancies, which attract crime,[140] drive up insurance rates, and further depress the value of other homes in the neighborhood, reducing local tax revenue for funding essential services such as roads and schools.[141]

40. These lending issues are particularly pertinent given the recent explosion in subprime lending in the United States. Between 1994 and 2005, the annual dollar volume of subprime lending grew from $35 billion to more than $600 billion, representing an increase from 5% to 20% of home-loan originations.[142] Subprime loans account for an estimated 13% of all mortgages currently outstanding, representing approximately $1.28 trillion.[143]

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[132] ACORN, *supra* note 131, at 22-23; BRADFORD, *supra* note 131, at 77.
[133] Fishbein & Bunce, *supra* note 126, at 273, 278-81.
[134] BOCIAN ET AL., *supra* note 130, at 20-22.
[135] Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy*, WALL ST. J., Dec. 3, 2007 (citing recent analysis showing that 55% of subprime loans issued in 2005 went to borrowers with credit scores high enough to qualify for conventional loans with far better terms; this figure rose to 61% by the end of 2006); *see also* BOCIAN ET AL., *supra* note 130, at 7 (citing FANNIE MAE FOUND., FINANCIAL SERVICES IN DISTRESSED COMMUNITIES (2001); FREDDIE MAC, AUTOMATED UNDERWRITING (1996)) (discussing estimates by Federal National Mortgage Association and Federal Home Mortgage Corporation). These estimates are confirmed by the leading national secondary mortgage market institutions. *See* KEN ZIMMERMAN ET AL., N.J. INST. FOR SOC. JUSTICE, PREDATORY LENDING IN NEW JERSEY: THE RISING THREAT TO LOW-INCOME HOMEOWNERS 1 (2002), *available at* http://www.njisj.org/reports/predatory_lending.pdf.
[136] *See* 42 U.S.C.S. § 3604(b); *see also* Hargraves v. Capital City Mortgage Corp., 140 F. Supp. 2d 7, 20 (D.D.C. 2000); Honorable v. Easy Life Real Estate Sys., 100 F. Supp. 2d 885, 887 (N.D. Ill. 2000).
[137] Predatory mortgage lending costs families in the United States about $9.1 billion each year. WEI LI & KEITH S. ERNST, CTR. FOR RESPONSIBLE LENDING, THE BEST VALUE IN THE SUBPRIME MARKET: STATE PREDATORY LENDING REFORMS 2 (2006), *available at* http://www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf.
[138] *See* Fishbein & Bunce, *supra* note 126, at 277; BRADFORD, *supra* note 131, at 78.
[139] A single foreclosure results in an estimated .9% decline in nearby property values. *See* ALMAS SAYEED, CTR. FOR AM. PROGRESS, FROM BOOM TO BUST: HELPING FAMILIES PREPARE FOR THE RISE IN SUBPRIME MORTGAGE FORECLOSURES 6 (2007), *available at* http://www.americanprogress.org/issues/2007/03/pdf/foreclosure_paper.pdf.
[140] A recent study found that a 3% increase in the foreclosure rate corresponds to an increase of neighborhood violent crime of nearly 7%. *See* Jay Bookman, *Foreclosure Damage Spreads Out*, TIMES HERALD-RECORD, Sept. 8, 2007; *see also* Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 16 HOUS. STUDIES 851, 851-66 (2006).
[141] ACORN, *supra* note 131, at 6-7.
[142] Robert B. Avery et al., *Higher-Priced Home Lending and the 2005 HMDA Data*, 84 FED. RES. BULL. 123, 125 (2006).
[143] Justin Lahart, *Why Investors Still Get Caught in Subprime Trap*, WALL ST. J., Feb. 22, 2007.

41. The number of foreclosures in the United States has also been rising during the last few years. In 2006, there were 1.2 million foreclosures nationwide, an increase of 42% from 2005.[144] It has been predicted that the number of foreclosures in 2007 may reach 2 million, or roughly 1 in every 62 American households, a rate not seen since the Great Depression.[145] In July 2007 alone, 179,599 foreclosure notices were sent to property owners.[146] A high percentage of recent foreclosures are in the subprime market,[147] and communities of color have been hit particularly hard.[148] With 10% of African Americans and 8% of Latinos currently at risk of losing their homes, the current foreclosure crisis "could mean the largest loss of wealth for African American and Latino families in the nation's history."[149]

42. Much of the excessive growth in subprime lending over the past ten years can be traced to the federal government's deregulation of the mortgage industry.[150] Many institutions making subprime loans, including mortgage companies and subsidiaries of national banks, are largely unregulated by federal authorities.[151] At present, the federal government has not established uniform standards for regulating mortgage lending institutions.[152] Moreover, the federal government's failure to regulate the secondary mortgage market "lies at the heart of today's mortgage meltdown."[153] Traditionally, the interests of borrowers and lenders have been aligned: if borrowers are unable to repay their debts, lenders generally do not make any money. However, the growth of the secondary mortgage market has enabled mortgage lenders to bundle their loans with other mortgages into securities, which are then sold on a secondary market shortly after the loans are initially made. This securitization of mortgage lending has de-coupled the interests of borrowers and lenders, reducing the incentive for lenders to ensure that borrowers are capable of repaying their loans.[154]

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[144] Andrew Rosenthal, *Can the Mortgage Crisis Swallow a Town?*, N.Y. Times, Sept. 2, 2007.
[145] *Id.*
[146] Patricia Kuo, *Pimco's Gross Urges Bush to Bail Out U.S. Homeowners*, Bloomberg News, Aug. 23, 2007, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=amVRExsd80cA&refer=home.
[147] For example, subprime mortgages accounted for more than half of the of the roughly 310,000 foreclosure proceedings initiated in the fourth quarter of 2006. *See* Ben S. Bernanke, Speech at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition, Chicago, Illinois (May 17, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm. The Center for Responsible Lending estimates that 2.2 million families have lost or will lose their homes as a result of abusive subprime loans, constituting one in every five subprime loans made in 2005 and 2006. *See Legislative Proposals on Reforming Mortgage Practices, Hearing Before the H. Financial Servs. Comm.*, 110th Cong. (2007) (statement of Michael Calhoun, President, Center for Responsible Lending), *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/htcalhoun102407.pdf [hereinafter Statement of Michael Calhoun]. New foreclosures on subprime adjustable rate loans in the second quarter of 2007 were 90% higher than in the previous year. *Id.*
[148] Apgar & Herbert, *supra* note 129, at vii.
[149] Davis, *supra* note 117.
[150] Robert Kuttner, *What's Behind the Sub-Prime Disaster*, Am. Prospect, Aug. 29, 2007.
[151] *Id.*
[152] Nat'l Ass'n of Mortgage Brokers, *Watters v. Wachovia Bank*: Bank Mortgage Lenders Remain Exempt from State Regulation (2007), *available at* http://www.namb.org/Images/namb/GovernmentAffairs/Word_From_Washington/WFW%202007-06%20(Watters%20v.%20%20Wachovia%20Bank).pdf.
[153] Statement of Michael Calhoun, *supra* note 147, at 6.
[154] *Id.*

43. The federal government has made a modest effort to expand access to mortgage refinancing through the Federal Housing Administration,[155] but these efforts are relatively minor. Moreover, beyond holding congressional hearings, the federal government has taken no new efforts to curb predatory lending or to combat the targeting of communities of color by predatory lenders. Despite the current financial crisis, the market is not self-correcting, as "future abuses are inevitable" without government reforms.[156]

Ineffective and Slow Enforcement Fails to Address Discrimination Comprehensively

44. Based on HUD's own data, it is estimated that the United States has approximately 3.7 million fair housing violations annually, and that approximately 2 million involve race discrimination.[157] But in 2006, HUD processed fewer than 11,000 total complaints, encompassing those based on family status, disability, religion, color, race, sex, and national origin discrimination.[158] Thus, less than one-half of 1% of the estimated fair housing violations that occur in the United States result in formal complaints processed by HUD. Of the fair housing complaints received each year, approximately 40% allege race discrimination.[159]

45. A study by the Government Accounting Office ("GAO") evaluated how HUD and state and local enforcement agencies that investigate fair housing complaints treated callers with potential complaints and found much evidence of poor performance.[160] For example, approximately thirty percent of complainants "noted that it was either somewhat or very difficult to reach a live person the first time they contacted a fair housing agency."[161] In addition, more than one-third said they "had difficulty contacting staff after the initial contact."[162] Staff at half of the agencies required complainants to fill out an intake form prior to initiation of any investigation, a process that "could take a week or more—during which the caller could lose a housing opportunity."[163] One test caller who

[155] Steven R. Weisman, *Bush Offers Relief for Some on Home Loans*, N.Y. TIMES, Aug. 31, 2007. Proposed changes to the federal mortgage insurance program will offer relief to approximately 80,000 more homeowners, a very small number considering the current wave of foreclosures. Additionally, although recent legislation approved by a Committee of the United States House of Representatives will provide some relief by reducing tax burdens imposed on victims of foreclosure, such legislation will obviously not do anything to help homeowners who are trying to avoid foreclosure. *U.S. House Panel Backs Tax Relief on Mortgage Debt*, REUTERS, Sept. 26, 2007.
[156] Statement of Michael Calhoun, *supra* note 147, at 9.
[157] NAT'L FAIR HOUS. ALLIANCE, THE CRISIS OF HOUSING SEGREGATION: 2007 FAIR HOUSING TRENDS REPORT 25 (2006) (citing 2004 Fair Housing Trends Report which reported findings from HDS 2000 study).
[158] News Release, U.S. Dep't of Hous. & Urban Dev., Housing Discrimination Complaints at an All-time High (Apr. 3, 2007), *available at* http://www.hud.gov/news/release.cfm?content=pr07-032.cfm.
[159] U.S. GAO, FAIR HOUSING: OPPORTUNITIES TO IMPROVE HUD'S OVERSIGHT AND MANAGEMENT OF THE ENFORCEMENT PROCESS, GAO-04-463, at 73 tbl 7 (2004) [hereinafter GAO 2004].
[160] *See generally* U.S. GAO, FAIR HOUSING: HUD NEEDS BETTER ASSURANCES THAT INTAKE AND INVESTIGATION PROCESSES ARE CONSISTENTLY THOROUGH, GAO-06-79 (2005) [hereinafter GAO 2005].
[161] *Id.* at 16.
[162] *Id.*
[163] *Id.* at 17.

stressed that her situation was urgent was nevertheless told that "filing a complaint was a 'slow process' and that her complaint would not be acted on for some time" regardless of how the intake information was received.[164] The GAO informed HUD that "[t]he time it takes to receive the form can delay the enforcement process, potentially resulting not only in the loss of a housing opportunity but also in complainants becoming frustrated with the process and deciding not to pursue their complaint."[165]

46. Large numbers of complaints that are received by HUD are closed without an investigation to determine whether discrimination has occurred. The GAO could find no explanation as to why, out of a sample of 2,000 complaints that appeared at intake to involve a potential fair housing violation, only 306 became filed or "perfected" complaints.[166] Of the total number of complaints filed with HUD, more than 14% of investigations are closed "administratively," and thus without resolution.[167]

47. In recent years, HUD has found discrimination in remarkably few cases. In nearly half of all cases that are investigated, the agency decides there is no reasonable cause to believe that discrimination has occurred.[168] HUD found reasonable cause to proceed in only 34 cases in fiscal year 2006, down from 88 cases in fiscal year 2001.[169] Only 3.3 percent of all cases filed between 1989 and 2003 resulted in a reasonable cause determination being issued.[170] There are, then, only a miniscule number of cases where HUD has investigated and found that discrimination occurred.[171] State and local agencies have a somewhat better track record than HUD and have found discrimination, or reasonable cause, in seven percent of their cases.[172]

48. Another measure of effectiveness in enforcing the law is whether agencies investigate cases promptly. Although Congress instructed HUD to investigate cases within 100 days unless it is infeasible to do so,[173] in 2001, only 17% of cases were investigated on time by HUD.[174] HUD's Report to Congress for 2006 reported that 1,172 complaints took more than 100 days for HUD to investigate and that 3,940 complaints being handled by state and local agencies took more than 100 days.[175] HUD has taken, on average, over 470 days to close cases.[176]

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[164] *Id.*
[165] *Id.* at 21-22.
[166] *Id.* at 25.
[167] GAO 2004, *supra* note 159, at 75 tbl.10.
[168] *Id.* at 33.
[169] Nat'l Fair Hous. Alliance, The Crisis of Housing Segregation, *supra* note 157, at 32.
[170] Michael H. Schill, *Implementing the Federal Fair Housing Act: The Adjudication of Complaints*, *in* Fragile Rights within Cities, *supra* note 18, at 143, 154, 156 tbl.7.3.
[171] *See* GAO 2004, *supra* note 159, at 34 ("A determination of reasonable cause accounted for the smallest share of outcomes, around 5 percent of all completed investigations.").
[172] *Id.* at 36.
[173] 42 U.S.C. § 3610(a)(1)(B)(iv).
[174] GAO 2004, *supra* note 159, at 37-38. This proportion rose to roughly 50% of the cases in 2003 after a major but temporary initiative. *Id.* at 38.
[175] U.S. Dep't of Hous. & Urban Dev., The State of Fair Housing: FY2006 Annual Report on Fair Housing 33, 35 (2007).
[176] John Goering, *The Effectiveness of Fair Housing Programs and Policy Options*, *in* Fragile Rights within Cities, *supra* note 18, at 253, 261-62.

49. HUD has failed to educate and inform United States residents about their rights and opportunities for redress under the Fair Housing Act. Based on data from HUD-commissioned studies, public knowledge of fair housing law did not improve between 2000 and 2005 despite some efforts by HUD to increase public awareness.[177] More importantly, more than 80% of people who thought that they were the victims of housing discrimination did nothing about it.[178] However, those with more knowledge of federal fair housing law were over two-and-one-half times more likely than those with little awareness to do something about perceived discrimination.[179]

50. HUD provides virtually no educational materials for the general public about fair housing issues, and materials prepared by its grantees are not distributed nationally or made available by HUD to be replicated by other groups. Contrary to the Fair Housing Act,[180] HUD failed to fund a national fair housing media campaign in fiscal years 2005 or 2006 and failed to provide funding to underwrite previous successful media campaigns.[181]

51. Key partners in fair housing enforcement activities are private fair housing groups, which are not government agencies but may be funded by HUD to conduct enforcement and education activities throughout the country. Such groups routinely process at least two-thirds of the nation's fair housing complaints[182] but HUD's Fair Housing Initiatives Program ("FHIP") is woefully underfunded. Although pending legislation calls for appropriating $52 million per year for FHIP,[183] Congressional appropriations for the FHIP program have dropped from a high in 1995 of $25 million to $18.1 million in 2007.[184] HUD's fiscal year 2007 budget lacked funding to create new groups, continue a national media campaign to increase public awareness of fair housing rights and responsibilities, or sustain existing groups, even well-qualified, previously funded groups.[185]

52. HUD's Office of Fair Housing and Equal Opportunity ("FHEO"), the department that is responsible for processing fair housing complaints, has been particularly susceptible to shifting goals and fluctuating funding following partisan changes in Congress and the White House.[186] The level of resources allocated to FHEO, adjusted for inflation, has steadily declined from an all-time high of

[177] MARTIN D. ABRAVANEL, URBAN INST., DO WE KNOW MORE NOW? TRENDS IN PUBLIC KNOWLEDGE, SUPPORT AND USE OF FAIR HOUSING LAW 19 (2006); *see also* Martin D. Abravanel, *Paradoxes in the Fair Housing Attitudes of the American Public, 2001-2005*, *in* FRAGILE RIGHTS WITHIN CITIES, *supra* note 18, at 81, 95-97.

[178] Abravanel, *supra* note 177, at 88 & tbl. 4.2; MARTIN D. ABRAVANEL & MARY K. CUNNINGHAM, URBAN INST., HOW MUCH DO WE KNOW? PUBLIC AWARENESS OF THE NATION'S FAIR HOUSING LAWS 25 (2002); *accord* ABRAVANEL, *supra* note 177, at 35-36. Further, "[a]lmost two of every five people in this situation believed there was no point to responding, that it would not have solved the problem or, in some instances, that it could have made the problem worse." ABRAVANEL & CUNNINGHAM, *supra*, at 27; *accord* ABRAVANEL, *supra* note 177, at 36-37.

[179] ABRAVANEL & CUNNINGHAM, *supra* note 178, at 26-27.

[180] *See* 42 U.S.C. § 3616a(d) (requiring HUD to "establish a national education and outreach program" that includes "public service announcements, both audio and video" and "television, radio and print advertisements").

[181] *See, e.g.*, U.S. Dep't of Hous. & Urban Dev., Fair Housing Ad Campaign, http://www.hud.gov/offices/fheo/adcampaign.cfm.

[182] GAO 2004, *supra* note 159, at 75 tbl.10.

[183] Housing Fairness Act of 2007, S. 1733, 110th Cong. (2007).

[184] U.S. DEP'T OF HOUS. & URBAN DEV., THE STATE OF FAIR HOUSING, *supra* note 175, at 2.

[185] *See* NAT'L FAIR HOUS. ALLIANCE, FHIP FACT SHEET 1-3, http://www.nationalfairhousing.org/resources/publicPolicy/articles/NFHA%20policy%20agenda.pdf.

[186] *See* Mara S. Sidney, *National Fair Housing Policy and Its (Perverse) Effects on Local Advocacy*, *in* FRAGILE RIGHTS WITHIN CITIES, *supra* note 18, at 203, 224-25.

$49.38 million in 1994, and although Congress has increased FHEO appropriations since 2000, these increases have not kept pace with inflation.[187] The number of full-time staff positions has also declined, from a high of 750 in 1994[188] to 598 in 2006.[189] Understaffing and underfunding in FHEO are significant problems, because fair housing enforcement is a staff-based activity involving investigations, interviews, data collection, and analysis.[190] As FHEO's staff levels have fluctuated and well-qualified staff have left or retired, fewer complaints have been processed, delays in resolving cases has increased, and fewer reasonable cause determinations have been made, while new staff has lacked the skills necessary to conduct thorough investigations, and settlement amounts have declined.[191]

53. The DOJ has the authority to initiate enforcement actions based on its own investigations. Despite the long history of housing discrimination in the United States, the DOJ did not implement a Fair Housing Testing Program until 1992,[192] and it still brings relatively few cases based on the results of testing.[193] Although the DOJ filed a total of 15 cases during 1999 and 2000 based on the results of its testing program, the DOJ has filed only 16 such cases from 2001 through 2006.[194] The United States' Periodic Report states that the Civil Rights Division of the DOJ "increased the number of fair housing tests conducted by 38 percent compared to fiscal year 2005,"[195] but it does not state the total number of fair housing tests conducted, where those tests occurred, the current and proposed levels of funding, the number of housing complaints alleging racial discrimination the DOJ received, or what forms and level of discrimination have been found in those cases investigated.

54. The DOJ brought only 31 housing and civil enforcement cases in fiscal year 2006,[196] of which a mere eight involved claims of race discrimination, down from 53 cases in fiscal year 2001[197] and a peak of 194 in 1994.[198] These numbers are clearly insufficient in light of HUD's estimate that over 2 million fair housing violations involving race occur annually.[199]

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[186] U.S. Comm'n on Civil Rights, Funding Federal Civil Rights Enforcement: 2005, at 39 (Sept. 2004), *available at* http://www.law.umaryland.edu/marshall/usccr/documents/cr12f962005draft.pdf.
[187] Nat'l Council on Disability, Reconstructing Fair Housing 207-08 (2001), *available at* http://www.ncd.gov/newsroom/publications/2001/pdf/fairhousing.pdf.
[188] U.S. Dep't of Hous. & Urban Dev., The State of Fair Housing, *supra* note 175, at 15.
[189] Nat'l Council on Disability, *supra* note 188, at 206. Experts estimate that a minimum of 750 full-time staff at FHEO are necessary to deal with the current level of complaints received by HUD. *See Fighting Discrimination Against the Disabled and Minorities Through Fair Housing Enforcement, Hearing Before the H. Subcomm. on Oversight and Investigations, and Subcomm. on Housing and Community Opportunity*, 107th Cong. 63, 73 (2002) (statement of Sara Pratt, Nat'l Council on Disability), *available at* http://commdocs.house.gov /committees/bank/hba82683.000/hba82683_0f.htm.
[190] Nat'l Council on Disability, *supra* note 188, at 210; *see also* Schill, *supra* note 170, at 147-49 (discussing reports concluding HUD enforcement was "plagued by delay and relatively low rates of reasonable-cause findings").
[191] U.S. Dep't of Justice, Hous. & Civil Enforcement Section, Testing Program, http://www.usdoj.gov/crt/housing /housing_testing.htm.
[192] Michael Selmi, *Public vs. Private Enforcement of Civil Rights: The Case of Housing and Employment*, 45 UCLA L. Rev. 1401, 1426 (1998).
[193] *Civil Rights Division Oversight, Hearing Before the S. Judiciary Comm.*, 110th Cong. (2007) (statement of Wade Henderson, President and CEO, Leadership Conference on Civil Rights), *available at* http://judiciary.senate.gov/testimony.cfm?id=2837&wit_id=6546.
[194] *Periodic Report*, *supra* note 103, at ¶ 67.
[195] *Id.*
[197] *Civil Rights Division Oversight, Hearing Before the S. Judiciary Comm.*, supra note 194.
[198] *Initial Report*, *supra* note 23, at 50 ("After the amended Act went into effect, the number of civil fair housing cases brought by DOJ increased from approximately 15 to 20 in the years prior to the 1988 amendments to a peak of 194 cases in 1994.").
[199] Nat'l Fair Hous. Alliance, The Crisis of Housing Segregation, *supra* note 157, at 26.

IV. Recommendations to Facilitate the United States Government's Compliance with CERD

Recommendations for the Department of Housing and Urban Development

55. HUD is required to administer its public housing programs in ways that affirmatively further fair housing and encourage greater residential integration. We recommend that HUD:

- **Encourage and support the development of public and assisted housing outside of areas currently occupied predominantly by people of color.** To ensure that new government assisted housing is not concentrated in segregated areas, HUD should adopt guidelines to encourage applications for developing low income housing in integrated areas, and reject plans for the redevelopment of public and assisted housing in integrated areas that would reduce the total number of existing affordable housing units in integrated areas.[200] Other viable public and assisted housing should also be preserved, in light of the severe housing shortages facing low income families in the United States.[201]
- **Right to return.** At the same time, HUD should support the right of all tenants who wish to return to the site of a redeveloped public housing community.

56. As the only federally-administered program that provides directly for housing mobility, Section 8 has the potential to encourage racial integration. HUD should support voluntary choices by families to move from high-poverty areas to lower-poverty areas; it should also facilitate movement to more integrated communities. We recommend that HUD:

- **Strengthen the portability of vouchers.** HUD should eliminate financial penalties imposed on public housing authorities when families move from one jurisdiction to another. HUD should also abandon rules adopted in 2003 and 2004 that limit Section 8 moves into lower-poverty, higher-rent areas.[202] Finally, HUD should direct public housing authorities in less segregated jurisdictions to absorb into their own voucher programs any voucher recipients seeking to move into such jurisdictions from neighboring areas with higher levels of segregation.[203]
- **Implement and fund a nationwide mobility and counseling program based on the successful Gautreaux Assisted Housing Program in Chicago.** Such a programs should provide voluntary participants with assistance finding housing, as well as carefully designed counseling programs. For example, HUD could reinstate front-end mobility counseling, abandoned in 2002, which

[200] POVERTY & RACE RESEARCH ACTION COUNCIL, STATEMENT OF FAIR HOUSING AND CIVIL RIGHTS ADVOCATES ON HOPE VI REAUTHORIZATION 2 (2007); *see also* Testimony of Dr. Jill Khadduri at 36-38, Thompson v U.S. Dep't of Hous. & Urban Dev., No. 95 Civ 00309 (MJG) (D. Md. Mar. 10, 2006) [hereinafter Khadduri Report].

[201] *See generally A Report to the Committee on the Elimination of Racial Discrimination on Racial Discrimination in Homelessness and Affordable Housing in the United States*, delivered to the U.N. Committee on the Elimination of Racial Discrimination (2007), which is consistent with the principles set out in the present report.

[202] Tegeler, *New Directions for U.S. Housing Policy*, *supra* note 56, at 99.

[203] *See* POVERTY & RACE RESEARCH ACTION COUNCIL, *supra* note 200, at 2; Khadduri Report, *supra* note 200, at 34-35.

advises families how they might use their vouchers to move into low-poverty areas. Second, HUD should combine front-end mobility counseling with additional post-move counseling to assist relocating families in accessing opportunities in their new neighborhoods.[204] Such counseling should be connected to essential services that have been successful in helping individuals find and retain jobs: job-placement programs, foundation and church-supported transportation assistance programs, and childcare assistance.[205]

57. We recommend that HUD substantially improve its system for dealing with complaints of housing discrimination. In particular, we recommend that Congress and HUD:

- Increase the funding and staffing levels for HUD's Office of Fair Housing and Equal Opportunity. Funding for FHEO has not kept pace with inflation, and staff levels within the office are well below the minimum level recommended by experts. Funding and staff levels for FHEO must be increased so that it can investigate and resolve complaints efficiently and effectively.
- Redesign education and outreach programs to address systemic shortcomings in all prior education programs and implement national fair housing media campaigns. HUD must redesign its efforts to make citizens aware of their rights and opportunities for redress under the FHA if HUD's complaint system is to function effectively.
- Increase funding for its Fair Housing Initiatives Program to at least $52 million annually. Fair housing enforcement groups are currently processing more complaints and conducting more investigations than HUD is, but inadequate funding is available for them to process so many complaints. Funding for FHIP should be increased significantly, to at least the $52 million appropriation in pending legislation.[206]
- Consider establishing a new, independent agency to conduct fair housing enforcement activities, including the operation of the FHIP program, the development of new national education and outreach materials, and the investigation of individual and systemic complaints. Given the poor performance of HUD in accepting and investigating complaints, creation of a new enforcement agency should be part of the public policy agenda of the United States.

Recommendations for the Department of Justice

58. As the principal legal authority tasked with enforcing federal fair housing laws, the DOJ should do more to combat illegal discrimination by private actors in the housing market. We recommend that the DOJ:

- Increase resources dedicated to investigating and prosecuting steering. The United States' Periodic Report highlights its efforts to increase testing for discrimination, but such enhanced efforts must result in concerted action. The DOJ must greatly increase the number of race-based housing and civil enforcement cases it files to ensure that the violations discovered through the testing program are remedied.

[204] PHILIP TEGELER, CONNECTING FAMILIES TO OPPORTUNITY: THE NEXT GENERATION OF HOUSING MOBILITY POLICY (citing Xavier de Souza Briggs & Margery Austin Turner, *Assisted Housing Mobility and the Success of Low-Income Minority Families: Lessons for Policy, Practice, and Future Research*, 1 NW J.L. & SOC. POL'Y 25, 40 (2006)), *in* ALL THINGS BEING EQUAL: INSTIGATING OPPORTUNITY IN AN INEQUITABLE TIME 3-5 (Brian Smedley & Alan Jenkins eds., 2007).
[205] *Id.*
[206] Housing Fairness Act of 2007, S. 1733, 110th Cong. (2007).

- **Investigate and prosecute cases of lending discrimination.** The DOJ should prosecute cases against mortgage lenders who engage in discriminatory practices. The federal government is better situated than are private individuals to litigate discriminatory lending cases, which are typically class actions that require complicated statistical analyses to account for the many variables used in making loan determinations.[207]

Recommendations for the United States Congress

59. As currently administered, the Low Income Housing Tax Credit is not expressly required to comply with federal fair housing policy, and it perpetuates residential segregation. Thus, we recommend that Congress:
    - **Incorporate explicit fair housing standards into the LIHTC statute.** Congress should encourage project siting that furthers fair housing goals and create incentives that promote economic and racial diversity. Examples include the prioritization of developments in areas with low crime rates and well-resourced, low-poverty schools, and the establishment of set-asides for voucher recipients in new LIHTC developments in high-opportunity neighborhoods.[208]
    - **Direct the Internal Revenue Service and HUD to collect data regarding the race and economic status of applicants and residents in LIHTC developments.** Such mandates should include the collection and reporting of racial and economic data about project residents and applicants.[209]

60. The federal government must address the targeting of communities of color by predatory lenders. To that end, we recommend that the United States Congress:
    - **Enact robust anti-predatory lending legislation.** Congress should adopt several reforms to curtail discrimination in the mortgage market and prevent predatory lending, including but not limited to: uniform pricing standards for all mortgage lending institutions;[210] licensing and registration requirements for mortgage brokers; a prohibition on financial incentives for brokers to steer borrowers towards subprime loans; the establishment of a duty of care owed by mortgage originators to borrowers; a requirement that creditors make a determination based on verifiable documentation that applicants have an ability to repay their loans; the elimination of prepayment penalties for subprime loans;[211] and a requirement that subprime lenders recommend

[207] *See* Selmi, *supra* note 195, at 1425. An example of a successful mortgage discrimination case brought by the federal government is *United States v. Decatur Federal Savings & Loan Association*, No. 92 Civ. 2198 (N.D. Ga. Sept. 17, 1992). In *Decatur Federal*, the DOJ determined that, although the defendant bank had operated since 1927 in Atlanta, a city with a large African American population, 97% of its mortgage loans were made in majority white census tracts; after conducting a market-share analysis, DOJ determined that these severe racial imbalances were statistically significant and could not be explained by socioeconomic differences between white and African American neighborhoods. *See* Richard Ritter, *The Decatur Federal Case: A Summary Report*, in MORTGAGE LENDING, RACIAL DISCRIMINATION, AND FEDERAL POLICY 447-48 (John Goering & Ron Wienk eds., 1996). The complex analyses that were involved in bringing this action demonstrate the need for federal resources to prosecute lending discrimination cases successfully.

[208] Tegeler, *New Directions for U.S. Housing Policy*, *supra* note 56, at 100-01.

[209] Such recordkeeping is routine for HUD-administered projects but is not yet followed in the LIHTC program. *See* ABT REPORT 2003, *supra* note 51; *see also* Tegeler, *New Directions for U.S. Housing Policy*, *supra* note 56, at 100.

[210] BOCIAN ET AL., *supra* note 130, at 24.

[211] *See* Statement of Michael Calhoun, *supra* note 147, at 10-17.

that applicants avail themselves of mortgage counseling.[212] However, Congressional remedies should not preempt more stringent state government regulations.[213] Furthermore, Congress should strengthen proposed legislation by establishing more potent remedies for violations of the duty of care and the prohibition on steering, and by creating assignee liability for mortgages sold on the secondary market, to realign the interests of borrowers and debt holders.[214]

Recommendations for State and Local Governments

61. Integrated schools lead to more integrated neighborhoods. To that end, we recommend that state and local governments:

    - Pursue alternative means to promote school integration. "[R]esearch . . . strongly shows that graduates of desegregated high schools are more likely to live in integrated communities than those who do not, and are more likely to have cross-race friendships later in life."[215] The United States Supreme Court's recent decision regarding school integration restricted, but did not prohibit, school districts from using voluntary integration plans or other narrowly-tailored, race conscious measures to create racially diverse schools. Therefore, districts should find creative ways to maintain integrated schools, including strategic site selection of new schools and the drawing of attendance zones with consideration of neighborhood demographics.[216]

62. Exclusionary zoning creates and maintains patterns of residential segregation. Therefore, we recommend that state and local governments:

    - Curb exclusionary zoning. State governments should impose state-wide limits on local land use laws that exclude affordable housing, and encourage local governments to prohibit the use of zoning laws to exclude traditional victims of discrimination and people who are not United States citizens.[217]

    - Adopt inclusionary zoning ordinances. States should mandate that municipalities adopt zoning ordinances that require a certain amount of affordable housing in new developments to provide more racially and economically integrated affordable housing opportunities.

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[212] Programs that advise borrowers as they choose between mortgages have been "the most effective tool for helping minority and lower-income families become successful homeowners." ACORN, *supra* note 131, at 12.
[213] *Id.*
[214] *See* Statement of Michael Calhoun, *supra* note 147, at 7-8, 17.
[215] Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1, 426 F.3d 1162, 1175 (9th Cir. 2005) (emphasis added), *rev'd*, 551 U.S. ___, 127 S. Ct. 2738 (2007); *see also* Amy Stuart Wells & Robert L. Crain, *Perpetuation Theory and the Long-Term Effects of School Desegregation*, 64 REV. EDUC. RES. 531, 531-52 (1994) (reviewing studies finding students in integrated schools more likely to have cross-racial social relationships later in life and concluding "interracial contact in elementary or secondary school can help blacks overcome perpetual segregation").
[216] *See* Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1, 127 S. Ct. at 2791-92 (Kennedy, J., concurring in part and concurring in the judgment).
[217] *See* U.N. Comm. on the Elimination of Racial Discrimination, Jan. 10, 2004, General Recommendation 30, Discrimination against non citizens (Sixty-fourth session, 2004), ¶ 32, U.N. Doc. CERD/C/64/Misc.11/rev.3, *available at* http://www1.umn.edu/humanrts/gencomm/genrec30.html ("Guarantee the equal enjoyment of the right to adequate housing for citizens and non-citizens, especially by avoiding segregation in housing and ensuring that housing agencies refrain from engaging in discriminatory practices.").

V. Conclusion

63. Residential segregation in the United States today is not merely the product of private action or consumer "choice." Rather, it was created in large measure as a result of explicitly exclusionary government programs, policies, and practices. The high level of residential segregation is perpetuated by acts of private discrimination and by governmental policies that discourage mobility and develop low-income housing primarily in higher poverty areas and communities with little opportunity for integration.

64. The United States' Periodic Report fails to account for the United States government's history of contributing to residential segregation, the manifold ways that United States policy maintains racial isolation today, and the many failures of the government to take adequate measures to combat private acts of racial discrimination in the housing market. Given the extremely high levels of residential segregation that still exist in America, the estimated 2 million fair housing violations on the basis of race that occur annually, and the ongoing crisis in predatory and subprime lending that puts millions of homeowners at risk of foreclosure, the need for the United States to fulfill its obligations under CERD is more pressing than ever.

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Table of Contents

Introduction

On April 4, 1968, the Rev. Dr. Martin Luther King, Jr., was assassinated, unleashing a firestorm of civil unrest in urban communities across the nation. His murder demonstrated that we were still a nation divided by race—in our neighborhoods, our schools, our workplaces, and our places of worship. It revealed with alarming clarity that race was a pungent, debilitating force that must be addressed. A week to the day after Dr. King's assassination, President Lyndon Johnson signed into law the federal Fair Housing Act (Title VIII of the Civil Rights Act of 1968). The law, co-sponsored by Senators Walter Mondale and Edward Brooke, had been languishing in Congress for two years; it passed only in response to the assassination and subsequent events. Many people forget that Dr. King focused heavily on fair housing issues with a keen recognition of what costs our society would pay for continued patterns of segregated living. Passage of the Fair Housing Act was a fitting, if inadequate, tribute to his memory.

As laws go, the Fair Housing Act better represented the intent of Congress that we achieve "truly integrated and balanced living patterns" than the practical necessities of achieving such patterns. Given the centuries-old practices of discrimination and denial of opportunity, founded in a legacy of slavery and government policy, the law was only a starting point in our nation's efforts to achieve equal housing. It relied primarily on voluntary compliance and private enforcement of its mandates.

In 1988, the law was amended by the Fair Housing Amendments Act, co-sponsored by Senators Edward Kennedy and Arlen Specter. This law significantly strengthened the enforcement powers of the Act, giving the Departments of Housing and Urban Development and Justice the authority and mandate to enforce the expanded and comprehensive requirements of the law while still providing for a private enforcement mechanism. The Fair Housing Act is now one of the most powerful tools in our civil rights arsenal. But a tool is only effective when wielded with skill and intent, and this report documents a failure on the part of the federal government to wield this tool effectively.

This year, we commemorate the fortieth anniversary of the Fair Housing Act and the twentieth anniversary of the Fair Housing Amendments Act. We commemorate, not celebrate, because we are still so far from achieving the balanced and integrated living patterns envisioned by the original Act's authors. While we have made some progress in reducing levels of residential segregation, most Americans live in communities largely divided by race and ethnicity. There are at least *four million* acts of housing discrimination every year. And we are on the brink of an economic crisis fueled by a failed subprime lending market, a market built primarily on borrowers and neighborhoods of color. The current foreclosure crisis is the embodiment of a history of discrimination in housing, lending, and insurance markets and reeks of both the complicity and failure of the federal government.

This report provides insight into our nation's struggles to achieve the benefits of living in richly diverse communities. We have come only a small way in attaining those benefits and must rededicate ourselves with intensity and determination to make fair housing a reality for all.

Executive Summary

The current foreclosure crisis is, at its core, the largest fair housing and civil rights issue facing our nation today. It is a manifestation of a history of discrimination and segregation and threatens to wipe out many of the advances we have made in the forty years since the passage of the Fair Housing Act in 1968. Section I of this report tells the story of how the subprime foreclosure crisis came about, what role discrimination and segregation played in its development, and what impact it will have on the already disadvantaged communities it has hit hardest. We reach an unimpeachable verdict on the following two propositions. First, the subprime foreclosure crisis has greatly contributed to problems we are facing as a nation. Second, the subprime crisis has been an unmitigated disaster for minority communities.

Forty years after the passage of the Fair Housing Act, there are more than 3.7 million instances of discrimination each year against African-Americans, Latinos, Asian Americans, and American Indians in rental and sales markets.[1] It is crucial, however, to point out that this estimate of annual aggregate fair housing violations is *extremely* conservative. For it does not seek to reflect discrimination against persons with disabilities—the group that files the highest number of complaints with HUD each year—nor discrimination on the basis of religion, sex, color, familial status or other ethnicities. It also does not reflect discrimination in the following areas: lending, insurance, planning, and zoning or racial and sexual harassment. The number does not include instances of linguistic profiling (discrimination on the telephone), discrimination via the internet, or discrimination when applications are filed or when people already occupy a residence. So, **we can easily estimate the annual incidence of discrimination to exceed four million** and can only wonder and worry about how much more there might be.

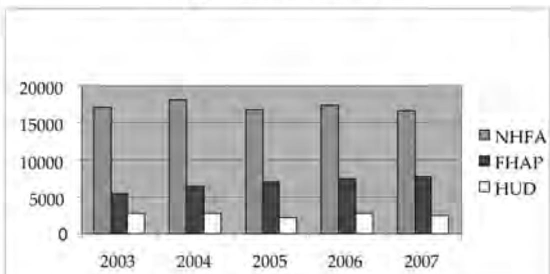
Testing programs have documented extensive and systemic patterns of discrimination in rental, real estate sales, mortgage lending, and homeowners insurance markets. Recent testing has identified continued racial steering by real estate agents and a failure of

[1] For the basis of this estimate, see NFHA's 2004 *Trends Report*, which reports findings from a study of Housing Discrimination Study 2000 data by John Simonson, University of Wisconsin – Platteville.

builders of multi-family housing to comply with design and construction standards that are now twenty years old. Section II provides information about the current state of fair housing and issues of particular concern in 2007, including the failure of Community Development Block Grant recipients to affirmatively further fair housing, discrimination on the basis of religion by an insurance company, use of credit scores as a proxy for race, and continued failures in the Gulf Coast that prevent a meaningful recovery for all of its residents, particularly those in classes covered by the federal Fair Housing Act.

In 2007, there were 27,023 complaints of housing discrimination. The number of complaints filed, however, still represents **less than one percent of the annual incidence of discrimination.** The total number of complaints has been fairly consistent over the past five years. *Private fair housing organizations continue to process more than 60 percent of the complaints*, despite the fact that over the past five years more than 25 organizations have closed or been on the brink of closing and survive with drastic reduction in staff.

Housing Discrimination Complaints



A large preponderance of complaints concern rental housing practices, as discriminatory practices in real estate, mortgage lending, and homeowners insurance transactions are difficult for home seekers to identify and few private fair housing agencies have staff available to address these complex areas. This highlights the need for comprehensive examination of these housing market sectors by the Department of Housing and Urban Development and the Department of Justice. Section III provides more detailed information about fair housing complaints filed with both public and private fair housing organizations.

One of the obvious reasons for continued high levels of discrimination is the failure of the Administration to request sufficient funding, the failure of Congress to allocate sufficient resources, and the failure of HUD and DOJ to effectively enforce the Fair Housing Act. Section IV highlights how the fair housing enforcement system has failed to fulfill this nation's mandate to eliminate discriminatory housing practices. HUD's efforts are characterized by inconsistent case processing standards, inadequate knowledge of legal standards and case law, and inability to process cases even remotely within the time frame required by law. The Department of Justice brings few cases each year, brings few race-based cases despite the incidence of racial discrimination and segregation, and in recent years has adopted policies that inhibit even further its ability to effectively enforce the Fair Housing Act.

Private fair housing organizations shoulder the greatest burden of fair housing education and enforcement activities in the United States, but their efforts are constrained by inadequate and inconsistent funding. HUD's Fair Housing Initiatives Program is the primary source of funding for many fair housing organizations. In the past five years, twenty-six private fair housing organizations have closed their doors or are in danger of closing. Funding streams are compromised by HUD's inconsistent methods of awarding grants, as well as awarding grants to organizations without the expertise or qualifications to provide fair housing education or enforcement services, at the expense of existing, full-service agencies.

These failures to enforce the Fair Housing Act have resulted in continued patterns of residential segregation based on race and ethnicity. Those patterns are costly to segregated communities and to the nation as a whole, as summarized in Section V. Unemployment levels for African-Americans and Latinos are significantly higher than for Whites, due in large part to the mismatch between the location of employment centers and minority neighborhoods. Children in segregated minority neighborhoods go to schools with significantly fewer resources and programs, have lower scores on performance tests, and graduate with alarmingly less frequency than students who attend predominantly White schools. There are significant adverse consequences for the health of persons residing in minority neighborhoods. People in communities of color have access to fewer health care facilities and physicians and their treatment is often characterized by a lower standard of care.

Our nation needs a host of changes in order to fully address discrimination and reduce segregation. This report contains several recommendations (Section VI), most important of which are that we need an independent fair housing enforcement agency, additional funding for fair housing education and enforcement programs, improved case processing by HUD and DOJ, regulatory changes to address unfair and predatory lending practices, and a more just and transparent process of implementing recovery efforts in the Gulf Coast region of the United States.

This report documents a problem too costly for our country to ignore. We can no longer tolerate housing discrimination and the persistence of segregated neighborhoods. The federal Fair Housing Act can help take us closer to our goal of balanced and integrated living patterns but only if it is utilized as the excellent tool that it is. As we commemorate the fortieth anniversary of the passage of this critical civil rights legislation, we must renew our commitment as individuals and a nation to creating the vibrant, diverse communities envisioned by Dr. Martin Luther King, Jr.

About the National Fair Housing Alliance
Founded in 1988 and headquartered in Washington, DC, the National Fair Housing Alliance is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Through comprehensive education, advocacy and enforcement programs, NFHA protects and promotes equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

Section I: Discrimination and the Inevitable Foreclosure Crisis

The subprime lending/foreclosure crisis is, finally, impossible to ignore. What has largely been relegated to the Business and Metro sections of many newspapers in recent years has now morphed into a bona fide financial crisis, with the danger of triggering a full-fledged economic crisis. Front pages of the world's most prominent newspapers are now awash with retrospectives and prognostications, diagnoses and warnings. Bear Stearns, not long ago worth $25 billion, was on the verge of being sold in March 2008 for just under $1.2 billion. And the Federal Reserve has already taken unprecedented action to grease the wheels of the nation's financial markets by risking taxpayers' money for mortgage-backed assets whose true value (if any) no one can be sure of. No one is quite sure how all this will play out, although it is safe to say that there are some extremely rocky times ahead.

But before all the recent drama unfolded, the roots of this crisis were apparent to those who pay at least as much attention to Main Street as they do to Wall Street. And for those who are acquainted with the streets of America's minority communities, the writing was clearly on the wall. Indeed, many housing scholars and activists, as well as advocates for minority communities, had been speaking of a subprime foreclosure crisis long before investors were experiencing wobbly knees. Yet because, at that time, the crisis was "only" affecting a narrow segment of the population, it received a fraction of the attention it is now getting.

Unfortunately, this suggests that there is some danger that now that the nation's financial and political elites are in "crisis mode," the families and communities who are victims of the subprime problem will fade into the background without ever having had their story told. And with the foreclosure crisis now moving "upmarket," as economist Dean Baker puts it, many will conclude that nothing especially problematic occurred within the subprime market. For those in the prime market are starting to feel the pinch too. But the ills of the subprime market cannot be chalked up to economic storms in which we have all been caught and which we must each weather using whatever resources we can muster. The subprime mortgage crisis was not and is not a purely natural phenomenon. Like the weather, it was foreseeable; unlike the weather, it was entirely avoidable.

The origins of the subprime foreclosure crisis can be found, in large part, in the ongoing racial discrimination and segregation whose roots reach back to the discriminatory social, financial and government policies of the early twentieth century. By the late 1960s, these forces had led to the creation of many communities of color beset by poverty, poor education, overcrowding, and dislocation from jobs and financial services. And despite the passage of the federal Fair Housing Act forty years ago in 1968, anemic fair housing enforcement has left the door open to predatory and abusive lenders who have little incentive to ensure that their underwriting practices lead to sustainable homeownership. Finally, in its shortsighted search for ever higher profits, Wall Street and hard money lenders were willing to overlook these practices by keeping its eye on the dollar signs that preceded abusive fees and the percentage signs that preceded predatory interest rates. Content that mortgage brokers were simply doing their job and confident that rising house prices would keep newly minted homeowners afloat, investors continued to send funds into minority neighborhoods—until, that is, the house of cards came crashing down.

This section of the report tells the story of how the subprime foreclosure crisis came about, what role discrimination and segregation played in its development, and what impact it will have on the already disadvantaged communities it has hit hardest. As for the larger financial and/or economic crises now gripping the nation, we do not argue that the problems in the subprime sector are the sole cause of our wider current economic woes. In many respects, the economic jury is still out on that question. But we do have an unimpeachable verdict on the following two propositions. First, the subprime foreclosure crisis has greatly contributed to problems we are facing as a nation. Second, the subprime crisis has been an unmitigated disaster for minority communities.

A History of Discrimination and Segregation

The Influx of Migrant Blacks to the North

The story of the subprime mortgage crisis in many ways begins at least as far back as the early 1900s. The relevant history is both complicated and bleak, but the key elements for the purposes of this report are these. According to housing scholar and historian Douglas Massey, who co-authored the landmark 1993 fair housing book *American Apartheid*, there was a short time after the Civil War when "it seemed that Blacks might actually assume their place as full citizens of the United States."[2] However, as industrialization increased in the North, the demand for migrant Blacks also increased, often due to their usefulness as strike breakers. "Poor rural Blacks with little understanding of industrial conditions and no experience with unions were recruited in the South and transported directly to northern factories…"[3] So the northern migration by Southern Blacks was looked upon as an effective way to satisfy industrial needs.

The Emergence of Especially Harsh Racism

In combination with their reaction to this new threat posed by a migrant Black population, plain old (re-)emergent racism on the part of White unions gave rise to

[2] Douglas S. Massey, "Origins of Economic Disparities: The Historical Role of Housing Segregation," in James H. Carr and Nandinee K. Kutty, eds., *Segregation: The Rising Costs for America* (New York: Routledge, 2008), pp. 39-80, p. 40.
[3] Ibid., p. 48.

"unusually severe discrimination," including the exclusion of Blacks from the skilled-craft unions, and the relegation of Blacks to the least lucrative contracts and jobs. As Blacks responded to this mistreatment by crossing more picket lines, a "cycle of mutual hostility and distrust" was entrenched, fueled by ever more increases in the Black population as a result of agricultural downturns in the South and the start of a labor-intensive war mobilization in 1914.[4]

As the years passed, these racist attitudes became more prevalent and their manifestations, including violence and destruction of property (often with dynamite), became more insidious, and "by World War II the foundations of the modern ghetto had been laid in virtually every northern city."[5] If there was any good news to be had it was that many had turned away from violence during the 1920s,[6] fearing legal action; the bad news is unsurprising: many Whites diverted their energies into establishing discriminatory housing and zoning policies designed to insulate "their" neighborhoods from Black residents. Various "neighborhood improvement associations" worked to win zoning restrictions that would fall hardest on Blacks, threatened to boycott real estate agents who were willing to work with Blacks, and sought to increase property values so they'd be within the reach of only Whites. Contracts, known as "restrictive covenants," were drawn up between members of a neighborhood so that White residents were legally bound to refrain from selling or renting to prospective Black residents.[7]

The Role of Real Estate Agents and Associations

A central player in the establishment and perpetuation of segregated cities was the real estate industry. Many local real estate boards worked to establish restrictive covenants, while an early incarnation of the national real estate association adopted an article in its code of ethics which held that "a Realtor should never be instrumental in introducing into a neighborhood…members of any race or nationality…whose presence will clearly be detrimental to property values in that neighborhood."[8] Taking a perhaps more financially lucrative tack, many real estate agents engaged in "blockbusting," the practice of scaring White homeowners out of a neighborhood with rumors and actions suggesting that the neighborhood was ripe for "racial turnover," and then buying properties cheaply from Whites and selling them for higher prices to incoming Blacks.

[4] Ibid.
[5] Ibid., p. 50.
[6] One tragic exception is the story of Dr. Ossian Sweet (among others). See *One Man's Castle: Clarence Darrow in Defense of the American Dream* by Phyllis Vine.
[7] Douglas S. Massey and Nancy A. Denton, *American Apartheid* (Cambridge: Harvard University Press, 1993), p.36ff.
[8] Massey, "Origins of Economic Disparities," op. cit., p. 56.

The Role of the Federal Government

It wasn't long before the government got in on the act. One example was the Home Owners Loan Corporation (HOLC), established in 1933 in response to the foreclosure crisis associated with the Depression. HOLC utilized a discriminatory risk rating system whereby prospective borrowers were favored if their neighborhood was deemed "new, homogeneous, and in demand in good times and bad."[9] Properties would be ranked low (and thus judged high-risk) if they were "within such a low price or rent range as to attract an undesirable element," which often meant that they were located near a black neighborhood.[10] The so-called "Residential Security Maps" used to make these classifications labeled the lowest ranking neighborhoods "fourth grade," and shaded them in red. According to housing scholars William J. Collins and Robert A. Margo, "the agency's revisions were unprecedented. Private financial institutions incorporated the new rating system in their own appraisals, thereby beginning the widespread institutionalization of the practice known as 'red-lining.'"[11]

As discriminatory policies and practices continued to persist within the real estate sector—one study in 1969 identified 46 separate tactics used by agents to keep Blacks out of White neighborhoods—private banks began to adopt the underwriting guidelines established by the federal government in the HOLC program. Finally, the HOLC risk rating system came to inform the federal government's Federal Housing Administration (FHA) and Veterans Administration (VA) loan programs in the 1940s and 1950s. The FHA made it possible to purchase a house with just a 10 percent down payment, as opposed to the customary 33 percent required before its establishment. Loan terms were also extended from 25 to 30 years. The VA program provided similar benefits, all while following FHA in rating properties in large part on the basis of the "stability" and "harmoniousness" of neighborhoods.[12] "If a neighborhood is to remain stable, it is necessary that properties shall continue to be occupied by the same racial and social classes. Changes in social or racial occupancy contribute to neighborhood instability and the decline of value levels."[13] To implement this policy, the FHA even went so far as to *recommend* the use of restrictive covenants to ensure neighborhood stability.[14]

The notion that race had a direct impact on property values was broadly adopted by the appraisal industry, and appraisers were trained to evaluate properties using race as a

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[9] Ibid., p. 69.
[10] Ibid.
[11] William J. Collins and Robert A. Margo, "Race and Homeownership, 1900-1900," available at: http://eh.net/Clio/Conferences/ASSA/Jan_00/margo.shtml.
[12] Massey, "Origins of Economic Disparities," op. cit., p. 71-72.
[13] Frederick Babcock, Director of FHA Underwriting Division, "Techniques of Residential Location Rating," *Journal of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards*, v. VI, n. 2 (April, 1938), p. 137.
[14] Massey, "Origins of Economic Disparities," op. cit., p. 71-72.

factor. McMichael's Appraising Manual, for example, provided the following ranking of race and nationality by impact on real estate values (in order of preference):[15]

1. English, Germans, Scotch
2. North Italians
3. Bohemians or Czechs
4. Poles
5. Lithuanians
6. Greeks
7. Russians, Jews (lower class)
8. South Italians
9. Negroes
10. Mexicans

Such lists remained in appraisal manuals long after the Fair Housing Act was passed in 1968.

Similar policies were employed in the insurance industry, as homeowners insurance companies adopted policies that resulted in either the outright denial of insurance in minority neighborhoods or the availability only of policies that provided inadequate protection at excessive cost to consumers.

Given the prevalence of race-based standards in appraisals, insurance, and government mortgage lending programs, it comes as no surprise that private banking and savings institutions also refused to offer mortgage loans in communities of color and integrated communities. *Even after passage of the Fair Housing Act, these practices received tacit approval from the federal banking regulatory agencies. It was not until 1976, when a coalition of civil rights groups sued them for failing to enforce the Fair Housing Act, that the federal banking regulatory agencies even acknowledged that they had any enforcement responsibilities under the Act.*[16] The settlement required the agencies to collect information on the mortgage lending practices of the institutions they regulated, and to establish and implement fair lending examination procedures.

Discrimination and Segregation Led to Civil Unrest

The FHA and VA programs, in combination with declining housing construction costs, quickly led to vast White suburbanization and the abandonment of urban centers. These urban centers increasingly grew to be predominately African-American communities. During the 1950s and 1960s, federal "redevelopment" and "urban renewal" programs were used to eliminate "urban blight" by razing neighborhoods and Black-owned

[15] McMichael's Appraising Manual, 4th Edition, 1951.
[16] *National Urban League et. al. v. Office of the Comptroller of the Currency, et al*, 1976

businesses. Many homeowners were relocated just blocks away in neighborhoods Whites had abandoned, and low income Black families were relocated to newly constructed public housing that was pushed into the middle of the Black community, thereby stalling encroachment of Black families into White areas.[17] By the 1960s, these policies and practices of segregation and isolation were accompanied by police brutality, while employment and voting rights violations bred fuming resentment that erupted in violent civil unrest.

Current Segregation in the United States

The story of housing segregation and discrimination since those fateful years of the 1960s is, in many ways, a disappointing one. To be sure, some improvements have been made since the federal Fair Housing Act was enacted in 1968 following the landmark events of that year. According to the U.S. Census Bureau, which follows other social scientists in measuring segregation along five different dimensions,[18] "All five measures of segregation indicate a [nationwide] reduction in residential segregation of Blacks [from non-Hispanic Whites] between 1980 and 1990, and a further reduction between 1990 and 2000."[19] Moreover, on the single most widely used index of segregation, dissimilarity, "only 8 of 220 metropolitan areas had an increase in residential [Black-White] segregation between 1980 and 2000, while 203 metropolitan areas had a decrease."[20] And in a neighborhood-level analysis of 69 of the largest metropolitan areas (25,134 neighborhoods), researchers at the Urban Institute found that the share of these neighborhoods that was "exclusively White"—i.e. less than 5 percent Black—fell from 65 percent in 1980 to 56 percent in 1990 and then to 47 percent in 2000.[21]

Still, America remains a significantly segregated country. Relying on the same neighborhood-by-neighborhood analysis, the Urban Institute's analysts found that "among neighborhoods that were exclusively White in 1990, 81 percent remained so in 2000, while 15 percent shifted into the *predominantly White* category [i.e. 5 to 10 percent Black population]." Meanwhile, virtually all—over 90 percent—of the neighborhoods that were predominantly or exclusively Black in 1990 were predominantly or exclusively Black in 2000.[22] It is therefore no surprise that while the typical White resident of a metropolitan area lives in a neighborhood that is 80.2 percent White, 6.7 percent Black,

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[17] Massey and Denton, *American Apartheid*, op. cit., p. 56.
[18] These are: evenness (dissimilarity), exposure, concentration, centralization, and clustering.
[19] U.S. Census Bureau, *Racial and Ethnic Residential Segregation in the United States*: 1980-2000 (August 2002), p. 59. Available at http://www.census.gov/hhes/www/housing/housing_patterns/pdf/ch5.pdf.
[20] Ibid., p. 64.
[21] Rawlings, L., et. al., "Race and Residence: Prospects for Stable Neighborhood Integration," in *Neighborhood Change in Urban America*, n. 3 (March 2004), p. 2. Available at http://www.urban.org/uploadedpdf/310985_NCUA3.pdf.
[22] Ibid., p. 3.

7.9 percent Hispanic and 3.9 percent Asian, the typical Black resident lives in a neighborhood that is 51.4 percent Black, 33 percent White, 11.4 percent Hispanic, and 3.3 percent Asian.[23] And while segregation has declined by over 12 percent in metropolitan areas which have less than five percent Black population, the decline in metropolitan areas with a Black population of 20 percent or more has been only about half that.[24]

These findings confirm that there is an ongoing crisis of segregation in America. While segregation does seem to be declining on some dimensions nationwide, it is declining very slowly, and indeed increasing in some areas. America's metropolitan areas remain far more segregated than they were in 1980, almost a decade before the Fair Housing Amendments Act of 1988, which expanded the fair housing enforcement powers of both the Department of Housing and Urban Development and the Justice Department.

Bifurcated Financial Service System

In addition to residential segregation, Americans still experience differential access to mainstream financial institutions on the basis of race. Housing experts Kathleen C. Engel and Patricia A. McCoy write that "When people of color are in the market for home loans, they often do not look beyond subprime lenders and mortgage brokers." One reason for this, they argue, is a "lingering mistrust of banks" that developed as members of that community experienced past discrimination by banks when anti-discrimination laws were not adequately promulgated or enforced.[25]

In fact, discriminatory treatment of people of color and members of other protected classes continued even after such actions became illegal under the federal Fair Housing Act.[26] For example, at the request of civil rights groups, in the early 1970s federal banking regulators surveyed the industry about its underwriting practices; a surprising number of institutions acknowledged using prohibited bases in their mortgage lending decisions. Another factor contributing to minorities' patronage of subprime lenders is the failure of regulated depository institutions (banks and thrifts) to develop appropriate lending products and market them effectively and aggressively in communities of color. Additionally, many banks and thrifts simply did not open branches in Black neighborhoods. In recent years this has left a vacuum that has been filled by subprime and payday lending.[27]

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[23] "Ethnic Diversity Grows, Neighborhood Integration Lags Behind," *Report by the Lewis Mumford Center* (April 2001), p. 3. Available at http://mumford.albany.edu/census/report.html.
[24] Ibid., p. 4.
[25] Kathleen C. Engel and Patricia A. McCoy,"From Credit Denial to Predatory Lending," in *Segregation: The Rising Costs for America*, op. cit., p. 93.
[26] See, for example, the *National Urban League et al. v. Office of the Comptroller of the Currency, et al.*
[27] James H. Carr and Nandinee K. Kutty, "The New Imperative for Equality," in *Segregation: The Rising Costs for America*, op. cit., pp. 1-38, p. 20.

In the decades since the passage of the Fair Housing Act, a number of other laws have been passed that are designed to increase access to mortgages and other types of credit for members of protected classes and low and moderate income consumers. These include the Equal Credit Opportunity Act (ECOA), the Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA). Collectively, these laws have provided important information for tracking mortgage market patterns, endowed numerous federal government agencies with responsibility for overseeing the lending practices and activities of many lending institutions, and created tools for enforcing fair lending compliance. Over the decades, some progress has been made in changing the way mainstream lending institutions view historically underserved communities. Private enforcement actions have provided some of the impetus for this change, as has public policy, on occasion. For example, in the 1990s during the Clinton Administration, CRA enforcement was stepped up and the Department of Justice played a more active role in fair lending enforcement. But, as we will see, the commitment to vigorous enforcement has been sporadic, and the regulatory structure has not kept pace with the changes in the mortgage lending industry. The result is that communities of color have been left vulnerable to exploitation and abuse.

The Context for the Current Crisis

The current crisis arises from the confluence of several trends in the mortgage market that have unfolded over the last decade and a half. These include the increased reliance on technology in mortgage originations, the restructuring of the mortgage lending industry, and the explosion of subprime lending fueled by innovations on Wall Street.

The impact on the mortgage industry of technological advances in computers and data management cannot be overstated. Twenty years ago, most mortgage loans in this country were underwritten manually. This meant that a person reviewed the information collected by the loan officer and made a decision about whether or not to approve the loan based on the credit history of the applicant and the appraised value of the property. This system allowed for wide variations in underwriting standards and how they were interpreted, often to the detriment of members of classes protected by the federal Fair Housing Act.

Automated Underwriting and Credit Scores

In the mid-1990s, this system began to change, largely at the behest of Fannie Mae and Freddie Mac – the government-sponsored enterprises (GSEs) which are the secondary market agencies that buy loans from originating lenders to maintain liquidity in the mortgage market. The GSEs introduced automated underwriting (AU) systems, a faster, more standardized – and theoretically more objective – way of evaluating the risk posed by borrowers. These systems were made possible by the increasing power and decreasing costs of computer technology. They were anchored by another technology-based innovation: credit scores. These are numerical indicators that are derived from an automated analysis of an applicant's historical use of credit. Credit scores were touted as providing an accurate and unbiased assessment of the risk that a particular borrower would default on a loan. Credit scores, in turn, paved the way for the introduction of risk-based pricing – that is, the notion that if a lender could accurately assess the repayment risk of a particular borrower, it could then price that borrower's loan at a rate that reflected that risk. This meant that rather than denying loans to higher risk borrowers, lenders could simply charge them higher interest rates. With the advent of risk-based pricing, credit – high priced credit – began to flow into previously credit-starved communities. Thus, credit scoring and automated underwriting revolutionized the mortgage market.

Industry Consolidation

At the same time as this technological revolution was occurring, there were a consolidation of the industry and a transformation of the channels through which borrowers and lenders came together. The advent of interstate banking in the mid-1980s launched an era of bank consolidation that was unprecedented, with a record number of bank mergers that resulted in a relatively small number of increasingly large institutions. Many small and mid-sized institutions disappeared, gobbled up in the merger mania.

In the race for "financial modernization," bank holding companies became increasingly complex as well, combining many different types of companies under a single corporate umbrella. Thus, a single bank holding company might own a commercial bank, a thrift, a mortgage company, a finance company, and a series of other businesses. This gave the company many different channels through which to serve different customers and communities. For example, the bank and mortgage company might offer prime mortgage loans in upper income, largely White communities, while the finance company might offer subprime loans in lower income communities and communities of color. Thus, the type of loan product a borrower ended up with could have less to do with his or her creditworthiness than with which of the lender's channels was operating in his or her neighborhood. For Community Reinvestment Act purposes, banks can claim credit for loans made by their affiliates, and the regulators do not distinguish between prime and subprime loans. This approach eliminates one potential incentive for banks to make sure that prime loans are available to prime customers, regardless of where they live.

Enter: Mortgage Brokers

This period also saw tremendous concentration within the mortgage lending business and a shift away from retail lending. In 1990, the top 25 mortgage originators nationwide accounted for less than 30 percent of the $500 billion of mortgage loans made that year. By 2002, the top 25 originators accounted for 78 percent of $2.5 trillion worth of loans.[28] Such consolidation was made possible by a change in the way the business was conducted. Lenders discovered that, in many cases, it was much cheaper to rely on third parties to find potential customers and gather their information than to maintain a large staff for this purpose. Thus began the rise of the mortgage broker. There were 7,000 mortgage brokerage firms operating in 1987. That number rose to more than 20,000 by 1995, and by 2002, 44,000 brokerage firms were in operation, with some 240,000 employees.[29] By recent accounts, brokers now originate more than 45 percent of the nation's mortgages.[30]

The use of brokers, who originate 70 percent of subprime loans,[31] represents a radical change from the previous era in which banks and thrifts dominated the mortgage business and made loans on a retail basis, using their own employees who were located in the lenders' branch offices and had direct contact with prospective borrowers. Brokers, in contrast, are independent agents who shop loan applications around among a number of different lenders. They offer borrowers convenience, because they generally go to the borrower, rather than vice versa. Many brokers market their services very aggressively in target communities, putting flyers in mailboxes, knocking on doors, and running ads on late night television. They tend to emphasize low monthly payments and easy qualification standards, rather than the type of loan and its long term costs. Brokers' lower overhead, aggressive marketing, and flexibility and convenience are allegedly difficult for banks to compete with. Many banks have decided, instead, to work with brokers.

In order to attract broker business, lenders offer incentives for brokers to bring loans to them. While they may take different forms, these incentives represent profit to the broker, and are paid for by the borrower. For example, lenders frequently pay brokers "yield-spread premiums," bonuses awarded when the terms of the loans they made were more lucrative than the minimum standards set by the lender. Other brokers received higher fees for selling mortgages with prepayment penalties.[32] Such incentives create a system in which the best deal for the broker is not necessarily the best deal for the borrower. This is a conflict of interest that is rarely apparent to the borrower, rarely resolved in the borrower's interest, and a recipe for abuse.

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[28] William Apgar, et. al., "Credit, Capital and Communities: The Implications of the Changing Mortgage Banking Industry for Community Based Organizations," Joint Center for Housing Studies, Harvard University, March 9, 2004, page 1, available at: http://www.jchs.harvard.edu/publications/communitydevelopment/ccc04-1.pdf.

[29] Ibid, p. 16.

[30] See MBA Research Data Notes, "Residential Mortgage Origination Channels," September 2006, p. 1.

[31] Ibid.

[32] *The Subprime Lending Crisis*, report by the Minority Staff of the Joint Economic Committee, October 2007, p. 20.

Subprime Lending Skyrockets

According to Federal Reserve Chairman Ben S. Bernanke and the Joint Economic Committee of Congress, subprime lending went from being $35 billion a year industry in 1994 to a $190 billion industry in 2001 to $600 billion in 2006.[33] This represents a leap from 4.5 percent of all single family mortgage originations in 1994 to 20 percent in 2006. What made this growth possible was securitization, a financial innovation engineered on Wall Street to attract investors. Securitization involves pooling a large number of mortgage loans and selling financial instruments (securities) backed by the pool. The borrowers' monthly loan payments are collected by an intermediary (a mortgage servicer) and passed along to the investors. Securitization created a massive source of capital utilized by stand-alone subprime lending entities and subprime subsidiaries of traditional banking institutions.

In recent years the predominant loan-type marketed by subprime lenders has been the hybrid adjustable-rate mortgage (ARM)—known as a 2/28 or 3/27 loan. These mortgage loans have a fixed interest rate for the first two (or three) years, at which point the rate adjusts, followed by serial rate adjustments (usually upward) every six months for the remaining 28 (or 27) years of the loan. Of the total subprime mortgage loans originated in 2005, more than 72 percent were either 2/28 or 3/27 hybrid ARMS.[34] The periodic rate increases associated with these loans can increase the borrower's interest rate by 1.5 to 3 percentage points, and the monthly payment can go up by as much as 30 to 40 percent.[35] This leads the borrower to suffer significant payment shock after the honeymoon of low fixed rates has ended. In some cases, there is no "honeymoon" as borrowers start out with unwarranted high interest rates that then adjust ever upward. Subprime hybrid ARMs generally carry pre-payment penalties that are in place throughout – and sometimes beyond – the initial fixed-rate period. Most do not collect monthly escrows for property taxes and insurance, which means that the borrower is responsible for making these payments when they come due.

This type of loan was never designed to be sustainable over the long term. It was predicated on the idea that the borrower could refinance at the point of the initial rate increase. Many borrowers report that this is just what their mortgage broker told them: "Don't worry, when the rate adjusts, you can refinance." And while it was true that housing prices in general were rising at unprecedented rates,[36] it was also true that

[33] Comments delivered by Ben S. Bernanke at the National Community Reinvestment Coalition Annual Meeting, Washington, D.C., March 14, 2008, available at: http://www.federalreserve.gov/newsevents/speech/bernanke20080314a.htm; Joint Economic Committee Report, op. cit.

[34] Joint Economic Committee Report, op. cit., p. 10.

[35] Ibid.

[36] According to a study by Robert Shiller which tracked the relationship between house price increases and inflation since the late 1800s, in the 100 years preceding 1995 house prices have not

repeated refinancings stripped homeowners of their home equity, with no guarantee of providing an affordable or sustainable loan payment.

Loans made to subprime borrowers are in general riskier than loans in the prime market, if only by virtue of their features and pricing structure. The risk associated with these loans has long been recognized. Subprime loans are *eight times more likely to default* than conventional loans. They carry a 72 percent greater risk of foreclosure than fixed-rate mortgages.[37] The implications of this are staggering. With nearly half a trillion dollars in subprime loans set for rate-resets in 2007 and 2008, hundreds of thousands of families will be at serious risk of foreclosure.[38] According to *USA Today*, more than 2 million homeowners are behind in their mortgages and another 2 million face loan resets.[39] With the rapid descent in house-prices, refinancing out of high-rate mortgages is no longer an option for most homeowners in need. Even if it were, it's not clear it would, in the present circumstances, do the trick. And resets are not the only problem. One striking trend has been a markedly higher default and delinquency rate on ARMs issued in recent years, delinquencies occurring well before any scheduled rate reset.[40]

Enter: Investors

One might wonder how it was possible that savvy investors would continue to pour dollars into such a risky proposition. Part of the answer was suggested by the Federal Reserve in November of 2007, when it stated that economic models used by lenders to estimate the likelihood of loan defaults "were overly focused on unemployment as a driver of problem loans," and that lenders' and investors' "confidence about favorable

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risen faster than inflation. But in the period from 1995 to 2006, house prices increased by more than 85 percent *after adjusting for inflation*. See Joint Economic Committee Report, op. cit., p. 2, citing Robert Shiller, Irrational Exuberance website 9/10/07, available at: http://www.irrationalexuberance.com. Dean Baker, co-director of the Center for Economic and Policy Research, estimates that this unprecedented inflation-adjusted increase in house prices likely reflects $8 trillion in housing bubble wealth. See Dean Baker, "Midsummer Meltdown: Prospects for the Stock and Housing Markets" (2007), p. 2, available at: http://www.cepr.net/documents/publications/DB_Midsummer%20Meltdown%20Final.pdf.

[37] Ellen Schloemer, Keith Ernst, Wei Li and Kathleen Keest, "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," December 2006, available at: www.responsiblelending.org. This applies to subprime loans originated in 2000, after controlling for credit score.

[38] See "Snapshot of the Subprime Market," Center for Responsible Lending, November 28, 2007, p. 2, available at http://www.responsiblelending.org/pdfs/snapshot-of-the-subprime-market.pdf.

[39] See "Criticism Rains Down on Mortgage Industry," USA Today, October 23, 2007; available online at http://www.usatoday.com/money/economy/housing/2007-10-23-mortgages-refinance_N.htm.

[40] "As Defaults Rise, Washington Worries," New York Times, http://www.nytimes.com/2007/10/16/business/16lend.html?ex=1350273600&en=bf9fd43058d4d207&ei=5124&partner=permalink&exprod=permalink.

home-price and interest rate developments" led them "to underestimate the risk of nonprime mortgages."[41] Add to this scenario a large pool of investors seeking to increase profits through high-interest lending mediated by brokers looking to originate the highest possible loans to win the highest possible fees and we have a recipe for disaster. Further, under current law, the investors were not liable for any fraudulent behavior on the part of the brokers or lenders who originate the loans in which they invest. Therefore, they had no incentive to weed out abusive practices.

In sum, what developed was a mortgage lending system in which brokers were paid to put borrowers into excessively expensive loans, loan originators immediately sold off their loans and had little interest in their long-term performance, and investors (until the current rash of foreclosures) earned huge profits but bore no liability for the actions of the brokers and lenders. It is hard to imagine a better recipe for fraud and abuse.

The Joint Center for Housing Studies' William Apgar has characterized the situation especially well:

> In a world in which the broker is detached from the lender and the lender is detached from the investor, market feedback loops are broken, or at best are slow to operate. Rather than work to root out abuse, under the current industry structure, some buyers pay more, brokers earn a premium return, and investors are compensated. Yet despite the fact that such high foreclosure rates, if realized, would have potentially devastating consequences for individual borrowers and communities, the [investor] disclosure documents simply state that the pools were priced to compensate investors for bearing the risks. The result is that the impact of foreclosures to borrowers and communities is ignored by the capital markets.[42]

Until now, that is, when those markets themselves are threatened.

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[41] Danielle DiMartino and John V. Duca, "The Rise and Fall of Subprime Mortgages," Federal Reserve Bank of Dallas Economic Letter, v. 2., n. 11 (Nov. 2007), p. 6, available at: http://www.dallasfed.org/research/eclett/2007/el0711.html. It did not help things that some housing scholars were adding fuel to the fire with their own models. For example, in 2003, smack in the middle of the house price run-up, Harvard University's Joint Center for Housing issued a report intended to dispel the worry that the U.S. was experiencing a housing bubble. "Large nominal home price declines are relatively rare and it takes significant and concentrated job losses—well beyond those in evidence in most places today—to precipitate a retreat," it said. See "The State of the Nation's Housing: 2003," p. 5, available at: http://www.jchs.harvard.edu/publications/markets/son2003.pdf.

[42] Apgar, op. cit., p. 44.

Lax Oversight by State and Federal Regulators

Another factor that contributed prominently to the ballooning of the subprime market was the opportunity for lenders to provide financial services in a highly unregulated atmosphere. Many lenders who peddled subprime loans were non-depository financial institutions who, in lieu of being regulated at the federal level, were regulated by various state finance departments. Unfortunately, state regulators, hindered by weak laws or a lack of resources, were not able to keep abreast of the abusive practices being perpetuated in communities across the nation. While many states and localities passed strong anti-predatory lending laws, state regulators were unable to keep up with the practices of the increasing number of lenders doing business within their borders.

In addition, many lenders increasingly relied upon the services of mortgage brokers to generate loans on their behalf. Many mortgage brokers, regulated at the state level, benefited from the lack of resources and legal ability of state regulators to effectively monitor and police their practices. Some states did not even bother to license mortgage brokers. For example, the state of Ohio only passed a law requiring mortgage brokers to be licensed in 2002. The law also required a civil and criminal background check on anyone seeking to obtain a license.

Federally regulated lenders also took advantage of lax oversight to originate huge volumes of loans. Depository institutions were able to use rulings from the Office of the Comptroller of the Currency (OCC) and other regulators to their benefit. The OCC, following a similar ruling issued by the Office of Thrift Supervision, issued a decision providing an exemption for its member institutions from state anti-predatory lending laws.[43] Not only did the decision provide pre-emption for the member bank, but the pre-emption extended to the affiliates and third party vendors of the member institution. Thus mortgage brokers doing business on behalf of the company and any subprime subsidiary would, according to the federal regulators, be exempt from state regulation and state lending laws that prohibited abusive lending practices. This was damaging to communities because many states that had responded more quickly than the federal government and established stringent anti-predatory lending statutes were unable to apply those statutes to the subprime affiliates of some federally regulated banks. However, the OCC ruling and others like it were a boon to lenders who were able to make larger profit margins on subprime loans. Lenders who for years had been telling civil rights and consumer advocacy groups that there was insufficient need for credit in minority neighborhoods, were now able to do high levels of lending through their subprime affiliates in central city neighborhoods – much to the detriment of homeowners and buyers in minority neighborhoods.

[43] *Office of the Comptroller of the Currency v. Spitzer*, 396 F.Supp. 2d 383 (S.D.N.Y. 2005)

Targeting Minority Borrowers

Until recently, the explosion of subprime lending was touted as a good thing, expanding homeownership opportunities for people of color and others previously shut out of the market. The homeownership drive, especially for minority families, began under the Clinton administration and continued under the Bush administration. It was a cornerstone of what President Bush called the "ownership society," with Bush declaring in 2002 that "We want everybody in America to own their own home." He even issued a challenge to lenders to create 5.5 million new minority homeowners by the end of the decade.[44]

Presidents Clinton and Bush were, of course, right that minority homeownership should be a major public policy concern. In the United States, homeownership is the primary source of family asset development and intergenerational wealth accumulation. According to the Harvard Joint Center for Housing Studies, among households under the age of 40 with a net worth between $20,000 to $50,000, homeowners have ten times the median net wealth of renters. Home equity accounts for half of that wealth. When the age-range is broadened to include households in their 40s and 50s, homeowners have almost 14 times the wealth of renters.[45]

Homeownership contributes a far larger share of assets for minorities than for Whites: home equity constitutes two-thirds of African-American families' assets, as opposed to two-fifths for White families'.[46] In large part because Black homeownership rates still lag significantly behind those for White families, the median net worth of African-American households in 2002 was $5,988, while median net worth for White households stood at $88,651.[47] Done correctly, increasing homeownership could be of tremendous benefit to people of color.

Even before the current crisis occurred, it was never true that subprime lending expanded homeownership for people of color. In fact, the evidence indicates that the opposite was true. HUD's research has found that 80 percent of subprime mortgages were refinance loans, made to customers who already own their home.[48]

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[44] Greg Ip, James R. Hagerty and Jonathan Karp, "Housing Bust Fuels Blame Game," *Wall Street Journal*, March 19, 2008, p. A1.
[45] *The State of the Nation's Housing 2006*, Joint Center for Housing Studies, Harvard University (2006), p. 19.
[46] Gregory D. Squires, "The New Redlining," in Squires, ed., *Why the Poor Pay More* (Westport, CT: Praeger, 2004), pp. 1-23, p. 5.
[47] Miriam Jordan, "Wealth Gap Widens in US Between Minorities, Whites," *Wall Street Journal* (Oct. 18, 2004), p. A2.
[48] See HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (Washington, D.C.: HUD, 2000).

Several recent studies document the existence of severe racial discrimination in the subprime market. For example, according to one study that analyzed more than 177,000 subprime loans, borrowers of color are more than 30 percent more likely to receive a higher-rate loan than White borrowers, *even after accounting for differences in creditworthiness*.[49]

Another analysis shows that borrowers residing in zip codes whose population is at least 50 percent minority are 35 percent more likely to receive loans with "prepayment penalties" than financially similar borrowers in zip codes where minorities make up less than 10 percent of the population.[50] More than 70 percent of all subprime loans come with such penalties, which box borrowers into high-rate loans even after they've bettered their credit and wish to refinance.[51] For example, for a family with a $150,000 mortgage at an interest rate of 10 percent, a typical prepayment penalty imposes a fee of $6,000 for an early payoff—an amount *greater than the wealth owned by the median African-American family*.[52]

Another striking study of discriminatory lending practices has found that *high-income* African-Americans in predominantly Black neighborhoods are three times more likely to receive a subprime purchase loan than *low-income* White borrowers.[53]

African-American and Latino borrowers are disproportionately represented in the high-cost loan market, with 55 and 46 percent of African-American and Latino borrowers, respectively, receiving high-cost loans. In contrast, only 19 percent of White borrowers are given high-cost loans.[54]

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[49] See Bocian, D. G., K. S. Ernst, and W. Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, May 2006, p. 3. Available at www.responsiblelending.org.

[50] See *Borrowers In Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, *op. cit.*, p. 1.

[51] Keith Ernst, D. N. Goldstein, and C. A. Richardson, "Legal and Economic Inducements to Predatory Practices," in Squires, ed., *Why the Poor Pay More*, op. cit., p. 108. See also Josh Nassar, "Abusive Lending and Pricing Disparities in the Subprime Market," presentation on behalf of Center for Responsible Lending, given at annual conference of the National Fair Housing Alliance, July 10, 2006. On file with the National Fair Housing Alliance; and "Snapshot of the Subprime Market," Center for Responsible Lending, November 28, 2007, p. 3, available at http://www.responsiblelending.org/pdfs/snapshot-of-the-subprime-market.pdf.

[52] See Bocian, D. G. and R. Zhai, *Borrowers In Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending, January 2005. Available at www.responsiblelending.org.

[53] Center for Responsible Lending's *Fact Sheet on Predatory Mortgage Lending*, *op. cit.* See also *Unequal Burden*, *op. cit.*, and *The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities*, ACORN, August 15, 2006, available at www.acorn.org.

[54] Calculations from data reported in Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, Higher-Priced Home Lending and the 2005 HMDA Data, Federal Reserve Bulletin A123, A160-

To make matters worse, many borrowers who end up in the subprime market don't even belong there. They actually qualify for loans in the prime market. Fannie Mae and Freddie Mac have found that up to 50 percent of those who end up with a subprime loan would have qualified for a mainstream, "prime-rate" conventional loan in the first place.[55] (According to a study conducted by the Wall Street Journal, this number may be as high as 61 percent.[56])

The Inevitable Foreclosure Crisis

The nation is now finding that the house price increases that masked the problems in the subprime market have ended: the bubble has burst. After reaching its peak in 2005, "the Standard & Poor's/Case-Shiller index of year-over-year home-price appreciation in 10 large U.S. cities was down 5 percent in August [2007]—its biggest drop since 1991," according to the Federal Reserve.[57] In a recent speech, Fed Chairman Bernanke highlighted a recent survey showing that nearly 30 percent of homeowners reported that they saw the value of their house decrease during 2007.[58] And according to Reuters, home prices fell 8.9% in 2007, while Baker calculates that prices dropped at a 16% annual rate in the final quarter of 2007.[59]

Falling house prices have led to record foreclosures in recent months. A recent study by an online marketplace for foreclosed properties reports that more than one million properties went into some stage of foreclosure in 2007, a 75 percent increase from 2006.[60] More than half of these foreclosure starts were on subprime mortgages.[61] The Wall Street Journal reports that, just as the number of homes entering foreclosure in the last quarter of 2007 rose to the highest level on record, last year was also the first time that

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161 (September 8, 2006). See also http://oversight.house.gov/documents/20070322175553-40982.pdf. These figures are based on combining the statistics for both purchases and refinances.

[55] See the Center for Responsible Lending's *Fact Sheet on Predatory Mortgage Lending* at http://www.responsiblelending.org/pdfs/2b003-mortgage2005.pdf, and ACORN's report *The Impending Rate Shock*, op. cit.

[56] See "Subprime Debacle Traps Even Very Creditworthy," December 3, 2007.

[57] Federal Reserve Bank of Dallas Economic Letter, op. cit., p. 8.

[58] Comments delivered by Ben S. Bernanke at the National Community Reinvestment Coalition Annual Meeting, Washington, D.C., March 14, 2008, available at: http://www.federalreserve.gov/newsevents/speech/bernanke20080314a.htm.

[59] Reuters, "Home Prices Plunge at Record Rate in 2007," Feb. 26, 2008, available at: http://www.reuters.com/article/businessNews/idUSNAT00374720080226; Dean Baker, "These Loans Were Made for Walking," available at: http://www.truthout.org/docs_2006/020408B.shtml.

[60]"RealtyTrac, Jan. 29, 2008, available at: http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3988&accnt=64847.

[61] Bernanke comments to NCRC, op. cit.

"American homeowners, in the aggregate, owned less than half the value of their houses," at 47.9%.[62] This number stood at higher than 80% in 1945.

These trends have also led to recent declines in homeownership rates. According to the Census Bureau, aggregate homeownership fell in the fourth quarter of 2007 to 67.8 percent, down from 68.2 percent in the third quarter.[63] The news is much worse for African Americans who saw their already severely low homeownership rate decline to 47.7 percent in the fourth quarter of 2007, down fully two percentage points from its peak in 2004.[64] According to Mike Calhoun, President of the Center for Responsible Lending, the subprime mortgage debacle "stands to likely be the largest loss of African-American wealth that we have ever seen, wiping out a generation of home wealth building."[65]

More than 7 million families in the United States now hold a subprime mortgage, and 2.2 million families with a subprime loan made from 1998 through 2006 will face foreclosure in the next few years. One in five subprime mortgages made from 2005 to 2006 will end in foreclosure.[66] The losses have finally reached a level that is threatening Wall Street and the entire economy. This has spurred long-overdue federal action. But it is unlikely that this action will help the hundreds of thousands of people, many of them people of color, who have already lost their homes to subprime foreclosures.

Given the financial dangers associated with subprime loans, prepayment penalties, excessive fees, exaggerated incomes, and abusively high interest rates, it is clear that the discrimination found in the subprime market constitutes a grave threat to the financial well-being of America's already under-served populations. African-American and Latino communities have already been hit hard, and we can expect homeownership rates to continue their descent.[67]

The Effects of Foreclosures in Minority Communities

The neighborhood effects stemming from the housing crisis will be enormous. According to the Center for Responsible Lending, foreclosures in 2005 and 2006 alone

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[62] Sudeep Reddy and Sara Murray, "Housing, Bank Troubles Deepen," *Wall Street Journal*, March 7, 2008, p. A1.

[63] http://www.census.gov/hhes/www/housing/hvs/qtr407/q407press.pdf

[64] Ibid., see also Baker, "Homeownership: The Fast Path to Poverty," November 12, 2007, available at: http://www.cepr.net/index.php/op-eds-columns/op-eds-columns/homeownership-the-fast-path-to-poverty/.

[65] http://news.bbc.co.uk/2/hi/business/6528387.stm.

[66] "Snapshot of the Subprime Market,"op. cit.

[67] See "Subprime Lending: Net Drain on Homeownership," CRL Issue Paper No. 14, Center for Responsible Lending, March 27, 2007.

led to the devaluation of 44.5 million homes. The total decline in house values and tax base from nearby foreclosures was estimated to be $223 billion.[68]

Additional research by Dan Immergluck of the Georgia Institute of Technology shows that for "every forclosure within one-eighth of a mile of a single-family home, property values are expected to decline by approximately 1 percent. For neighborhoods with multiple foreclosures, property values are impacted even more. In Chicago, we estimated the cumulative impact of two years of foreclosures on property values to exceed $598 million, for an average of $159,000 per foreclosure."[69]

A 2004 study in Philadelphia found that each home within 150 feet of an abandoned home declined in value by an average for $7,627; homes within 150 to 299 feet declined in value by $6,810; and homes within 300 to 449 feet declined in value by $3,542.[70]

When houses are foreclosed and then abandoned, as they often are, cities must often absorb the cost of dealing with demolishing or otherwise dealing with them. According to Engel and McCoy, "Studies calculating the costs to cities of resolving abandoned and foreclosed residential properties find that they range from $430 to $40,000 per home."[71] And when neighborhoods deteriorate through foreclosures that lead to demolition, crime often increases. A separate study by Immergluck and Geoff Smith of the Woodstock Institute in Chicago estimates that for every one percent in a city's foreclosure rate, crime increases 2.33 percent.[72]

Of course, declining property values and increasing foreclosures are associated with reduced property tax revenue and increased government costs such as fire and police services. On one estimate, state and local governments will lose more than $917 million in property tax revenues as a result of lower housing values stemming from subprime foreclosures.[73] This has a tremendous effect on funding for schools and provision of municipal services of all types.

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[68] "Overview of Subprime Mortgage Market" (powerpoint presentation), Center for Responsible Lending, November 29, 2007, p. 18.
[69] Testimony of Dan Immergluck, Ph.D., before the Committee on Oversight and Government Reform, Subcommittee on Domestic Policy, March 21, 2007.
[70] Mayor and City Council of Baltimore v. Wells Fargo Bank, *Complaint for Declaratory and Injunctive Relief and Damages*, op. cit., p. 2
[71] Engel and McCoy, "From Credit Denial To Predatory Lending," op. cit., p. 101.
[72] "After Foreclosures, Crime Moves In," Boston Globe, Nov. 18, 2007, available at: http://www.boston.com/news/nation/articles/2007/11/18/after_foreclosures_crime_moves_in/.
[73] Joint Economic Committee Report, op. cit., p. 1.

Case Study: ***Baltimore v. Wells Fargo***

On January 8, 2008, the Mayor and City Council of Baltimore, MD, filed a federal lawsuit against Wells Fargo Bank under the Fair Housing Act. According to the City, Wells Fargo has engaged in a pattern and practice of unfair, deceptive, and discriminatory lending activity since at least 2000.

Baltimore has been hit especially hard by foreclosures in recent years. Foreclosure activity increased fivefold from the first to second quarter of 2007, and there have been more than 33,000 foreclosure filings since 2000. But this wave of foreclosures has fallen disproportionately on Baltimore's African-American communities. In 2005 and 2006, two thirds of Wells Fargo's foreclosures were in census tracts that are more than 60 percent African-American, whereas just 15.6 percent were in tracts that are less than 20% African-American.[74]

The City charges that Wells Fargo employed the practice of "reverse redlining": the bank targeted areas traditionally underserved by mainstream, prime-rate lenders in order to originate lucrative but unduly risky loans with customers who trusted the lender, believed the written loan terms would be the same as the terms promised orally, or lacked the experience or financial knowledge required to identify abusive loan terms. Following a common thread running through minority communities throughout America, Baltimore has struggled to recover from a history of racial discrimination in lending. For example, in 1937, the federal government published a map entitled "Residential Security Map for Baltimore," which was designed to identify neighborhoods within which it was "safe" for lenders to operate without fear of "disruption" by racial tension or poverty-related causes.[75]

As the only lender who made more than 1,000 loans in Baltimore in each year from 2004 to 2006, Wells Fargo's practices have tremendous impact on the stability of the City's housing situation. With a history of discrimination and segregation, Baltimore's minority communities are especially vulnerable to predatory and abusive lending practices. This is precisely what appears to have occurred. Both the City's foreclosures and those connected to Wells Fargo are disproportionately concentrated in Baltimore's African-American neighborhoods. Half of Wells Fargo's foreclosures from 2005 to 2006 were in census tracts that are more than 80 percent African-American, whereas only 15.6 percent were in tracts that were less than 20 percent African-American. And while just 2.1 percent of Wells Fargo's loans in predominantly White neighborhoods result in foreclosure, the figure is four times that in predominantly African-American

[74] Mayor and City Council of Baltimore v. Wells Fargo Bank, *Complaint for Declaratory and Injunctive Relief and Damages*, p. 2, available at: http://www.relmanlaw.com/City%20of%20Baltimore%20v.%20Wells%20Fargo%20-%2008-cv-62%20-%20Complaint.pdf.
[75] Ibid., p. 12.

neighborhoods. This leads to a foreclosure rate in African-American neighborhoods that is twice the City's average, and a foreclosure rate in White neighborhoods that is half the average.[76]

One startling aspect of Baltimore's minority communities' foreclosure crisis is that approximately 70 percent of Wells Fargo's Baltimore loans that result in foreclosure are fixed rate loans—and this ratio holds constant across both White and African-American neighborhoods.[77] This is startling because it means foreclosures cannot be blamed on the vagaries of fluctuating interest rates, and thus that the underwriting procedures employed by Wells Fargo are highly irresponsible. The fact that there is such a stark differential between foreclosure rates in White neighborhoods and rates in Black neighborhoods can support the charge that the bank's underwriting standards were especially reckless in the latter. Wells Fargo also placed higher-caps on adjustable rate loans made in African-American neighborhoods than it did on those made in White neighborhoods (14.13 percent versus 13.61 percent).[78]

The patterns and practices identified by the City of Baltimore in its lawsuit against Wells Fargo fit the profile of predatory lending described in this report. The origination of unsustainable and discriminatory loan terms in African-American neighborhoods is consistent with a desire to profit by targeting vulnerable communities in order to sell high-cost loans to investors seeking high-returns.

Section II: The Nature and Extent of Housing Discrimination

Forty years after the passage of the Fair Housing Act, there are more than 3.7 million instances of discrimination each year against African-Americans, Latinos, Asian Americans, and American Indians in rental and sales markets.[79] It is crucial, however, to point out that this estimate of annual aggregate fair housing violations is *extremely* conservative. For it does not reflect discrimination against persons with disabilities—the group that files the highest number of complaints with HUD each year—nor discrimination on the basis of religion, sex, familial status, color or other ethnicities. It also does not reflect discrimination in the following areas: lending, insurance, planning, and zoning or sexual or racial harassment in housing. The number does not include linguistic profiling (discrimination on the telephone) or via the Internet or discrimination when applications are filed, offers submitted in sales negotiations or when people already occupy a residence. So, **we can easily estimate the annual incidence of discrimination to exceed four million** and can only wonder and worry

[76] Ibid., p. 17, 20.
[77] Ibid., p. 21.
[78] Ibid., p. 31.
[79] For the basis of this estimate, see NFHA's *2004 Trends Report*, which reports findings from a study of HDS 2000 data by John Simonson, University of Wisconsin – Platteville.

about how much more there might be. One of the most effective ways of documenting discrimination is through testing of housing, lending, and insurance providers. The National Fair Housing Alliance (NFHA) and its members conduct most of the testing in the United States.

NFHA conducts testing to identify systemic patterns and practices of discrimination. In the 1990s, NFHA brought several cases against the nation's largest homeowners insurance providers and four mortgage lending institutions. These cases resulted in wholesale changes throughout much of the industry. Insurance companies eliminated or revised many discriminatory underwriting criteria, opened many offices or service centers in African-American and Latino neighborhoods, and conducted training and testing of company personnel and agents. There are still insurance agents and companies who do not comply with fair housing laws, and NFHA continues its work to address these discriminatory practices. In November 2007, NFHA and Fair Housing Advocates Association of Akron, OH, filed suit against GuideOne Insurance in the United States District Court for the Northern District of Ohio for discrimination based on religion (more information below).

Real Estate Sales Discrimination

In 2003, NFHA embarked on a multi-year, twelve-city enforcement project to test for housing discrimination in real estate markets. The purpose of this project was to conduct targeted enforcement testing of housing providers who violated the Fair Housing Act during research conducted during HUD's Housing Discrimination Study 2000 (HDS 2000). In the twelve metropolitan areas investigated to date, NFHA's testing revealed discriminatory steering practices and other illegal behaviors that are both striking and pervasive. Since 2005, NFHA has filed 11 real estate discrimination cases with the Department of Housing and Urban Development. *No investigation has yet been completed by HUD.* One case was dual-filed with the Michigan Department of Civil Rights which issued a charge on the same day NFHA filed the case in federal court. (*NFHA & Kimberly Hobson-Hollowell & Darrick Hollowell v. Town & Country – Sterling Heights d/b/a Century 21 Town & Country; Century 21 Real Estate LLC; and Edward Dallas*, US District Court for the Eastern District of Michigan, Southern Division Case No. 4:07-CV-10385). There is extensive information about the testing and cases in NFHA's 2006 and 2007 Fair Housing Trends Report. What follows is a brief summary of the real estate testing findings.

In twenty percent of the real estate tests, African American or Latino testers were denied service by real estate agents or provided limited service. This included refusal to meet with Black or Latino testers, failure to show up for appointments with minority testers, meeting with the minority tester but not showing the tester any homes, and showing only one or two houses to the minority tester, while the White tester saw several houses. There were several instances in which the White tester was offered incentives, such as contributions to closing costs and/or lower interest rates, which were not offered to the African-American or Latino tester. In addition, there were numerous instances in which the Black or Latino tester was required to provide a pre-approval letter or other financial information before viewing houses, while the White tester was not required to do the same. In some instances, both the White and minority teams were requested to provide pre-qualification or pre-approval letters. There were no instances in which a White tester was required to provide a pre-approval letter, while the Black or Latino counterpart was required to provide the letter in order to view homes for sale.

Agents throughout the nation made inappropriate and illegal comments based on race and national origin, racial composition of neighborhoods, religion, and schools. In addition to perpetuating segregation by limiting the neighborhoods in which homes were shown, in numerous instances real estate agents made blatant comments to Whites, African-Americans and Latinos steering them away from certain communities. NFHA discovered significant racial steering by numerous real estate companies in these twelve metropolitan areas. In the tests where testers were actually shown homes, **the rate of racial steering was 87 percent.** This is a significant finding and helps explain continued patterns of racial and ethnic residential segregation in America.

Racial steering occurs when real estate agents limit housing choice to neighborhoods occupied predominantly by persons of the buyer's race or national origin: White buyers see houses in White neighborhoods, African-American buyers see houses in African-American neighborhoods, Latinos see houses in Latino neighborhoods, etc. This steering occurred even when Whites expressed an interest in seeing homes in interracial neighborhoods or when African American or Latinos asked to see a specific home in a White neighborhood.

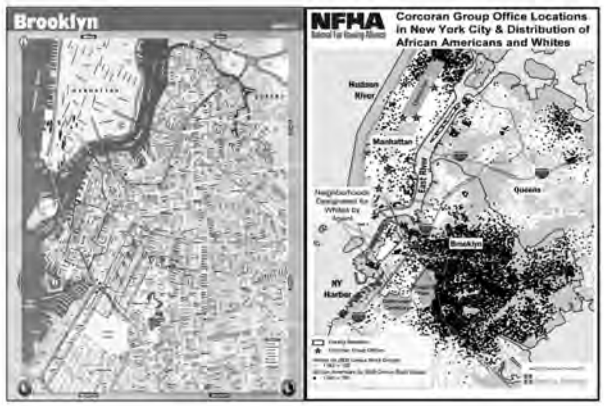
Current federal, state and local laws, including the federal Fair Housing Act, prohibit housing discrimination and steering. HUD's regulations implementing the federal Fair Housing Act state that:

> *It shall be unlawful, because of race, color, religion, sex, handicap, familial status, or national origin, to restrict or attempt to restrict the choices of a person by word or conduct in connection with seeking, negotiating for, buying or renting a dwelling so as to perpetuate, or tend to perpetuate, segregated housing patterns, or to discourage or obstruct choices in a community, neighborhood or development.* (24 CFR Part 14, Section 100.70(a)).

Racial Steering Increased from 1989 to 2000: According to data from the 2000 Housing Discrimination Study, steering by agents, which occurred either by agents verbally discouraging buyers from certain neighborhoods or only showing houses in particular neighborhoods, actually increased from 1989 to 2000.

When White purchasers are discouraged from neighborhoods of color, while African-American purchasers are steered to those same neighborhoods, there is a clear violation of the federal Fair Housing Act. Sometimes real estate agents steer by limiting the location of the homes they show buyers. In other cases, real estate agents steer by making comments and editorializing about communities and neighborhoods. In tests conducted by NFHA, White testers were given *encouraging* information about White neighborhoods. For example, agents made comments about lower tax rates, better schools, and a "better lifestyle." At the same time, agents provided discouraging information to Whites about communities with higher African-American populations, saying that the schools were not as good, referring to the African-American community as a more retail area, and discussing higher taxes and utilities in the African-American community. In contrast, the African-American buyer might be discouraged from looking at the White neighborhood because it has a stigma as "where people come to retire" and encouraged to look at the African-American community because it is less expensive.

This type of editorializing and steering by comments is a violation of HUD's regulations. The provisions related to unlawful steering practices include "discouraging any person from inspecting, purchasing or renting a dwelling because of race . . . or national origin, or because of the race . . . or national origin of persons in a community, neighborhood or development" (24 C.F.R. § 100.70(c)(1)), and "discouraging the purchase ... of a dwelling, by exaggerating drawbacks or failing to inform any person of desirable features" (24 C.F.R. 100.70(c)(2)), and "communicating to any prospective purchaser that he or she would not be comfortable or compatible with existing residents ..." (24 C.F.R. 100.70(c)(3)).



In one example, a White male agent produced a map of Brooklyn and drew redlines around the areas where the White home buyer should look for homes. He drew arrows to identify neighborhoods that were "changing." The agent was intentionally steering the buyer away from interracial and neighborhoods of color.

Steering illegally and inevitably constrains the prospects of homeseekers, since agents are often a buyer's primary source of information on available houses and often work hard to win the trust of their clients. When agents exploit this trust and steer in ways that perpetuate segregation, their actions help increase demand among certain groups for homes in certain neighborhoods and communities. Greater competition for homes in White neighborhoods caused by steering artificially drives up the values of houses in those neighborhoods and depresses values in integrated and minority neighborhoods.

While not the exclusive cause of segregation, discriminatory real estate practices clearly contribute to continued patterns of racial and ethnic segregation in the United States. While the Census Bureau documents that rates of segregation have declined between 4 and 12 percent since 1980, the average White person in metropolitan American lives in a neighborhood that is 80 percent White, almost 65 percent of African-Americans live in segregated neighborhoods, and almost 52% of Latinos live in segregated neighborhoods (see additional information about segregation in Section I).

Discrimination against Persons with Disabilities in Design and Construction

In recent years NFHA has increased its testing activities in the area of discrimination against persons with disabilities in the design and construction of housing.

Examples of accessibility barriers include the absence of curb cuts or handicap accessible parking spaces with adjacent access aisles, inaccessible kitchens and bathrooms, narrow door widths and passageways, insurmountable thresholds and inaccessible switches, outlets and environmental controls within units and throughout common use areas. One builder/owner even has step in place to enter the bedroom. In addition, in some Ovation rental communities, model units used to showcase the space to potential lessees are located on the second floor of non-elevator buildings, rendering the model inaccessible to wheelchair users and people with mobility impairments. Such individuals are, thus, denied housing opportunities at these complexes.

Ovation Development Corporation – Las Vegas, NV

On August 7, 2007, NFHA filed a housing discrimination lawsuit against Ovation Development Corporation, a builder and property manager of multi-family rental apartments in the Las Vegas area and several of its affiliated entities. In the lawsuit, NFHA alleges that Ovation discriminated against people with disabilities by improperly building units that failed to comply with federal accessibility standards in their design and construction. The lawsuit was filed in the United District Court for the District of Nevada.

The lawsuit is based on an investigation of 11 apartment complexes. The complexes are located in Las Vegas and Henderson and include Acapella, Adiamo, Amalfi, Firenze, Positano, Tesora, Tivoli, Tuscany, Venicia, Verona and Viviani. Together, the 11 complexes comprise 1,518 ground floor units and 368 buildings. All 11 properties failed to meet the accessibility requirements of the Fair Housing Act, which makes it illegal to discriminate based on race, color, national origin, religion, sex, disability or familial status. In addition, many of the properties also have violations of the accessibility requirements of the Americans with Disabilities Act (ADA).

Since its founding in 2001, Ovation has demonstrated a pattern and practice of discrimination against people with disabilities by designing and constructing multifamily dwellings with significant design flaws that render them inaccessible to people with disabilities. In 2001 and 2005, the U.S. Department of Justice filed two suits against Pacific Properties and Development Corporation, whose principal is the founder of Ovation. The suit alleged inaccessible features at four multi-family housing complexes built by Pacific Properties. In settlement, the founder of Ovation, in his capacity as an officer of Pacific Properties, was placed under a continuing order of the court that prohibited him from participating in the design and/or building of covered multi-family housing without the accessible features mandated by the Fair Housing Act.

A.G. Spanos Companies – Stockton, CA

On June 21, 2007, NFHA and four of its members filed a housing discrimination lawsuit against A.G. Spanos Companies, a builder and developer of multifamily housing and commercial properties in at least 16 states.

The lawsuit alleges that Spanos failed to comply with federal accessibility standards in the design and construction of its properties. The lawsuit was filed in the Federal District Court of San Francisco.

NFHA and its members—Fair Housing of Marin, Fair Housing Napa Valley, Metro Fair Housing Services, and the Fair Housing Continuum—investigated 35 apartment complexes in California, Arizona, Nevada, Texas, Kansas, Georgia, and Florida. All of these complexes failed to meet the accessibility requirements of the Fair Housimg Act and the Americans with Disabilities Act. These 35 properties, totaling more than 10,000 individual apartment dwelling units, represent only a sample of the at least 82 Spanos properties that are covered by the federal Fair Housing Act. The suit also alleges that A. G. Spanos has engaged in a continuous pattern and practice of discrimination against persons with disabilities in their design and construction since at least 1991. Spanos Companies' motion to dismiss the fair housing claims were denied by the federal judge on April4, 2008.

Rental Discrimination in the Wake of Hurricane Katrina

NFHA's recent investigations have not been limited to real estate sales practices. In December 2005, NFHA issued *No Home for the Holidays*, a report describing a 66 percent rate of discrimination against African-American hurricane evacuees. In an investigation conducted three weeks after Hurricane Katrina, NFHA uncovered differential treatment of White and African-American homeseekers, including quoting higher rent prices or security deposits to African-American testers and offering special inducements or discounts to White renters.

In response to these troubling findings, NFHA initiated an investigation of housing discrimination in several cities to which many persons had evacuated in an effort to monitor whether hurricane evacuees were receiving fair and equitable access to housing. From mid-September through mid-December, 2005, NFHA conducted investigations of rental housing providers in seventeen cities in five states (Alabama, Florida, Georgia, Tennessee and Texas). Most of the differential treatment revealed in NFHA's testing fell into the following categories: failure to tell African-Americans about available apartments; failure to return telephone messages left by African-Americans; failure to provide information to African-American testers; quoting higher rent prices or security deposits to African-American testers; and offering special inducements or discounts to White renters. As a result, NFHA filed five complaints with HUD against apartment complexes in Birmingham, AL, Dallas, TX, and Florida. Only one compliant has been resolved since December 2005. Currently, four complaints are pending with HUD regional offices.

In 2006, based on additional testing, NFHA released *Still No Home for the Holidays*, which reported race discrimination in two housing complexes in Texas and Florida. As a result, NFHA filed additional complaints with HUD against Crestbrook Apartments in Burleson, Texas, and Governors Gate Apartment Homes in Pensacola, Florida. Both of these complaints are pending. The 2006 tests once again uncovered differential treatment in the following areas: failure to tell African-Americans about available apartments; failure to return telephone messages left by African-Americans; and failure to provide information to African-Americans.

Other Fair Housing Issues and Concerns from 2007

Supreme Court Decision in Voluntary School Integration Case

On June 28, 2007, the United States Supreme Court issued at 5-4 ruling that found unconstitutional voluntary school integration programs in Seattle, WA, and Louisville, KY. These programs were designed to promote integration and opportunity in districts where segregated housing patterns contributed to segregated schools.

While the opinion of a plurality of the Justices, written by Chief Justice John G. Roberts, Jr., claimed that it was unconstitutional to "discriminate on the basis of race"—i.e. implement race-conscious measures designed to promote integration in schools—in order to combat discrimination on the basis of race, Justice Anthony M. Kennedy, who cast the deciding vote, refused to go so far as Roberts.

In his partial dissention, Justice Kennedy wrote, "in the administration of public schools by the state and local authorities it is permissible to consider the racial makeup of schools and to adopt general policies to encourage a diverse student body, one aspect of which is its racial composition."[80] Schools therefore continue to have the clear endorsement of a majority of the Supreme Court to pursue educational diversity and equal opportunity.

There remain a number of options to create schools that reflect the diversity of our nation, including increased diversity of neighborhoods through funding by Congress for fair housing efforts and better enforcement of the federal Fair Housing Act by the

[80] 551 U. S. ____ (2007), available at: http://www.supremecourtus.gov/opinions/06pdf/05-908.pdf.

Department of Housing and Urban Development, state and local fair housing enforcement agencies, and the Department of Justice.

U.N. Committee on the Elimination of All Forms of Racism

In 1964, in response to the apartheid regime in South Africa, the United Nations approved the Convention on the Elimination of All Forms of Racial Discrimination. Since then, the Convention has been ratified by 173 countries, with the United States Senate ratifying it in 1994. Under this Convention, states are required to examine and address policies that are both explicitly discriminatory as well as those that have demonstrably discriminatory effects. States are also required to take affirmative steps to address discrimination within their borders.[81]

The Convention requires periodic compliance reviews during which parties present evidence of compliance to the U.N. Committee on the Elimination of Racial Discrimination (CERD). CERD then questions the parties' delegations to the U.N. and issues Concluding Observations intended to guide member countries in their implications of their obligations under the Convention.

As part of its compliance review, the United States submitted a report to the U.N. Committee in April 2007. This was only the second report submitted since ratification thirteen years earlier.[82] The United States' 25 member delegation then appeared before the Committee in February 2008.

Prior to the Committee's questioning of the delegation, it had received several reports submitted by "shadow" delegations from various U.S. non-governmental organizations intended to inform the Committee's questioning. One such report, entitled "Residential Segregation and Housing Discrimination," was written by staff of several civil rights and fair housing organizations, including the National Fair Housing Alliance.[83] This report provided extensive evidence to support its conclusion that "racial segregation remains a persistent fact of American life," and that "Discrimination…continues to pervade nearly every aspect of the housing market in the United States."[84]

Having studied this and other shadow reports, the U.N. CERD Committee expressed "open skepticism" regarding the U.S. delegation's claims about America's progress in

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[81] "The International Convention on the Elimination of All Forms of Racial Discrimination—2007," *Poverty & Race*, v. 16, n. 2 (March/April 2007).
[82] Poverty and Race Research Action Council, "Report from Geneva: U.N. Committee Reviews U.S. Record on Race," available at: http://www.prrac.org/pdf/ReportFromGeneva.pdf.
[83] The report is available at:
http://www.prrac.org/pdf/FinalCERDHousingDiscriminationReport.pdf.
[84] Ibid.

addressing racial discrimination and disparities, according to one observer.[85] In its Concluding Observations, the Committee registered several concerns and reservations about the U.S.'s compliance. A major concern focused on the U.S.'s disregard for its obligations, under CERD, affirmatively to address "practices and legislation that may not be discriminatory in purpose, but in effect." After expressing concern about the concentration of minorities in poor residential areas, "the persistence of *de facto* racial segregation in public schools," and the "persistent racial disparities in the criminal justice system," the Committee highlighted the United States' "lack of appropriate and effective mechanisms to ensure a co-ordinated approach toward the implementation of the Convention at the federal, state, and local levels."[86]

Westchester, NY, and the Federal Obligation to "Affirmatively Further Fair Housing"

The Housing and Community Development Act of 1974 requires federal, state and local entities, including states, cities and counties, to act affirmatively to further fair housing. This "affirmatively furthering" obligation requires that entities that receive funding from HUD take steps to identify and address housing discrimination throughout their communities.

One of the most significant funding streams is the Community Development Block Grant (CDBG) program, used to develop housing and community infrastructure, and to fund programs and activities that benefit low- and moderate-income families and the community at large. HUD requires states, cities and counties that receive this funding to prepare an Analysis of Impediments to Fair Housing Choice (AI) as part of their planning process.

NFHA estimates that less than 10 percent of the more than 1,100 CDBG entitlement jurisdictions in the country actually have programs to address fair housing concerns in their communities. Even fewer provide funding to private fair housing organizations serving their jurisdiction. To be sure, it has been difficult to enforce this requirement because HUD has not promulgated regulations for its enforcement, although the law was passed in 1974.

Many communities fail to prepare an acceptable AI; in addition, those that do often fail to follow them or do not update them when their communities experience changes. Despite its authority to do so, HUD has not imposed sanctions on communities that have failed to affirmatively further fair housing, has not required communities to update their AIs at least every five years, and has not required communities to follow their AIs.

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[85] "Report from Geneva," op. cit.
[86] CERD, "Concluding Observations," March 7, 2008, available at: http://www2.ohchr.org/english/bodies/cerd/docs/co/CERD-C-USA-CO-6.pdf.

One fair housing center has taken a unique approach to addressing local jurisdictions that take government funds but do not affirmatively further fair housing: a charge under the False Claims Act of 1863. In 2006, the Anti-Discrimination Center of Metro New York filed *US ex rel, Anti-Discrimination Center of Metro New York, Inc. v. Westchester County, NY,* in which the Center claims that the County presented false claims to the federal government when it repeatedly certified that it had affirmatively furthered fair housing and accepted $45 million in CDBG funds, violating the federal False Claims Act. The lawsuit alleges that Westchester County is strongly segregated by race and national origin and that the County's AI failed to address the residential segregation over a period of years. The lawsuit charts the numerous situations in which the County has failed to encourage or worked to oppose housing that will serve people of color.

On July 13, 2007, Judge Denise Cote issued a ruling on Westchester's motion to dismiss the suit. The motion was denied. In her ruling, Judge Cote highlighted Westchester's own admission that it had not conducted an appropriate Analysis of Impediments, which would require a study of housing discrimination based on race, because Westchester "did not include Yonkers."[87] Judge Cote then went on to note that it is quite unclear why Westchester would think this absolves Westchester from its federal obligations. The case is currently in discovery and depositions stage, with summary judgment motions due September 19, 2008.

Insurance Discrimination Based on Religion

An investigation conducted by testers posing as insurance customers revealed that GuideOne Insurance provides and markets its products and services to homeowners on the basis of their religion and religious status. In November 2007, NFHA and Fair Housing Advocates Association of Akron, OH, filed suit against GuideOne in the United States District Court for the Northern District of Ohio.

GuideOne offers and advertises its homeowners insurance products in a discriminatory fashion based on religious status and a preference for Christians. In addition, GuideOne offers its insurance products and services in a discriminatory fashion by offering special terms and conditions to what it calls "churchgoers." Beginning in 2005 and continuing through the present, GuideOne has developed, marketed, advertised, and added to its homeowners insurance policies a special endorsement under the trade name "FaithGuard." Those terms and conditions include:

a. Waiving the insurance deductible if there is a loss to personal property while that personal property is in the care, custody, and control of the insured's church;

[87] *United States of America ex rel. Anti-Discrimination Center of Metro New York, Inc. v. Westchester County*, No. 06 Civ. 2860, at p. 5 (S.D.N.Y. July 13, 2007) (order denying motion to dismiss).

b. Paying church tithes or church donations up to $750 if the insured suffers a loss of income from a disability caused by any accident that occurs at the insured's residence; and

c. Doubling medical limits for an injury if someone is injured while attending an activity hosted by the insured at the home of the insured if the activity is conducted on behalf of the insured's church.

These benefits of the FaithGuard policy endorsement are not available to persons who suffer a covered loss or disability while engaged in similar activities but who are not religious, who do not belong to a church, or who do not attend church or participate in religious activities.

The FaithGuard endorsement and its benefits were launched in 2005 and are offered in at least 19 states. Those states include: Alabama, Colorado, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Minnesota, Mississippi, Missouri, Nebraska, Ohio, Oklahoma, Oregon, Tennessee, Washington, and Wisconsin. According to statements made by its officials, GuideOne is selling, renewing, or issuing homeowners insurance policies with the FaithGuard policy endorsement at a rate of more than 160 per day.

NFHA and Fair Housing Advocates Association have investigated GuideOne's homeowners insurance policies and practices in Ohio and elsewhere, including through the use of fair housing testing. Plaintiffs' testers called GuideOne, posing as prospective purchasers of homeowners insurance and seeking to secure insurance for homes that they intended to purchase or already owned. These tests confirmed that GuideOne has implemented and maintained the discriminatory policies and practices discussed herein.

In additiou, the Plaiutiffs' testing and investigatiou confirmed that GuideOne routinely inquires into the religious affiliation of all applicants for homeowners insurance. It has created a special application form, to Plaintiffs' knowledge not used by any other insurance company, which asks for the applicant's religious denomination. Such an inquiry is illegal under the federal Fair Housing Act.

Federal Trade Commission Report on the Use of Credit Scoring in Insurance

On July 24, 2007, NFHA joined several other consumer and civil rights organizations in coudemning a cougressionally mandated report on insurance credit scoring by the Federal Trade Commission (FTC). The groups noted that the report seemed as if out of the insurance industry's playbook and they called for Congress to reject the defective study and ban the use of credit scoring in insurance. Section 215 of the Fair and Accurate Credit Transactions Act of 2003 required the Federal Reserve Board and the FTC to study the impact of credit scoring on the availability and affordability of credit and insurance and to determine whether credit scoring was truly related to insurance losses or simply a proxy for race, income or other factors.

Insurance credit scoring is the use by insurers of consumers' credit reports for determining insurance eligibility and premiums. Unknown to most consumers, insurers' use of consumer credit information has spread to almost all insurers and is one of the most important factors in determining how much a consumer pays for auto or homeowners insurance. Previous studies by the Missouri and Texas Departments of Insurance have found that insurance scoring discriminates against low income and minority consumers because of the racial and economic disparities inherent in scoring. The Missouri study concluded that a consumer's race was the single most predictive factor determining a consumer's insurance score and, consequently, the consumer's insurance premium.

The relationship between insurance credit scores and race is so strong that even though the FTC used data handpicked by the industry, it found that credit scoring discriminates against low income and minority consumers, and that insurance scoring was a proxy for race. The FTC study also confirms that, despite growing reliance on credit-based insurance scores, scant evidence exists to prove there is a meaningful connection between a consumer's score and auto insurance losses. Without the need to demonstrate such a connection, insurers could use any consumer characteristic, such as hair color, to price insurance products. Buried in the report is the fact that the alleged correlation between risk and credit-based insurance scores might be explained by other factors. Instead of pursuing these other factors, the FTC employed subjective and pejorative racial stereotypes to try to support the alleged link between credit-based insurance scores and legitimate risk.

The FTC study is fatally flawed because the insurance industry controlled the data used in the analysis. Instead of requiring the submission of comprehensive policy data by a large number of insurers, the FTC used data handpicked by the insurance industry. Two of the five FTC commissioners also either challenged or expressed concerns with the report's findings.[88]

Fair Housing Issues on the Gulf Coast

While so many parts of the country are battling the foreclosure tsunami, the Gulf Coast states have been spared the worst of this storm. In large part, this is because so many homes damaged in another storm – Hurricane Katrina – have yet to be repaired, and so

[88] "I distrust the integrity of the underlying data set upon which the study was based," said Pamela Jones Harbour. Commissioner Jon Leibowitz is quoted as saying that "the differences in credit-based insurance scores across racial and ethnic groups are a disturbing reminder that our society is—still—not race blind, and that vestiges of our history of discrimination remain ever-present."

many homeowners are still waiting for assistance to rebuild. Under these conditions, foreclosure is not a viable option for lenders and servicers. But subprime lending is widespread in the Gulf region, and many homeowners are struggling to make their monthly mortgage payments. Unfortunately, the threat of foreclosure is increasing. NFHA has been working with its members in New Orleans and Gulfport, Mississippi, to offer assistance to homeowners whose mortgage payments are excessive or who are facing foreclosure. The organizations' counselors are having considerable success negotiating loan modifications that result in long-term affordability for homeowners.

Subprime foreclosures aside, the Gulf coast states are still struggling in other ways to recover from the devastation of those storms. And the struggle is greatest for low income people and members of classes protected under the Fair Housing Act. Congress appropriated $16.5 billion in Community Development Block Grant (CDBG) funds to aid the region in recovering from the storms. CDBG funds are intended primarily to benefit low and moderate income people. In addition, Congress requires that they be spent in ways that affirmatively further fair housing.

These mandates should offer hope that the recovery process would create a region that, from a fair housing perspective, is better in the future than it was in the past. However, the Gulf coast states' programs for spending the CDBG funds all contain serious flaws, and HUD has failed to implement requirements that protect the rights and meet the needs of persons covered by the Fair Housing Act. The result is a recovery process that, to date, falls far short of fulfilling that promise.

Three primary roadblocks are hindering the recovery: homeowners lack the funds to fully repair or rebuild their homes, plans for restoring the stock of affordable housing do not come close to meeting the need, and the pace at which federal disaster recovery funds are being made available to those for whom they are intended is far too slow. While the specifics in each state vary somewhat, the issues cut across the Gulf. The examples below illustrate the problems that are preventing an equitable recovery and the development of inclusive communities in the Gulf.

Louisiana: Flawed Formula Leads to Racial Disparities

Louisiana's program for rebuilding hurricane-damaged housing is called the Road Home. The homeowner grant portion of the Road Home was designed to compensate homeowners for their uninsured losses – the cost of damage to their homes that was not covered by insurance or assistance from FEMA.

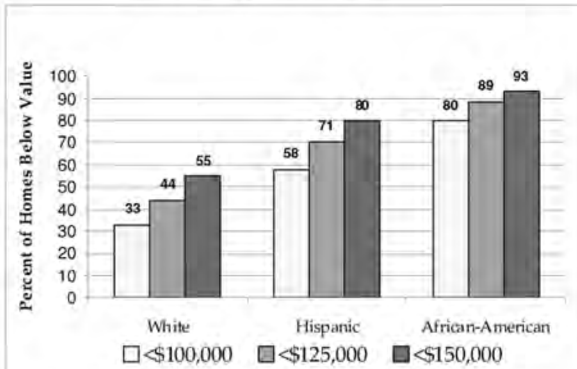
Unfortunately, the formula used by the Road Home to determine the amount of assistance has a built-in racial bias and appears to be systematically providing smaller rebuilding grants to homeowners of color and those whose homes are located in communities of color. This is because the Road Home formula is based on the pre-storm value of the home. An analysis of Census data conducted for NFHA by Calvin Bradford demonstrates that there is a systematic difference in the value of homes owned by African-Americans and Whites in New Orleans. Further, the value of a home is not related to the cost to repair or rebuild that home, and those receiving smaller grants because their homes have lower values are not receiving sufficient funding for the repairs they need to make.

According to the 2000 Census, approximately 33 percent of the homes owned by White homeowners in Orleans Parish were valued at less than $100,000, as compared to nearly 80 percent of those owned by African-Americans. In other words, African-American families were 2.4 times more likely to own a house valued under $100,000 than White families. The situation is similar for Hispanic homeowners: 58 percent of the homes owned by Hispanics in New Orleans are valued at less than $100,000, making them 76 percent more likely than White homeowners to own a house valued at this level.

Looking at homes valued under $150,000 (the maximum Road Home grant amount), we see the same pattern: 55 percent of the homes owned by Whites fall into this category, compared to 80 percent of those owned by Hispanics and 93 percent of those owned by African-Americans, creating disparity ratios of 1.45 and 1.69, respectively. In other words, 45 percent of the homes in Orleans Parish owned by Whites are valued above $150,000, while only 20 percent of those owned by Hispanics and a mere 7 percent of those owned by African-Americans are valued above this amount. **The result is that the vast majority of African-American and Hispanic homeowners in New Orleans – in stark contrast to their White neighbors – would be ineligible for the maximum Road Home grant, even if they didn't receive a penny in insurance or FEMA benefits.** The following chart illustrates these disparities.

Racial Impact of Road Home Formula in New Orleans

Based on Housing Values from the 2000 Census



Clearly, this disparity puts homeowners of color and others in communities of color at a significant disadvantage. It is likely to leave many Louisiana homeowners who are members of protected classes under the Fair Housing Act without sufficient resources to repair or rebuild their homes, or should they choose to sell their homes to the State, without enough funds to purchase another home. This disparity creates a barrier – insurmountable to many – that is making recovery difficult, if not impossible.

A recent report by the Louisiana Housing Finance Agency underscores this point. It flags the problem of basing the calculation for the rebuilding grant on the pre-storm value of homes.

> For areas with lower property values that were severely damaged, the cost of repair exceeds the pre-storm value. With construction costs estimated at $120 per square foot, many homeowners will likely be tens of thousands of dollars short of fully funding repair. Even with the Additional Compensation Grant (ACG) of up to $50,000 for low and moderate income homeowners, there may not be enough funding to replace a home. This is particularly burdensome for middle income families who do not qualify for the ACG but reside in a neighborhood where housing values were low before the storm. There are many instances of this in neighborhoods such as the Lower 9th Ward…where

homes were completely destroyed and pre-storm value is less than replacement cost.[89]

Although the report does not analyze the data by race, an accompanying map of average grant size by neighborhood demonstrates the racial impact clearly. Lakeview, a predominantly White neighborhood in the northwestern section of Orleans Parish, has the highest concentration of grants at or near the maximum $150,000. In other parts of Orleans Parish, which have higher concentrations of African-American residents, the average Road Home grant amounts are much lower.

NFHA has been working with its local partner, the Greater New Orleans Fair Housing Action Center (GNOFHAC), to bring this and other problems with the Road Home program to the attention of policy makers. We have highlighted the issue through letters to the Governor and the Louisiana Recovery Authority (the agency charged with administration of the Road Home program), as well as letters and testimony to the Louisiana State Senate. We are continuing to pursue changes to the Road Home formula, with the goal of ensuring that homeowners of color receive enough assistance to be able to rebuild their homes.

Mississippi: Failure to Restore Affordable Rental Housing

For members of protected classes, one of the biggest hurdles to recovery from the storms of 2005 is the lack of affordable rental housing. The storms decimated the rental housing stock, and the widespread damage caused increased demand after the storms as homeowners and recovery workers entered the rental housing market. This, in turn, has produced significant rent increases, making it particularly difficult for renters with limited incomes to return. Two important characteristics of the rental housing stock in the Gulf are that much of the stock consists of one or two-unit buildings, in contrast to the apartment buildings that characterize other markets, and many of the affordable units were not subsidized. High reconstruction costs and increased operating costs (utilities, insurance) have put additional pressures on rents for these units, with no subsidies to offset them.

This issue has come to the fore in Mississippi, where the Governor has proposed to divert $600 million in CDBG funds originally earmarked for housing recovery to expansion of the Port of Gulfport, which received approximately $50 million in damage from Hurricane Katrina. The expansion plan involves building new inland facilities for storage, as well as adding casinos, hotels and resort condominiums to the Port. Despite vocal protests from housing advocates, and over the objection of key members of Congress, HUD approved the Governor's requested diversion of funds. This comes at a

[89] "Louisiana and New Orleans Metro Housing Needs Assessment," Louisiana Housing Finance Agency, February 15, 2008, executive summary at page 9.

time when thousands of Mississippians are still living in toxic FEMA trailers because no other housing is available.

From a fair housing perspective, the Governor's plan is particularly troubling because Mississippi has allocated nowhere near enough funding to restore the affordable rental housing that was lost, and a comparison of the state-wide estimates of units damaged and the number of units expected to be repaired or restored through the CDBG-funded programs currently in place shows a substantial gap.

RENTAL HOUSING UNITS			
	Units Damaged	**Units Replaced w/CDBG Funds**	**Net Loss of Units**
Small Rental	47,013	6,000	41,103
Multi-family Rental	15,457	5,753	9,727
Very Low-Income Rental	37,105	5,730	31,375

NFHA's analysis shows that this loss of affordable rental housing will hit members of protected classes especially hard, since Census figures for the three coastal counties in Mississippi (Hancock, Harrison and Jackson counties) show that prior to the storm they were more likely to be renters:

- White households were least likely to be renters, with 16 percent of White households renting their home in Hancock County, 19 percent in Harrison County, and 20 percent in Jackson County
- African-American households were much more likely to be renters: 35 percent in Hancock County, 21 percent in Harrison County, and 46 percent in Jackson County.
- Hispanic households were even more likely to be renters: 36 percent in Hancock County, 62 percent in Harrison County, and 54 percent in Jackson County.
- Asian-Americans had the highest percentage of renters: 50 percent in Harrison County and 34 percent in Jackson County. The Census reported no Asian households in Hancock County.
- 42 percent of female-headed households were renters, compared to 31 percent of the population overall.
- 36 percent of families with children were renters, compared to 29 percent of households without children. In Harrison County, 42 percent of households with children were renters, compared to 35 percent of households without children.

In collaboration with the Gulf Coast Fair Housing Center, in Gulfport, MS and other local and national allies, NFHA has worked to focus attention – in Mississippi, at HUD and in Congress – on the tremendous need for affordable rental housing in the Mississippi communities devastated by Hurricane Katrina.

NFHA is also focusing on the needs of homeowners. Because of our concerns that Mississippi's formula for homeowner assistance may be biased against members of protected classes, we are working with our allies to obtain detailed information about the characteristics of applicants for those programs and the outcomes of their applications. We are also investigating the impact on protected classes of the eligibility restrictions imposed by the State, among other fair housing issues.

Alabama: Inordinate Delays in Spending

In Alabama, the greatest damage from Hurricane Katrina occurred in Mobile County, particularly in the communities right along the Gulf Coast. Much of this area is unincorporated, and residents are dependent on the County for assistance in rebuilding. Rather than running the disaster recovery programs at the state level, as has been done in Louisiana and Mississippi, Alabama set up a competitive process through which local jurisdictions could apply for funding for a variety of recovery projects. Mobile County received some $17 million in CDBG funding to help rebuild hurricane-damaged housing.

As of this month, two and a half years after Hurricane Katrina, Mobile County has provided assistance to only two homeowners. Hundreds of others are still waiting to find out if they will be eligible for assistance, and if so, how much they will receive. Hundreds of others are hoping for another chance to apply, since the Red Cross and most other charitable organizations are no longer offering assistance in Mobile County. As in other parts of the Gulf Coast region, alternative housing options are extremely limited. Some residents are still in FEMA trailers, often to the detriment of their health. Others are living in homes that are not really habitable or in sheds on the properties where their homes once stood.

The process in Mobile County has been characterized by missteps from the beginning. The program design is very complicated and difficult for residents to understand. Very little outreach was done about the program, and none in languages other than English, despite the presence of significant numbers of non-English-speaking residents. Some homeowners who had applied for assistance from charitable organizations were discouraged from applying for CDBG funds through the County. The time period during which applications were available, and for turning them in, was just a few weeks. Despite all these obstacles, some 1200 residents applied for assistance. Now the County is eliminating homeowners whose properties it believes to have had pre-storm damage or "deferred maintenance," although CDBG guidelines clearly allow for repairs to such homes.

Until the current funds are spent, it will be difficult for Alabama to make the case that more resources are needed. Yet local advocates estimate that at current funding levels, and under current program guidelines, fewer than 10 percent of those who applied will receive rebuilding funds. And no funding has been earmarked for rebuilding rental housing. Clearly, more funding is needed in Alabama. Unfortunately, despite the fact that Alabama's Senator Shelby is the ranking Republican on the Senate Banking Committee – the committee that authorizes funding for this purpose – neither he nor other members of the Alabama delegation have responded to pleas from constituents to request additional recovery funds for the state.

In Alabama, NFHA has been working in partnership with the Fair Housing Center, Inc., of Mobile, and other allies to support the efforts of residents in communities hard hit by Hurricane Katrina. As one of the few national organizations working on hurricane recovery issues in Alabama, we have endeavored to make sure that needs in that state have not been forgotten or overlooked. We have helped to clarify the regulations and requirements of the CDBG program, reviewed and critiqued Mobile County's disaster recovery program and its implementation, and pressed for the County to move more quickly and equitably to get funds into the hands of those who so desperately need them. NFHA and the Fair Housing Center will continue to work toward these goals, and to encourage community residents to organize effectively to speak out on their own behalf.

Section III: A Molehill Compared to a Mountain

Housing Discrimination Complaints for 2007

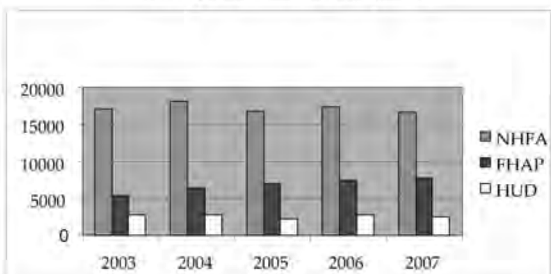
Each year NFHA collects data from both private fair housing groups and government entities in order to present an annual snapshot of fair housing enforcement in America. And each year these numbers paint the same picture: even compared to an extremely conservative estimate of the gross number of annual fair housing violations, the aggregate number of complaints documented and investigated by all polled entities is miniscule. The following chart reports on complaint filings and (in the case of DOJ) case filings reported by private and governmental fair housing agencies and organizations since 2003. Fair Housing Assistance Program (FHAP) organizations are state and local government organizations that receive HUD funding to investigate and process fair housing complaints. Under the Fair Housing Act, HUD is required to refer cases to these agencies if the agencies are "substantially equivalent" under the law, i.e. that the state or local law is substantially equivalent to the federal law.

TOTAL FAIR HOUSING COMPLAINTS FILED						
Agency	**Claims/ Complaints**	**2003**	**2004**	**2005**	**2006**	**2007**
NFHA	Complaints	17,022	18,094	16,789	17,347	16,834
FHAP *	Claims and Complaints	5,352	6,370	7,034	7,498	7,705
HUD *	Claims and Complaints	2,745	2,817	2,227	2,830	2,449
DOJ *	Case Filings	29	38	42	31	35
Totals		**25,148**	**27,319**	**26,092**	**27,706**	**27,023**

* HUD, FHAP and DOJ data are for Fiscal Year 2007. DOJ data represent case filings of HUD Election and Enforcement cases, and Pattern or Practice cases. DOJ's jurisdiction under the Fair Housing Act is limited to pattern or practice cases and cases referred by HUD. HUD, FHAP and NFHA data represent fair housing complaints received and/or processed.

In 2007, there were 27,023 complaints of housing discrimination. **The number of complaints filed, however, still represents less than one percent of the annual incidence of discrimination.** The total number of complaints has been fairly consistent over the past five years. Private fair housing organizations continue to process more than 60 percent of the complaints, despite the fact that over the past five years more than 25 organizations have closed or been on the brink of closing.

Housing Discrimination Complaints



Discrimination by Protected Class

The following chart breaks out the percentage of claims/complaints by protected class.

DISCRIMINATION BY PROTECTED CLASS				
Basis	**NFHA**	**HUD**	**FHAP**	**DOJ**
Race	20%	39%	36%	23%
Disability	33%	49%	42%	49%
Family Status	15%	12%	15%	14%
National Origin	11%	12%	13%	9%
Sex	4%	8%	10%	3%
Religion	1%	2%	3%	3%
Color	1%	1%	2%	n/a
Other*	16%	5%	6%	3%

* The "other" category for NFHA complaints represents complaints arising from categories protected at the state or local level including sexual orientation, source of income, marital status, medical condition, age, or student status. The "other" category for HUD and FHAP complaints represents complaints of retaliation. HUD, FHAP, and DOJ data are for Fiscal Year 2007. Totals may exceed 100 percent, because a single complaint may have multiple bases. Percentages are rounded to the nearest whole number.

Discrimination on the basis of disability has dominated complaint loads for the past few years, and the trend continues for this year as well, for all types of reporting entities. It is important to note that HUD and DOJ have dedicated resources to rooting out discrimination based on disability, and taken those resources away from fair housing efforts for other protected classes.

Discrimination by Housing Market Sector

1. **Rental Market Discrimination— Private Groups Report 12,606 Complaints[90]**

Of the many categories of complaint data for housing discrimination, rental cases continue to represent the largest number of complaints. Most housing discrimination

[90] Complaint data by type of allegation does not equal the total number of complaints because not all organizations provided this type of information, and some complaints fall in multiple categories.

complaints are filed against apartment owners and managers for discriminating against renters on the basis of race, disability, family status and national origin. In 2007, private fair housing groups reported 12,472 complaints of housing discrimination in the rental market.

2. Home Sales Discrimination—Private Groups Report 636 Complaints

Through complaints and NFHA's testing and investigation program, NFHA has identified a broad range of discriminatory sales behavior. These patterns of behavior include real estate agents who:

- deny appointments to African-Americans;
- require African-Americans and Latinos, but not their White counterparts, to provide proof of financing prior to viewing homes;
- steer Whites to White neighborhoods and people of color to neighborhoods where people of color predominate;
- make discriminatory comments to Whites, including derogatory comments about African-Americans, Latinos and Jews;
- tell Whites what school districts to avoid and, at the same time, show homes to African-Americans and Latinos in the very school districts Whites are told to avoid.[91]

Patterns of behavior also include a seller's refusal to negotiate the price of the home when offers are made by African-Americans, Latinos, or Asian Americans but a willingness to negotiate when a White buyer makes a similar or less favorable offer. Other sellers take their homes off the market or use delaying tactics in order to avoid a sale to people of color. There is additional information about discriminatory real estate practices in the section on the state of fair housing as well as extensive information in NFHA's 2006 and 2007 Fair Housing Trends Reports, available on the NFHA website at www.nationalfairhousing.org

3. Mortgage Lending Discrimination— Private Groups Report 1,245 Complaints

Mortgage lenders may discriminate against homebuyers in several ways:

- product steering to subprime or FHA loans;
- stricter qualification standards;
- higher interest rates, points, fees, and other terms of financing;
- less assistance in meeting qualification standards;

[91] These last two specific forms of discriminatory behavior were uncovered in NFHA's recent sales steering investigation.

- inferior customer service;
- more costly and lengthier application processes; and
- inaccurately low appraisals in African-American, Latino and integrated neighborhoods.

Predatory lending practices have also been shown to be targeted at minority neighborhoods, in violation of the Fair Housing Act. Discriminatory predatory lending harms individual borrowers and destabilizes communities and neighborhoods by causing widespread foreclosures, which reduces property values. There is additional information in this report about discrimination and predatory lending in Section I.

In the face of the subprime foreclosure crisis, the Department of Housing and Urban Development has initiated only three fair lending investigations since 2006 and has processed only 137 fair lending complaints. The Department of Justice filed only one mortgage lending case in 2007. Combined, this amounts to only 10 percent of the cases that private groups have filed.

4. Homeowners Insurance Discrimination—Private Groups Report 46 Complaints

Discrimination related to homeowners insurance can be difficult to identify because its implementation is rarely overt. For example, when African-Americans and Latinos call agents and leave messages requesting insurance quotes and other information, they often find that their calls are not returned. Such "linguistic profiling" – whereby a person is treated differently based on a racially- or ethnically-identifiable voice – is a significant and documented phenomenon in many types of housing transactions. The result is that some insurance agents promise to provide insurance quotes but never do so, while sending quotes to Whites. There is additional information about insurance discrimination in Section II of this report.

5. Harassment—Private Groups Report 1,246 Complaints

Federal fair housing statutes make it illegal to direct abusive, foul, threatening, or intimidating language or behavior toward a tenant, resident, or homeseeker because of their membership in one of the federally protected classes. Examples of complaints of this kind include racist comments between two tenants and directed at a third or a landlord's intimations that he will get to repairs more quickly if sexual favors are offered by the tenant. This year's number of harassment complaints is more than twice the number of harassment complaints received by private groups last year (564).

Section IV: The Federal Fair Housing Enforcement System Is Still Broken

Lack of enforcement of fair housing laws is the main cause of the mismatch between the high incidence of housing discrimination and the low incidence of complaints of housing discrimination. Landlords, real estate agents, lenders, insurance agents and others have limited fear of getting caught in the act of discriminating simply because neither the federal, state nor local governments have made fair housing enforcement a priority. Even those who are prosecuted often pay such a small penalty that discrimination becomes just another cost of doing business. As a result, housing providers continue to discriminate and our country remains highly segregated.

HUD's Meager Fair Housing Effort

As mentioned above, while there are at least 4 million fair housing violations annually, only 27,023 complaints were filed in 2007. Private fair housing groups processed 16,834 of the 27,023 complaints and cases filed in 2007 – a total of 62 percent of all complaints. (This number does not account for double counting of complaints that are referred to HUD and FHAP, and for which fair housing groups are often not given credit for filing.) HUD processed only 2,449 complaints and state and local agencies (FHAPs) processed 7,705. This is a decrease for HUD from last year and modest increase for FHAP agencies from last year. As shown in the chart that follows, the number of cases HUD is processing has drastically declined since the 1992 high of 6,578 complaints.

Number of HUD Administrative Complaints by Year	
1990	4286
1991	5836
1992	6578
1993	6214
1994	5006
1995	3134
1996	2054
1997	1808
1998	1973
1999	2198
2000	1988
2001	1902
2002	2511
2003	2745
2004	2817
2005	2227
2006	2830
2007	2449

Aged Cases

Although the Fair Housing Act regulations require that HUD process a case in 100 days or less (except for complex or systemic cases), HUD routinely has a significant "aged" case load, and many cases are open for months and even years and never investigated. In its annual report to Congress released April 1, 2008, *HUD reported that 1,353 cases passed the 100 day mark in FY07, 181 more than in FY06.*[92] This does not include the number of cases that were aged prior to the start of FY07. NFHA has several cases filed at HUD, none of which has been investigated within 100 days. Although many of these cases represent complex or systemic issues, only one case has been referred to HUD's systemic case unit. Some of this may reflect the fact that the Office of Fair Housing and Equal Opportunity is understaffed, and some of it reflects a breakdown of investigatory practices and systems. We also note that there are 4,081 ongoing investigations by Fair Housing Assistance Program Agencies (HUD's counterparts at the state/local levels) that have passed the 100 day mark, an increase of 141 over FY06.[93]

One NFHA member has several design and construction complaints that have been pending with HUD for almost 4 years. Several of NFHA's cases are three years old. Given HUD non-performance on these complaints, NFHA filed its design and construction cases in federal court.

HUD Charged Only 31 Complaints in 2007

After an investigation, HUD makes a determination as to whether or not there is reasonable cause to believe that illegal discrimination has occurred. If HUD finds reasonable cause, the agency must prepare a final investigative report, make a written determination of its cause finding, and issue a charge. Issuance of a charge is the standard way that government enforcement of fair housing laws is initiated. Following issuance of a charge, the parties to a case – the complainant(s) and the respondent(s) – may elect to have the case heard in federal district court in a case filed by DOJ. If no election is made, a HUD Administrative Law Judge hears the case.

HUD issued only 31 charges following a determination that there was reasonable cause to believe that unlawful discrimination occurred in fiscal year 2007. The number of charges issued by HUD in 2007 dropped from even the small number of 34 issued in FY 2006. Even the recent high of 88 charges in FY 2001 is much too low in light of the level of housing discrimination in America. HUD has consistently set the bar for issuance of a charge too high; issuance of a charge should mean only that there is reasonable cause to believe that there has been a violation – not proof beyond a reasonable doubt.

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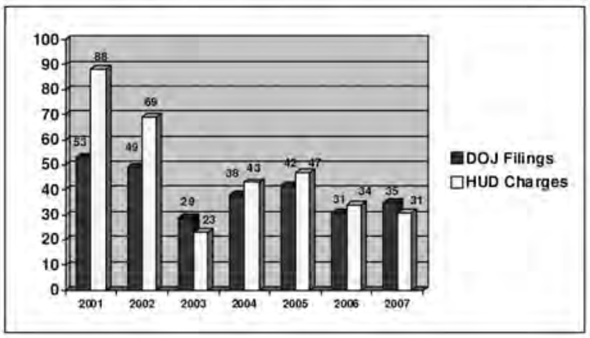
[92] *The State of Fair Housing – FY2007 Annual Report on Fair Housing*, US Department of Housing and Urban Development, the Office of Fair Housing and Equal Opportunity (March 31, 2008), p. 30.
[93] Ibid., p. 56.

Fair Housing Act Cases in which HUD Issued a Charge Fiscal Years 2001-2007							
2001	2002	2003	2004	2005	2006	2007	TOTAL
88	69	23	43	47	34	31	335

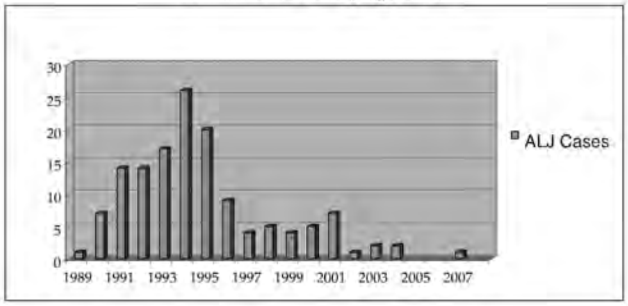
Complaints charged by HUD and consent decrees/lawsuits filed by DOJ



Administrative Law Judge Function is Essentially Defunct

While Administrative Law Judge case processing was considered a positive feature of the Fair Housing Amendments Act of 1988, HUD's failure to properly process, cause, and charge cases, particularly in recent years, has made a farce of the system. The following chart illustrates the number of HUD ALJ proceedings since 1989. **There were no cases in 2005 and 2006 and only two cases in 2007.**

Administrative Law Judge Cases



In February, NFHA staff were told that HUD currently has no Administrative Law Judges for fair housing cases. Fair housing proceedings must be heard by an ALJ in another department, such as the Environmental Protection Agency.

Inconsistent Standards and Inadequate Investigations

HUD enforcement efforts operate largely through ten "HUB" regional offices. HUD allows these offices in many cases to create their own policies and practices. NFHA has provided information to HUD and met with HUD officials on many occasions to object to the fact that fair housing case processing and legal standards differ from region to region. Many investigators lack information related to basic fair housing case law and many are unable to properly investigate a case. In a recent appellate decision in the Second Circuit (*Boykin v. KeyCorp*, C.A.2 (N.Y.), 2008), the Court identified HUD's practice of allowing inconsistent policies between HUBs as a significant problem. In this particular case, HUD's inconsistent policy related to when an administrative case was considered closed and whether or not a regional HUB sent a closure letter to a complainant, even when the matter had been referred to a Fair Housing Assistance Program agency. The court provided the following assessment of HUDs reasoning in the matter: ". . .we note that HUD's own characterization of this interpretation as 'a matter of practice' does not suggest that it was thoroughly considered. Nor can we conclude, on the record before us, that HUD's practice is validly reasoned. "

The following case studies are specific examples of HUD's flawed case processing system.

Case Study: Crestbrook Apartments

Beginning in 2005, NFHA conducted an investigation of the rental practices of Crestbrook Apartments in Burleson, TX. After revealing multiple instances of housing discrimination, NFHA filed a complaint with HUD on December 28, 2006. Through its own subsequent investigation, HUD verified that Crestbrook agents discouraged Black potential applicants by providing false information about the application process and by providing Black potential applicants with less favorable service and information about available units than was provided to White potential applicants. Additionally, HUD uncovered evidence of a practice of discrimination against Black applicants in application procedures.

Despite these discoveries, HUD did not attempt to conciliate or move forward with a charge of discrimination based on the evidence collected. HUD then erroneously and without appropriate process issued a "no reasonable cause" determination in the matter. Yet the evidence clearly meets the standards for housing discrimination set out in HUD's own regulations.[94] Moreover, in its Determination of No Reasonable Cause, HUD distorted facts by ignoring and suppressing evidence of Fair Housing Act violations. Further, HUD neglected to provide NFHA with standard information about the investigation as it progressed and failed to follow procedures established in the federal regulations.

NFHA has since requested that HUD reopen and complete this investigation, issue a finding of reasonable cause, and evaluate the investigative procedures that led to the unwarranted "no reasonable cause" determination. NFHA's request for reconsideration was granted, and the case was reopened. Fortunately, NFHA has the resources and knowledge with which to make such a request; most housing discrimination complainants would be unable to identify and counteract HUD's failures in a similar manner.

DOJ's Dwindling Involvement in Fair Housing Enforcement

DOJ Filed Only 35 Cases in 2007

The Department of Justice has also filed fewer fair housing cases in the past two years than in previous years. DOJ filed 35 fair housing cases in 2007 and 31 cases in 2006, compared to 42 in 2005, and down from 53 in 2001. The number of cases filed each year since 2003 is significantly lower than the number of cases filed from 1999-2002.

[94] See 24 CFR Part 14.

Total DOJ Cases Filed by Year								
FY99	**FY00**	**FY01**	**FY02**	**FY03**	**FY04**	**FY05**	**FY06**	**FY07**
48	45	53	49	29	38	42	31	35

DOJ's Fair Housing Authority and Mandate

Segregation and discrimination in America are so systematic and so widespread that nothing short of major institutional solutions will do. Indeed, this was the perspective of the Fair Housing Act and its 1988 Amendments, and these pieces of legislation place much authority and responsibility in the hands of the Department of Justice. DOJ is the principal legal authority tasked with enforcing federal fair housing laws, and it has both a clear mandate and wide discretion with respect to fair housing enforcement.

The 1968 Fair Housing Act gave DOJ the authority to prosecute cases involving a "pattern or practice" of housing discrimination, as well as cases involving acts of discrimination that raise "an issue of general public importance." As LCCREF's report *Long Road to Justice* documents, the Civil Rights Division of DOJ used this authority successfully to secure negotiated consent decrees and to challenge discriminatory zoning ordinances in court. One such zoning case involving the city of Black Jack, Missouri, resulted in the court's ruling that an ordinance needn't be intentionally discriminatory to violate the Fair Housing Act. According to the court, "Effect, and not motivation, is the touchstone, in part because clever men may easily conceal their motivation, but more importantly, because…whatever our law was once,…we now firmly recognize that the arbitrary quality of thoughtlessness can be as disastrous and unfair to private rights and the public interest as the perversity of a willful scheme."[95] The authority to prosecute such cases involving "disparate impact" is an important and powerful tool, one that ought to be used vigorously to combat the discrimination that exists today in the housing and lending markets.

In addition to these tools, the Fair Housing Amendments Act of 1988 added to DOJ's fair housing authority and responsibilities. When, after investigation, HUD issues a Charge of Discrimination in response to a fair housing complaint, the complainant or respondent may elect to have the claims asserted either in an administrative proceeding *or* in federal court. If the latter is elected, DOJ "shall commence and maintain, a civil action on behalf of the aggrieved person in a United States district court" on behalf of the aggrieved person within 30 days.[96] The 1988 Amendments also require HUD to refer to DOJ all matters involving alleged fair housing violations by any state or local zoning

[95] *United States v. City of Black Jack*, 508 F2nd 1179, 1184-86 (8th Cir. 1975). See the discussion in *Long Road to Justice*, The Leadership Conference on Civil Rights Education Fund, Sept. 2007. Available at reclaimcivilrights.org.
[96] 42 U.S.C. 3612.

or land-use laws, and the Attorney General now has authority to initiate civil lawsuits in response to these referrals.[97] DOJ is also permitted seek monetary relief in "pattern or practice" cases ($50,000 for a first violation and up to $100,000 for subsequent violations).[98]

Finally, the Civil Rights Division of DOJ has the authority to establish fair housing testing programs, which it first did in 1991. The division also subsequently established a fair lending program designed to challenge discriminatory lending mortgage practices and to educate lenders of their obligations under the Fair Housing Act and Amendments.

DOJ's Recent Record

As documented above, the Department of Justice has filed fewer fair housing cases during the past two years than in previous years. DOJ filed 35 fair housing cases in 2007 and 31 fair housing cases in 2006, compared to 42 in 2005, and down from 53 in 2001. While we do not dispute that DOJ has filed several cases with important outcomes, the decline in the number of cases and the failure to focus on patterns that contribute to segregated living in this nation merit serious concern.

The Department provided to NFHA data for Fiscal Years 1999-2007. The data reveal some disturbing trends:

- In the four years 1999-2002, DOJ brought 195 cases; in the five years 2003-2007, DOJ brought 175 cases.
- In the four years 1999-2002, DOJ brought 35 pattern and practice cases based on race; in the five years 2003-2007, DOJ brought 24 pattern and practice cases based on race.
- In the four years 1999-2002, DOJ filed 24 pattern and practice cases based on its testing program; in the five years 2003-2007, DOJ filed 11 pattern and practice cases based on its testing program.
- In the four years 1999-2002, DOJ filed 15 *amicus curiae* briefs; in the five years 2003-2007, DOJ filed 3 *amicus* briefs.

One reason for the decline in filed cases may be that DOJ has recently taken the stance that it is not required to file "election" cases from HUD, insisting that it may instead perform additional investigations, thereby duplicating HUD's activities and prolonging the process. One example occurred in Chicago where DOJ refused to file a federal suit after HUD referred an election case, even in spite of intervention by a Congressional

[97] See Bill Lann Lee, "An Issue of Public Importance," in *Cityscape: A Journal of Policy Development and Research*, v. 4, n. 3 (1999), pp. 35-56, p. 47n17.
[98] Ibid., p. 37.

representative. The case eventually settled – but the DOJ's actions served to undercut the relief provided to the complainants in the case.

Another significant problem is DOJ's refusal to prosecute disparate impact cases. In 2003, DOJ announced that it would no longer file disparate impact cases involving housing discrimination.[99] The federal government is often the only entity with the capacity to investigate and litigate such fair housing complaints. Disparate impact cases are crucial in the fight against housing discrimination. As the courts emphasized in permitting disparate impact cases in the first place, many rental, sales, insurance, and related policies are not discriminatory on their face, but have a disparate impact that is at odds with the purpose of fair housing legislation. Recent examples of proposed ordinances and laws that have prima facie disparate impact include (1) placing a limit on the number of persons per bedroom, which has a disparate impact against families with children, and (2) imposing a minimum loan or insurance amount, which has a disparate impact against properties in minority neighborhoods.

In the realm of mortgage lending, the Civil Rights Division failed to recognize and combat the deleterious and discriminatory effects of practices within the subprime market. It also did little to induce or require conventional lenders to operate within minority communities. Although it brought a series of successful, high-profile lawsuits against mortgage lenders engaged in "pattern or practice" discrimination in the 1990s, DOJ has prosecuted only a handful of new lending discrimination cases since 2000, despite the significant discriminatory predatory lending that has been going on throughout the past several years.

Moreover, despite continuing indications of redlining in the homeowners insurance industry, the Division has missed several opportunities to confront the discrimination directly and to correct underlying practices. Aside from two cases in the mid 1990s against the insurance companies Nationwide and American Family, the Division has missed the opportunity to take enforcement efforts in this area, leaving it to the private fair housing groups and their lawyers. One suit brought against Nationwide by Housing Opportunities Made Equal in Richmond, Virginia, was instigated by the housing group's dissatisfaction at the Housing Division's settlement with Nationwide. The subsequent suit resulted in the largest jury verdict ever in a Fair Housing Act case – over $100 million dollars.

Fair Housing Initiatives Program (FHIP): Private Efforts Are Underfunded

Although private fair housing organizations routinely process at least 60 percent of the nation's fair housing complaints, the primary funding stream for these efforts, HUD's Fair Housing Initiatives Program (FHIP), is woefully under-funded. The efforts of fair

[99] HUD HUB Directors' meeting (Rhode Island, 2003).

housing organizations are critical to the achievement of fair housing in our nation as they provide education on the local level to the housing industry and potential victims of housing discrimination. They also provide frontline enforcement of the law, largely through testing, to substantiate claims of discrimination and to address systemic discriminatory practices. Despite this, the FHIP program is still funded significantly below the level authorized twelve years ago.

FHIP is the only program that is funded by the government but operated by private organizations to advance the rights and remedies provided under the Fair Housing Act. First authorized by Congress under the Housing and Community Development Act of 1987 as a demonstration program, the initial FHIP authorization was for $3 million in 1989, which funded the approximately thirty agencies in existence at that time. The number of organizations that qualify for FHIP funding has increased significantly, with 140 organizations over the past ten years qualifying for awards that are designed to support fair housing enforcement.

Congress funded FHIP at a high of $26 million in 1995. However, in subsequent years, funding has been earmarked for research and other projects, which, while important, are inappropriate uses of FHIP funding.

Congressional Appropriations for FHIP Since 1994[100]	
Fiscal Year	**FHIP Funding**
1994	$ 21 million
1995	$ 26 million
1996	$ 17 million
1997	$ 15 million
1998	$ 15 million
1999	$ 16 million *
2000	$ 18 million *
2001	$ 17 million *
2002	$ 19 million *
2003	$ 18 million *
2004	$ 18 million *
2005	$ 18 million *
2006	$ 18 million *
2007	$ 18 million *
2008	$ 23.6 million +
2009 - proposed	$ 19 million *

**actual funding level available for general FHIP activities, excluding set-asides*
+ actual funding level for FHIP not yet known

Although the official amount proposed by the Administration for FHIP in FY2009 is $26 million, it includes $6.8 million in set-asides, leaving $19.2 million for FHIP activities – a 15% cut from the final budget for FY08.

While we have seen some recent improvements, HUD has also had its share of management problems in past years with regard to FHIP. There have been delays in the publication of Notices of Funding Availability (NOFA), delays in the announcement of funding awards, and further delays in negotiation of contracts that have caused eligible organizations to lose funding, staff, and other resources because they do not have consistent funding. Delays caused by the NOFA process have also caused budget carryovers and occasioned criticism from Congress because funding is not always obligated as quickly as it could be. A 2001 report by the National Council on Disability recommended that FHIP be revitalized in light of significant operational flaws that adversely affect enforcement.[101]

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[100] FHIP was a pilot program from 1989 to 1993. It was authorized as a program in 1994.
[101] *Reconstructing Fair Housing*, National Council on Disability (November 6, 2001).

In FY2009, the President's budget proposal is listed as including $26 million for the Fair Housing Initiatives Program, but this masks a $6 million set-aside for the Housing Discrimination Study of 2010. The Housing Discrimination Study (HDS) is an illegitimate use of FHIP funding, as HDS is designed purely as a research mechanism, and should be funded through HUD's Office of Policy Development and Research.

FHIP applicants also cite concerns with the process by which FHIP applications are evaluated since similar applications sometimes receive vastly different scores. The evaluation process has often been described as a "lottery," with no consistent measures for evaluation panel members or from year to year.

In addition, over the past five years, at least fourteen fair housing organizations nationwide have closed their doors due to lack of funding (see chart below.) At least twelve other organizations have had to significantly curtail or eliminate their enforcement activities due to cutbacks, including reduction of staff. All told, **26 fair housing centers, or one quarter of all fair housing centers throughout the country, have closed or are at risk.** In some cases, groups served densely populated and large metropolitan areas; in other cases, groups served an entire state and their closing continues to have a drastic effect on a substantial geographic area.

Part of this problem is related to insufficient funding levels. Part is related to HUD's inconsistent system of funding organizations and its continued practice of funding new, and often unqualified, organizations at the expense of existing and experienced fair housing organizations. Substantial education and outreach funding is provided to organizations without fair housing knowledge or experience. These are often one time grants that do little to promote fair housing, particularly as the organizations are unequipped to deal with any enforcement matters that may arise. In addition, many of these groups are forced to contact qualified fair housing organizations to obtain the necessary information to even fulfill the requirements of the grant agreement.

Closed Fair Housing Organizations	
Organization	**Location**
Arkansas Fair Housing Council	Arkadelphia, AR
Cuyahoga Plan of Ohio, Inc.	Cleveland, OH
Housing For All	Denver, CO
Housing Opportunities Made Equal at NEWSED Community Development Corporation	Denver, CO
Intermountain Fair Housing Council	Boise, ID
Jackson County Fair Housing Center	Jackson, MS
Kansas City Fair Housing Center	Kansas City, MO
Leadership Council for Metro Open Communities	Chicago, IL
Minnesota Fair Housing Center	Minneapolis/St. Paul, MN
Montana Fair Housing, Inc.	Missoula, MT
North Carolina Fair Housing Center	Durham, NC
Open Housing Center	New York, NY
Tenant's Action Group of Philadelphia, Fair Housing Program	Philadelphia, PA
Wyoming Fair Housing, Inc.	Casper, WY

Section V: The Costs of Segregation

The costs of discrimination and segregation go far beyond those outlined in the Section I on the current foreclosure crisis and its impact on families and communities. Many of these costs have been documented in a recently published book, **Segregation: The Rising Costs for America**. The book was sponsored by NFHA and co-edited by James H. Carr and Nandinee K. Kutty. The book contains eleven chapters that explore costs related to employment, health care, education, social networks, and discriminatory/predatory lending. What follows is a brief summary of some of the key findings in the book as well as other research related to the costs of segregation. We encourage everyone to read the book for which there is an order form on the NFHA website at www.nationalfairhousing.org.

Employment Inequalities

While employment gaps have narrowed in the past few decades, there are still significant differences in rates of employment between Whites, Blacks, and Hispanics. At the end of 2004, the employment rate for Whites was 63.2 percent and for Blacks was 57 percent. For Hispanics, the rate was actually higher at 63.9 percent; however, the unemployment rate for Hispanics at 6.7 percent was fifty percent higher than the unemployment rate for Whites at 4.6 percent. The unemployment rate for Blacks at 10.8 percent was more than twice the unemployment rate for Whites.[102] These differences in employment rates can be explained to some extent by discrimination in the employment marketplace and by factors associated with segregated residential living patterns.

Recent research in six metropolitan regions by Margery Austin Turner of the Urban Institute finds that "minority workers (and especially low-wage Black workers) [are] overrepresented in central cities, while jobs (especially low-wage jobs) are situated widely throughout the suburbs." Even though there has been some movement of minority workers to residential suburban areas, "these are often not the suburban jurisdictions that offer the most promising job opportunities. Correspondingly, Black workers in particular are underrepresented in jobs that are located in predominantly White suburban communities." Turner adds that ". . .residential segregation continues to put considerable distance between minority workers, especially Blacks, and areas of greatest employment opportunity."[103]

In addition to a "spatial mismatch" between employment centers and African American and Latino neighborhoods, Turner identifies additional factors that affect employment opportunity and success:

> *Skills and Experience*
>
> Key work skills, such as cognitive skills, computer skills, and interpersonal skills, are a growing determinant of employment success, even for low-wage jobs. Racial segregation contributes to minorities' unequal educational attainment, and their disadvantaged position in the labor market.
>
> *Information and References*
>
> A job seeker's access to information about possible job openings and the employer's information about a candidate's likely performance are also important factors in determining labor market success. The spatial separation of employment centers from minority neighborhoods may prevent a minority job seeker from finding out about potential opportunities when they are advertised only in community newspapers, bulletin boards, or help wanted signs. In addition, many employers rely on referrals from existing employees to fill open positions, because so many jobs require cognitive and social skills. Social networks may determine what openings a job seeker learns about, and whether he or she receives credible references.

[102] Margery Austin Turner, "Segregation and Employment Inequality," in James H. Carr and Nandinee K. Kutty, eds., *Segregation: The Rising Costs for America* (New York: Routledge, 2008), p. 133.
[103] Turner in *Segregation*, pp 165-166.

Prejudice and Discrimination

> There is strong evidence that prejudiced attitudes on the part of employers result in discrimination against qualified minority applicants. Blacks, in particular, are unlikely to be hired for jobs that require higher cognitive skills, such as daily computer use, arithmetic, and customer interaction. Residential segregation may sustain minorities' misperceptions and fears about Whites. [104]

Paired testing research that showed that Black men were less likely than similarly qualified White men to be invited to apply or be offered an interview of employment dates back to 1990. More recent research shows that persons with names that identify them as members of a particular race or ethnicity are treated differently by potential employers, despite having similar qualifications. Those who submitted resumes with "White" sounding names (Emily and Brendan) were fifty percent more likely to receive callbacks from potential employers than those who submitted resumes with "Black" sounding names (Lakisha and Jamal).[105]

Educational Inequalities

The demographics of housing and schools are deeply interwoven and their reciprocal relationship is important in understanding how segregation is perpetuated. Simply put, segregated neighborhoods create segregated schools because schools draw students from the surrounding geographic region. Alternatively, a school's socioeconomic and racial composition often serves as an indication of its academic quality and signals to parents and homeowners the desirability of the surrounding neighborhood. The effect is that segregated schools reinforce segregated neighborhoods. Moreover, resistance to and fear of integration often results in White flight, further exacerbating neighborhood segregation and disparities in social, economic and racial/ ethnic representation.[106]

Since public schools are funded by property taxes, segregation deprives many school districts of important resources. In order to compensate for the reduced tax revenues as a result of reduced home values, municipalities may be led to increase tax rates, thereby creating new disincentives to move to those communities. In an *amicus* brief filed in 2006 with the U.S. Supreme Court, a diverse group of housing scholars and research and advocacy organizations report that in 2002-2003, "only 28% of all White public school students (K-12) attended high-poverty schools (defined as schools where 40% or more of

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[104] Turner in *Segregation*.
[105] Bertrand, Marianne and Sendhil Mullainathan. 2003. "Are Emily and Brendan More Employable than Lakisha and Jamal? A Field Experiment on Labor Market Discrimination." NBER Working Paper No. 9873. Cambridge, MA: National Bureau of Economic Research.
[106] Frankenberg, E., *The Impact of School Segregation on Residential Housing Patterns*, Harvard Civil Rights Project, 2002.

the students were eligible for free and reduced lunches)...In contrast 71% of all Black public school students and 73% of all Latino public school students attended high-poverty schools during the same period."[107]

Predominantly White schools also benefit from stability in teaching staff. A 2003 report by the *Atlanta-Journal Constitution* described a study by researchers at Georgia State University which found that "White teachers – who compose 80 percent of the state's teaching force – are much more likely to leave schools that serve higher proportions of Black students. The study found that 32 percent of White elementary school teachers left predominantly Black schools in 2001. This revolving door leads to less experienced teachers in the classroom at Black schools."[108]

In **Segregation: The Rising Costs for America**, Deborah McKoy and Jeffrey Vincent outline the effects on education of neighborhood concentrations of race and poverty:

> **Impacts on Students and Families:** Children in predominantly White schools have higher achievement scores and significantly higher rates of graduation than children in predominantly minority schools.
>
> **Impacts on Teachers and Classrooms:** Teachers in schools in neighborhoods with concentrated poverty have older and fewer instructional resources and less access to multimedia and technology resources.
>
> **Impacts on Schools and School Districts:** School operations are negatively affected by inconsistent fewer resources, and many activities and services, such as sports, art, music, healthcare, and security guards, are reduced or eliminated.[109]

In contrast, the benefits of desegregation are clear, and have been affirmed repeatedly by the Supreme Court itself, most recently in a case involving the University of Michigan Law School:

> In addition to the expert studies and reports entered into evidence at trial, numerous studies show that student body diversity promotes

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[107] *Brief of* Amici Curiae *Housing Scholars and Research & Advocacy Organizations in Support of Respondents in* Parents Involved in Community Schools v. Seattle School District No. 1, et. al., *op cit.*, p. 5, citing Gary Orfield and Chungmei Lee, Civil Rights Project, Harvard University, "Why Segregation Matters: Poverty and Educational Inequality" (January 2005), available at http://www.civilrightsproject.harvard.edu/research/deseg/Why_Segreg_Matters.pdf.
[108] Atlanta Journal-Constitution, "Black Schools, White Schools" (June 22, 2003).
[109] Deborah L. McKoy and Jeffrey M. Vincent, "Housing and Education," in James H. Carr and Nandinee K. Kutty, eds., *Segregation: The Rising Costs for America* (New York: Routledge, 2008), pp. 130-131.

> learning outcomes, and "better prepares students for an increasingly diverse workforce and society, and better prepares them as professionals." ...These benefits are not theoretical but real, as major American businesses have made clear that the skills needed in today's increasingly global marketplace can only be developed through exposure to widely diverse people, cultures, ideas, and viewpoints.[110]

Health Inequalities

For minority populations, especially African-Americans, confinement to segregated neighborhoods is, as we have seen, often practically equivalent to confinement to poor neighborhoods. While there are, in absolute terms, more poor Whites in the United States than poor Blacks, race plays a central role in determining the character of the typical neighborhood in which a poor person lives. That is, "most poor White people are residentially located next to non-poor White people, while most poor African-Americans are concentrated in high-poverty neighborhoods."[111] And as one would expect, the link between poverty and ill health is also strong. There are many reasons for this, but a major element is the spatial mismatch in poor neighborhoods between residence and health care facilities and professionals. For example, while the overwhelmingly White Washington, DC suburb of Bethesda, Maryland, "has one pediatrician for every 400 children," the predominantly Black and poor neighborhoods in Washington's southeast side "have one pediatrician for every 3,700 children."[112]

Yet there is also reason to believe that the difficulty in gaining access to medical treatment is not the whole story behind, for example, the fact that in 1998 the "age-adjusted all-cause mortality rate for Blacks [was] one and a half times as high as that of Whites" – a number that hadn't changed in *forty years*.[113] Further research has found that for a wide range of types of medical care, "African-Americans and members of other minority groups are less likely than Whites to receive appropriate medical treatment after they gain access to medical care...and [this] is not accounted for by differences in socioeconomic status, insurance, or disease severity." The mechanisms underlying these disparities are still unclear, but sociologists strongly suspect that "negative stereotypes of race and residence play a role."[114]

In their chapter in **Segregation**, Dolores Acevedo-Garcia and Theresa L. Osypuk offer further documentation of grave racial health disparities. For example, they note that

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[110] *Grutter v. Bollinger*, 123 S.Ct 2325 (2003).
[111] David R. Williams and Chiquita Collins, "Racial Residential Segregation: A Fundamental Cause of Racial Disparities in Health," *Public Health Reporters*, v. 116 (Sept./Oct., 2001), p. 409.
[112] Gregory R. Squires and Charis E. Kubrin, *Privileged Places*, (Colorado: Lynne Rienner, 2006), p. 12.
[113] Williams and Collins, "Racial Residential Segregation," op. cit., p. 405.
[114] Ibid., p. 411.

"even after taking into account maternal age, education, and health behaviors and medical risk factors during pregnancy, Black babies are more likely to be of low birth weight" than White babies.[115] This is all the more troubling in light of the fact that "Black babies born to immigrant mothers are significantly less likely to be of low birth weight than their counterparts born to (presumably genetically similar) U.S.-born Black mothers."[116]

Acevedo-Garcia and Osypuk also note that after controlling for age, income, education, and location, "Blacks were more likely than Whites to live in inadequate housing." This means, for example, that Blacks are more likely to be exposed to household allergens from "mold, mice and rates, cockroaches, and dust mites," each of which can be associated with asthma.[117] Additional dangerous exposure to toxins and illness often occurs as a result of the presence of lead in the household, unsafe drinking water, ineffective waste disposal, and overcrowding.[118]

Acevedo-Garcia and Osypuk discuss a housing mobility program that was sponsored by HUD and which appears to demonstrate the clear link between poor neighborhoods, in which minorities are disproportionately represented, and negative health outcomes. The Moving to Opportunity (MTO) experiment moved eligible participants from center-city public housing located in high-poverty neighborhoods in five metropolitan areas. Participants "were randomly assigned to one of three groups:"

1. The treatment group (also referred to as the experimental or MTO group) was offered both a Section 8 housing voucher that could be redeemed only in a low-poverty neighborhood…and housing search counseling.
2. The Section 8 group was offered a geographically unrestricted Section 8 housing voucher.
3. The in-place control group did not receive a voucher, but remained eligible for public housing.[119]

Remarkably, "the MTO demonstration has shown better health in the MTO group, and in some instances also in the health of the regular Section 8 voucher group vis-à-vis the control group of public housing families."[120] "MTO adults also showed significant improvement in mental health, including reductions in psychological distress and depression, and increasing feelings of calm and peacefulness."[121]

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[115] *Segregation*, p. 198.
[116] Ibid.
[117] Ibid., p. 206.
[118] Ibid., p. 207.
[119] Ibid., p. 209-210.
[120] Ibid.
[121] Ibid.

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Segregation and the scholarly work that informs its chapters demonstrate clear and entrenched causal connections between discrimination, segregation, and confinement to high-poverty neighborhoods and poor education, lack of job opportunities, and health disparities. The book succeeds in its aim of proving, once and for all, that it is time to ensure that the opportunities so many of us have depended on for success in our lives are delivered to all Americans. Indeed, a compelling argument is made that "many of the programs or opportunities needed to promote economic mobility for historically disadvantaged groups…are the same programs that would benefit most Americans."[122] The bad news is that for too long our nation has been divided by injustice; the good news is that the endeavor finally to secure justice would better our prospects by unifying our country.

Section VI: Recommendations

This report documents a problem too costly for our country to ignore. We can no longer tolerate housing discrimination and the persistence of segregated neighborhoods. Many of the recommendations that follow require additional funding, but these funds represent a small fraction of the cost of failing to address what are comprehensive social and economic ills. Some of these recommendations require only a change in policy. All are necessary to achieve our nation's goal and the benefits of balanced and integrated living patterns.

Increase Fair Housing Funding and Focus Resources on Investigations

Enact the Housing Fairness Act

Introduced in 2007, the Housing Fairness Act (H.R. 2926/S.1733) represents a significant rededication to fair housing funding by the Congress. The legislation authorizes funds to root out housing discrimination through a $20 million nationwide testing program, a doubling of the funding authorization for the Fair Housing Initiatives Program to $52 million, and the creation of a $5 million competitive matching grant program for private nonprofit organizations to examine the causes of housing discrimination and segregation and their effects on education, poverty, and economic development. The nationwide testing program alone would allow for 5,000 paired tests, amounting to an average of fifty paired tests in each of the nation's one hundred largest metropolitan

[122] James H. Carr and Nandinee K. Kutty, "The New Imperative for Equality," in *Segregation: The Rising Costs for America*, op. cit, p. 34.

statistical areas (which contain 69 percent of the nation's population). NFHA urges the Congress to pass this important legislation.

Increase Appropriations for the Fair Housing Initiatives Program

NFHA calls on HUD and Congress to increase appropriations for the Fair Housing Initiatives Program to at least $52 million in fiscal year 2009 to meet the demand. In FY2006, for example, 269 organizations applied for FHIP funding – *a total of $51.75 million in requests* – but only 102 groups received grants totaling $18.1 million. In FY 2007, only 87 groups received grants: 55 organizations received Private Enforcement Initiative (PEI) grants ($14 million) and 32 groups received Education and Outreach Initiative (EOI) grants (3.1 million) for a total of $17.1 million. (HUD has not publicly released the number of organizations that applied in FY2007.)

An appropriation of $52 million would enable FHIP recipients to address thousands of additional complaints. This increase also has the potential to accomplish two important goals:

1. encourage those encountering housing discrimination to come forward to file their complaints with greater hope of resolution; and
2. provide fair housing groups with the capacity to address larger systemic issues, including sales practices, predatory lending practices and insurance policies that are discriminatory.

Restructure the Fair Housing Initiatives Program

We applaud HUD for following NFHA's suggestion of creating a three-year grant cycle for qualified full-service private nonprofit fair housing organizations beginning in 2005. Currently, 39 organizations are funded at that level. While this longer-term funding provides some stability, it also constrains the funds available to other qualified organizations because the funding level is so low. A total of only 55 organizations received enforcement grants ranging from $70,000 to $275,000.

As outlined in NFHA's proposal entitled *A Reformed Fair Housing Initiatives Program: the Private Enforcement Initiative*,[123] FHIP should include funding to provide training to agency personnel and to implement programs to improve and enhance agency performance. The minimum grant award should be $300,000 annually and increase to $1 million annually depending upon the service area's population size, number of investigations handled, demographics and other performance measures.

[123] See *A Reformed Fair Housing Initiative Program: the Private Enforcement Initiative*, NFHA (2005).

Fund an Annual National Media Campaign

NFHA calls on HUD to abide by the FHIP authorizing statute to fund an annual national media campaign rather than violating the statute as it has for the past three years. In 2005, HUD failed to fund a national campaign. In 2006, HUD funded a $300,000 hurricane-based campaign through the New York State Human Rights Commission, which HUD has since characterized as a national media campaign. In 2007 it violated the statute by funding an advertising agency for the campaign rather than a non-profit organization representing groups of persons protected by the Fair Housing Act.[124] HUD awarded $1 million to New America Media to develop a campaign to educate the public about discriminatory lending.

Create an Independent Fair Housing Enforcement Agency

An independent fair housing agency should replace HUD's Office of Fair Housing and Equal Opportunity (FHEO) in order to provide the United States with a truly objective and effective civil rights enforcement institution. Year after year, we have documented a paucity of cases, mismanagement of investigations, and a failure to charge cases. No improvements have been forthcoming, and HUD's failures have allowed not only for continued residential segregation in this nation but for a host of economic and social costs associated with such segregation.

Currently, when a fair housing/lending complaint is filed against a HUD program, or a HUD-funded agency or organization (public housing authorities, for example), HUD's FHEO is responsible for investigating the complaint. This puts FHEO in a position of investigating its own agency. There are inherent conflicts of interest within HUD. The Office of Fair Housing and Equal Opportunity must investigate discriminatory claims involving programs and entities funded by other offices of HUD. For example, Flagstar Bank was found to violate the federal Fair Housing Act. HUD received notice of the judge's decision. Flagstar Bank is a FHA direct endorsement lender, which means that FHA accepts loans from the bank without oversight. FHEO was supposed to report the fair housing act violation to FHA and ask that the FHA direct endorsement privilege be rescinded and HUD was supposed to issue a debarment of doing business with Flag Star. Even after a second federal fair housing act action, FHEO and HUD never took any action against Flagstar Bank.

As FHEO must coordinate its efforts with many other offices at HUD, this compromises what should be independent, objective investigations, putting them through the litmus

[124] 42 USC 3616a section (d)(1) states: "The Secretary, through contracts with one or more qualified fair housing enforcement organizations, other fair housing enforcement organizations, and other nonprofit organizations representing groups of persons protected under title VIII of the Civil Rights Act of 1968 [42 U.S.C. 3601 et seq.], shall establish a national education and outreach program.

test of public policy considerations and the very real issue of being ranked lower than other HUD priorities. In addition, HUD collaborates with many actors in the real estate, lending and insurance communities who may also be the subjects of investigations.

Other recommendations in this report about HUD and related programs should be incorporated into an independent fair housing agency.

HUD and DOJ Must Use Their Full Authority to Enforce the Fair Housing Act

HUD Must Enforce the CDBG Requirement to Affirmatively Further Fair Housing

HUD's Community Development Block Grant (CDBG) funding is the only other federal funding source available for fair housing activities. With the level of housing discrimination that NFHA has documented in its annual *Fair Housing Trends Reports*, NFHA urges HUD to promulgate enforceable and meaningful regulations requiring local jurisdictions to include fair housing in their comprehensive plans and their funding decisions. Those regulations should require that Analyses of Impediments to Fair Housing Choice (AIs): are prepared; accurately reflect the community's needs; describe strategies to improve fair housing compliance; are followed; and are updated at least every five years. If a state or local government fails to comply with these obligations, the regulations should require that HUD reduce or terminate CDBG funding. HUD's Office of Community Planning and Development (CPD) should require recipients to set aside adequate funding for fair housing education and enforcement staff and associated costs.

HUD and DOJ Must Improve Their Processing of Cases

With the annual number of complaints approaching 27,000, and the estimated number of violations more than four million, it is insufficient that last year HUD issued only 31 charges of discrimination and DOJ filed only 35 cases, 16 of which were HUD election cases, and therefore duplicate some of the HUD charges. These numbers speak for themselves. HUD must have consistent and quality standards for investigations, ensure its investigators are well versed in legal standards and case law, and improve its case processing so that cases are investigated in a timely manner. In addition, HUD has spent millions of dollars in the past twenty years educating builders about design and construction requirements. No builder can fail to be acquainted with these requirements. HUD should move these resources to systemic enforcement of the law.

DOJ Must Follow the Statute and Pursue Cases Charged by HUD

The Fair Housing Act as Amended (1988) clearly states that DOJ must pursue cases charged by HUD. DOJ took the position in 2005 that it is not required to file these cases but that it may instead perform additional investigations, thereby prolonging and duplicating the process.

In addition, there are two areas of enforcement at DOJ that have been underutilized in recent years: cases brought under their testing program and mortgage and predatory lending cases. Cases in those two areas have dropped precipitously in the past few years. With this underutilization, DOJ is neglecting its opportunity and obligation to fight housing discrimination.

DOJ Must File Disparate Impact Cases

DOJ has publicly stated its position that it will not litigate disparate impact cases involving housing discrimination.[125] Disparate impact cases are crucial in the fight against housing discrimination. Many rental, sales, lending, insurance, and related policies are not discriminatory on their face, but have a disparate impact on members of protected classes. Even though there may not be any intent in the policy, it can have just as detrimental an effect on individuals and families trying to find housing.

Address Unfair and Predatory Lending Practices

Fair housing centers are at the forefront of the foreclosure crisis – working to counsel people who have been victims of housing discrimination and predatory lending practices and finding ways to enforce the laws intended to protect them. Today, too many individuals and families are targeted for abusive home loans that strip away their hard-earned home equity and put their homes at a high risk of foreclosure. People of color are at greater risk of losing their homes – and their hard-earned wealth – as a result of high-cost, risky lending and abusive servicing.

Congress must enact comprehensive predatory lending legislation that includes: effective rights and remedies; prohibitions against steering; a designation of "high-cost" that includes all loan fees; a ban on yield spread premiums; a ban on pre-payment penalties; no federal preemption; and advanced disclosure of costs and fees. NFHA supports S.2452, the Home Ownership Preservation and Protection Act.

The Federal Reserve and other regulators should expand their fair lending examinations to substantially include the actions of the affiliates and third party vendors of their member lending institutions. The Federal Reserve must enact a strong rule under the Truth in Lending Act. The proposed rule states only that creditors would be prohibited from engaging in a pattern or practice of extending credit without considering borrowers' ability to repay the loan; it does not allow for individual or group complaints. This is too burdensome and would probably make it impossible for an

[125] HUD HUB Directors' meeting Rhode Island 2003.

individual to do anything to remedy his or her situation. The final rule must, among other things, do the following: ban pre-payment penalties and yield spread premiums; restrict bait-and-switch tactics, especially at the closing table; cover all loans, not only subprime loans; require the verification of income on all home mortgages; and require escrowing of taxes and insurance.

To assist those currently in bad loans and at risk of foreclosure, Congress must enact strong legislation that permits bankruptcy courts to restructure mortgages on a family's home. NFHA supports S.2636, the Foreclosure Prevention Act and H.R.3609, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007.

In the face of countless studies demonstrating the targeting of minority homebuyers by unscrupulous lenders, HUD has initiated only 3 fair lending investigations since FY2006 and has processed only 137 fair lending complaints; Justice filed only 4 cases in FY2007. Combined, this amounts to only 10 percent of the cases that private groups have filed. Since federal financial regulatory agencies refer fair housing cases to the Department of Justice, it is clear that these agencies have failed in their responsibility to identify and counteract discriminatory and predatory lending practices. They need to improve training on these issues and increase the attention and importance assigned to fair housing requirements.

Require New Construction to Meet Fair Housing Standards

Multi-family loan originators, the GSEs and regulators should ensure that new construction multi-family housing loans comply with the accessible design and construction requirements of the Fair Housing Act. They should institute appropriate due diligence requirements to ensure multi-family design and construction compliance, including (at a minimum) plan review, architect and developer certification of compliance with FHA and identification of the FHA safe harbor relied upon, contractor certification and on-site review. If lenders ensured that borrowers complied with the law, it would benefit millions of Americans. According to the National Center for Health Statistics, 34.3 million people (12 percent of the U.S. population) are physically limited in their usual activities due to a chronic condition. More than 7 million use assistive technology—canes, walkers, and wheelchairs—for mobility impairments, and more than 4 million use assistive devices such as back braces and artificial limbs to compensate for musculoskeletal impairments. This number will likely grow as veterans return from Iraq and Afghanistan. These veterans deserve to find apartments that are accessible, as required by law.

Gulf Coast Recovery Efforts Must Improve

Increase Funding for Housing Recovery in the Gulf.

Two and a half years after Hurricane Katrina, people of color and low- and moderate-income people in communities all across the Gulf Coast still have nowhere to live or insufficient funds to fully rebuild their homes. More resources are needed to complete the task of rebuilding in a way that provides safe, decent and affordable options to all residents of the region. *Congress must pass S. 1668 or other measures to provide these resources.*

Strengthen the Fair Housing Requirements of CDBG.

CDBG funds are required to be spent in ways that affirmatively further fair housing, but the specifics of this mandate remain ambiguous. NFHA and its members in the Gulf have found a host of ways in which CDBG grantees all across the Gulf have fallen short of fulfilling this fair housing mandate., without consequences. *HUD must strengthen the regulations that implement this requirement and provide more effective oversight. If HUD fails to act, Congress must step in.*

Increase the Transparency, Accuracy and Timeliness of Public Information

While disbursing the funds, rather than reporting on them, is an understandable priority in the aftermath of a disaster the magnitude of the 2005 hurricane season, good public reporting systems are also critical to ensuring that those funds are spent appropriately. For CDBG grantees in the Gulf, there have been considerable time lags in making accurate, understandable information about their spending available to the public in a readily accessible form. Further, current regulations do not require grantees to make public any information about the extent to which the funds benefit members of classes protected under the Fair Housing Act. *HUD must work with grantees to improve the CDBG reporting systems, and it must strengthen the fair housing reporting requirements.*

Improve Eligibility Requirements and Disbursement Systems

Disaster recovery funds must get into the hands of those who need them more quickly, more fairly and with a more transparent process. Two and a half years after the hurricanes, too many people in the Gulf still have not received the assistance they need to rebuild or return to their homes. Some grantees have established guidelines that arbitrarily and unfairly exclude particular groups from eligibility for assistance. In Mississippi, residents whose homes experienced damage from hurricane-force winds, but no storm surge damage, cannot receive assistance. In Mobile County, AL, homeowners who had "deferred maintenance" prior to the storm cannot receive assistance. And in all of the locations where NFHA and its members are working, homeowners have great difficulty getting timely and accurate information about how eligibility for assistance is determined, how their grants were calculated, and the status of their applications. *These systems must be improved and made more transparent and responsive to the public.*

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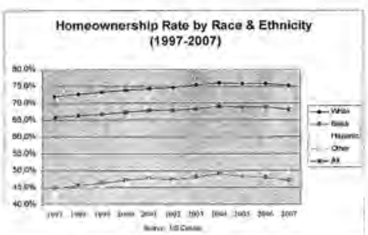
2008 Fair Housing Fact Sheet

April 11, 2008

Introduction

In 2008, the headlines have been filled with talk of growing foreclosures and the risks of subprime loans. Foreclosures are expected to impact the African-American community disproportionately—the Center for Responsible Lending (CRL) estimates that 1 in 10 recent black borrowers may be affected.[1] This is due in part to the increased likelihood that blacks will have a subprime or high-priced loan: 54% of all loans to blacks were high-rate in 2006, compared to 47% for Latinos and only 18% for whites. This crisis may have already impacted black homeownership which has declined from 49.1% at its high in 2004 to 47.2% in 2007—the lowest of any group. Homeownership is the key to financial security for many and home equity accounts for two-thirds of African-American assets, compared with only 40% for white families.[2] Now there is increasing evidence that some banks and brokers targeted some African-American communities for high-priced loans in what may be called "reverse redlining", yet it appears the federal government is not aggressively pursuing its role in enforcing the nations fair housing laws.



Minority Targeting & Fair Housing Enforcement

According a new report from the National Fair Housing Alliance (NFHA), a lack of federal civil rights enforcement has contributed to the subprime crisis. Several studies have shown that African-American borrowers are being targeted by brokers and others for high-priced loans. One study by CRL found that borrowers of color are 30% more likely to receive a higher-rate loan than whites even after accounting for differences in creditworthiness. Another study found that *high-income* blacks in predominantly minority neighborhoods are three times more likely to receive a subprime loan than *low-income* whites.[3]

Despite the growing evidence of targeting, the federal response has been weak. As can be seen in the chart above, NFHA reports that in 2007 there were 27,023 fair housing complaints based on race, disability, family status, national origin or other protected class (a slight decline from 2006). 62% were filed by private agencies operating under Fair Housing Initiatives Program (FHIP) grants, 29% were filed by state and local agencies funded by Fair Housing Assistance Program (FHAP) grants and only 9% were filed at the federal level by either the

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[1] Ellen Schloemer et al. *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners.* Center for Responsible Lending, 2006

[2] Squires, Gregory D. *Why the Poor Pay More.* Praeger, 2004.

[3] Center for Responsible Lending. *Unfair Lending: The Effect of Race and Ethnicity on the Price of Mortgages* (2006) and ACORN *The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities* (2006)

Department of Housing and Urban Development (HUD) or the Department of Justice (DOJ). Mortgage complaints are a small percentage of this total. DOJ filed only one mortgage lending case in 2007, and HUD has initiated only three fair lending investigations since 2006 and processed only 137 fair lending complaints. In comparison, private fair housing groups filed 1,245 mortgage complaints in 2007.[4]

An example of minority mortgage targeting comes from Baltimore, where the City of Baltimore sued a major lender for providing higher priced loans to poorer mostly minority neighborhoods and whose loans had resulted in more foreclosures than any other lender in the city. While 2.1% of this bank's loans in predominately white neighborhoods ended in foreclosure (half the city's average), over 8% of loans in predominately African-American neighborhoods were in foreclosures (a rate twice the city's average).[5]

A key question is how many people who have subprime loans could have qualified for lower-rate prime loans and therefore were wrongly steered to inappropriate products? This issue has particular relevance given the dramatic growth of the market (from 8% of loans in the 2003 to 28% in 2006), and the fact that 70% of these loans have prepayment penalties that inhibit borrowers from refinancing.[6] A study cited by the *Wall Street Journal* found as many as 61% of subprime borrowers in 2006 could have qualified for more conventional products based on their credit scores. This compares to only 41% of the subprime loans made in 2000.[7] While this study did not account for all the variables that affect pricing, it certainly raises questions.

Federal Funding for Fair Housing

Despite the growing scale of the problem, federal funding for fair housing has remained essentially level for the past few years, with a slight increase last year instituted by the newly Democratic Congress. This year the Bush administration is asking for $26 million for the FHIP program, which funds private fair housing agencies. This would be an increase except for the fact that $6 million of that money is actually for a separate HUD study, leaving only $19 million for fair housing enforcement—a 20% cut from 2008. The administration has also proposed a slight decrease, for state and local fair housing agencies funded under FHAP (from $26 million to $25 million).[8] Agencies funded by these two programs accounted for 91% of fair housing complaints filed in 2007. As the scale of this crisis and its impact on minority communities becomes clearer, the need for these programs has never been greater.

[4] All complaint statistics are from the National Fair Housing Alliance *2008 Fair Housing Trends Report*.

[5] Baltimore v. Wells Fargo, complaint available at http://www.relmanlaw.com/

[6] Center for Responsible Lending. *A Snapshot of the Subprime Market*. November 28, 2007.

[7] Brooks & Simon, "Subprime Debacle Traps Even Very Creditworthy". *Wall Street Journal*. December 3, 2007.

[8] All data from the National Low Income Housing Coalition (www.nlihc.org).

USA TODAY

A growing number allege unfair treatment in housing market

By Deborah Barfield Berry and Robert Benincasa, Gannett News Service

WASHINGTON — Nearly 40 years after a national law banned housing discrimination, an increasing number of complaints are alleging unfair treatment of minorities, the disabled, families and other groups.

The Department of Housing and Urban Development and housing assistance agencies logged 10,328 complaints last year, a 12% jump from 2005. That's the highest number since HUD started keeping track in 1990, when it included complaints from the disabled and families with children.

"Some people want to say these are things that happened in the old days," said Kim Kendrick, assistant secretary for HUD's Office of Fair Housing and Equal Opportunity. "It doesn't happen in the old days. It happens today."

A Gannett News Service analysis of 44,000 housing discrimination complaints filed between 2002 and 2006 with HUD and its contract agencies shows allegations of unfair treatment are widely dispersed across the nation.

In St. Louis, a mother complained a landlord told her he wouldn't rent to families with pets or children.

In Worcester, Mass., a man with kidney disease said a landlord refused to rent to him because his disability was "too much baggage."

In San Jose, Calif., Hispanic families complained their apartment manager spoke disparagingly of Mexicans and gave their repair requests lower priority.

In Chesterfield, Va., a black woman said a white property owner told her the house she was interested in "will not be sold to coloreds."

"It was like he had just punched me," said Nealie Pitts, 59, whose eyes still fill with tears when she talks about the 2002 incident.

Between 2002 and 2006, seven states and the District of Columbia averaged more than 10 housing discrimination complaints per 100,000 housing units, according to the GNS analysis. The average state rate was 7.6 complaints per 100,000 units.

The highest was Nebraska with 17, followed by Kansas, Iowa, Missouri, North Dakota, Hawaii and Wyoming. According to officials in some of those states, the reasons range from aggressive work by fair housing groups to longstanding racial tensions to an influx of immigrants.

Nebraska has a history of racial divisiveness and now faces a growing immigrant population, according to housing officials and lawmakers there.

"These things are part of the reality of the community we're in," said Gary Fischer, general counsel for Family Housing Advisory Services Inc. in Omaha. "They didn't get that way overnight. I do not think Nebraska is unique. That's the fabric here, but that's the fabric in many places."

States with the lowest average complaint rates were Alaska, Minnesota, West Virginia and Wisconsin. All had fewer than four complaints per 100,000 units.

The 1968 Fair Housing Act, amended in 1988, bans discrimination in the housing market based on disability, race, sex, national origin, religion, skin color or whether a family has children. The law covers rentals, purchases and financing.

Reasons for the growing number of discrimination complaints vary, housing officials say. Some areas are dealing with new waves of immigrants. Others have old houses that aren't readily accessible to the disabled.

Last year's record number of complaints also could result from stepped-up enforcement and efforts by HUD and other agencies to make people aware of their rights, housing officials say.

Agency's performance criticized

But critics of HUD say the agency is too slow to investigate complaints. And they note federal housing officials filed a civil discrimination charge in only 1% of the complaints they received last year.

HUD officials say the law requires them to work with both parties in a case to try and reach a settlement. Last year, 38% of the complaints to HUD were settled.

Federal officials and fair housing advocates say it's difficult to know whether housing discrimination is on the rise in a particular area. But they agree the problem is more pervasive than the number of complaints suggests.

Many victims believe filing a complaint isn't worth the trouble or don't know where to go, government studies show. And although the Fair Housing Act protects illegal immigrants, they're unlikely to complain for fear of being deported, civil rights groups say.

Private housing groups also get complaints that aren't included in the data.

The GNS analysis also found that:

• Counties in the top 20% for housing discrimination complaint rates over the last five years tend to be less racially and ethnically diverse than counties in the bottom 20%.

- Race-related complaints were most common in the South, where they accounted for nearly half of complaints last year. Race-related complaints made up 44% of cases in the Midwest, 32% in the North and 28% in the West.

- In almost one third of counties, no housing discrimination complaints were filed with HUD or its contract agencies between 2002 and 2006. Most of those counties had fewer than 10,000 households.

- Housing discrimination complaints related to disability are as common as those related to race.

Nationally, disability-related cases accounted for 40% of complaints filed with HUD and its contract agencies last year. Race-related complaints accounted for 39%.

Housing experts expect disability complaints to climb as the nation's population ages and older Americans better understand their housing rights.

Peter Raimondi, a 79-year-old polio victim who uses crutches, filed a housing discrimination complaint four years ago after his condominium board in Bel Air, Md., refused to let him install a curb cut and ramp near his condo.

A judge recently sided with Raimondi. The case is on appeal.

"I don't think people do it out of malice," Raimondi said of discrimination against the disabled. "I think they don't know."

Discrimination more subtle today

Even when complaints are filed, proving them can be difficult. Last year, HUD dismissed 40% of complaints, citing lack of evidence. One reason may be that housing discrimination today can be subtler.

"The days are gone when people say, 'We don't rent to you people,'" said John Simonson, who in 1977 led the first national study on racial discrimination in housing. "In rentals they treat you nicely. They just don't give you the unit."

Still, some housing advocates say federal officials aren't doing enough to deter homeowners, real estate agents, landlords and others from breaking the law.

HUD must investigate discrimination complaints within 100 days. But a 2005 report by the Government Accountability Office found the agency missed that deadline in more than a third of cases.

HUD officials say they have boosted training to improve response time.

In addition, the agency has launched 15 high-profile investigations in the last two years, including two in Louisiana linked to events after Hurricane Katrina.

After the 2005 hurricane, New Orleans officials complained to HUD about websites that were offering emergency housing for "whites only."

"We all thought that kind of issue was over with," said James Perry, executive director of the Greater New Orleans Fair Housing Action Center. "It means we have a lot more work to do."

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Discrimination more subtle today

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Children and disabled pushed away; Housing discrimination persists despite federal law
TELEGRAM & GAZETTE (Massachusetts) June 9, 2008 Monday

1.

TELEGRAM & GAZETTE (Massachusetts)

June 9, 2008 Monday
ALL EDITIONS

SECTION: LOCAL NEWS; Pg. B1

LENGTH: 1387 words

HEADLINE: Children and disabled pushed away;
Housing discrimination persists despite federal law

BYLINE: Thomas Caywood, TELEGRAM & GAZETTE STAFF

BODY:

Franklin Sagbay and Julia Campuzano already had paid a $725 security deposit on a Worcester apartment late last year when they showed up to get the keys from the landlord.

They left empty-handed and as victims of illegal housing discrimination - a problem that activists working to enforce housing anti-discrimination laws say persists here and across the nation four decades after Congress passed the landmark Fair Housing Act.

Mr. Sagbay, Ms. Campuzano, her husband, her 5-year-old daughter and another adult roommate had planned to live in a Birch Street apartment. Mr. Sagbay had handled the arrangements for the roommates up to that point, and that day in late November was the first time the landlord, Van Le of Dorchester, had met Ms. Campuzano.

When Mr. Le saw that Ms. Campuzano was pregnant, he allegedly refused to hand over the keys, or to refund the security deposit, according to a pending housing discrimination complaint filed recently with the Massachusetts Commission Against Discrimination.

Mr. Le allegedly pointed at Ms. Campuzano's swollen abdomen and told the prospective tenants that he didn't want any babies in the apartment. Mr. Le's telephone wasn't answered over the past two weeks, and the real estate agent listing the apartment said the building has since been foreclosed upon and that she didn't have any way to reach Mr. Le. He had not yet responded to the MCAD complaint by press time, officials said.

"I didn't know where I was going to go with my kids," Ms. Campuzano said recently through an interpreter.

She said the rejection hurt and angered her, but she didn't realize she had been a victim of illegal housing discrimination until later when she told the story to a hospital social worker.

"We're human beings. We deserve a place to live like anybody," she said.

The roommates eventually found another apartment, but the rent is higher than the one they were turned away from, they said.

The Fair Housing Act bars housing discrimination on the basis of race, color, religion, national origin, gender, children and disability. State law further outlaws housing discrimination in Massachusetts on the basis of ancestry, marital status, public assistance, military service, sexual orientation and age.

The growing number of complaints such as the one lodged by Mr. Sagbay and Ms. Campuzano represent a tiny fraction of the actual incidences of housing discrimination, according to the National Fair Housing Alliance. The advocacy group's 2008 report estimated the 27,023 housing discrimination complaints filed nationally last year at less than 1 percent of the actual number of incidents.

Legal Assistance Corporation of Central Massachusetts - a nonprofit legal agency based in Worcester that filed the complaint on behalf of Mr. Sagbay and Ms. Campuzano - logged 114 housing discrimination complaints last year from across Worcester County. The agency is on pace to top that number this year, having received 50 complaints through the first four months of this year.

Many of those complaints are resolved fairly quickly wheu one of the agency's lawyers contacts the landlord, but in egregious cases and those in which the landlord refuses to comply with the law voluntarily, LACCM files a complaint with the state discrimination commission or in state court. Most of those complaints are settled prior to trial or a state public hearing with the landlord agreeing to pay monetary damages, attend fair housing training and turn over records so their business practices can be monitored, officials said.

"Housing discrimination really affects people's chance for success in life and has more significant impact than other kinds of discrimination. It affects access to jobs, education, transportation and safe communities," said LACCM Executive Director Jonathan L. Mannina.

"There is some ignorance in the community about what the fair housing act requires," he added. "But there are people who know what the law is and continue to discriminate, and that's very concerning."

Most of the cases handled by the agency involve discrimination against disabled people and people with children, but race and housing subsidies also generate a number of complaints in Central Massachusetts, he said.

A Holyoke-based housing agency, the Massachusetts Fair Housing Center, also investigates housing discrimination complaints in northern Central Massachusetts, particularly in the Fitchburg and Leominster areas, and state law enforcement officials prosecute some housing discrimination cases too.

Early last month, Attorney General Martha Coakley's office hit an Orange mobile home park operator with a housing discrimination lawsuit alleging the company wouldn't allow a disabled resident, who recently had multiple foot surgeries, to install a handicap ramp. The case, which is pending in Franklin Superior Court, targets Leisure Woods Estates, owner of Leisure Woods Mobile Home Park on East River Street.

Erica L. Johnson, a program director with the Massachusetts Fair Housing Center in Holyoke, said her agency, which is solely focused on investigating and preventing housing discrimination, is busier than ever. The agency typically investigates 300 to 400 cases of housing discrimination a year in Central and Western Massachusetts, she said.

LACCM and MFHC divide their efforts between educating landlords and tenants about fair housing laws and investigating complaints.

"We have had some big cases in that area," Ms. Johnson said of Leominster and Fitchburg. "They were cases of national origin discrimination. But across the board, whether it's out there or back here, the ones we see most often are disability discrimination and children. Landlords will say right out, `You have kids? You can't live here.'"

Over the last four years, she said, the agency's lawsuits against landlords have all been settled out of court, and the settlement agreements prevent her from identifying specific landlords publicly.

In one current case, she said, the agency got wind of a landlord who discouraged people with children from trying to rent apartments. So the agency sent out two investigators to try to verify the complaints.

"The first was a woman with kids," Ms. Johnson said. "The landlord was like, `Oh, well, you know, I don't know if you would like it here. I don't know if it's going to work out for you here. I think you'd like it better somewhere else.' "

The next investigator, who told the landlord she didn't have kids, got the red carpet treatment, Ms. Johnson said.

LACCM also conducts such "paired tests" using trained volunteers, who earn a small stipend. The testers each attempt at different times to rent an apartment or house. The only significant difference between the two in any given test is that one has children or is handicapped or is a member of a particular race and so on.

A $230,000 grant from the U.S. Housing and Urban Development Department awarded to LACCM in October requires the agency to do at least 50 paired tests in Worcester County this year.

Worcester also has dedicated a city employee, whose salary is funded in part by the HUD grant, to do outreach to tenants and landlords about housing discrimination, Mr. Mannina said.

Older rental homes contaminated with lead paint are another frequent source of housing discrimination here. Some landlords use the presence of lead paint, a known danger to small children, as an excuse not to rent to families with children, but Mr. Mannina said the law requires them to have it removed.

"It's absolutely clear under Massachusetts law that that is illegal discrimination," Mr. Mannina said. "If the landlords are in the rental business and can't afford to de-lead, they shouldn't be in the rental business."

But Mr. Mannina and Ms. Johnson point out that landlords are not required to rent to somebody just because they fall under one of the categories protected under state and federal laws. Bad credit, poor references and an inability to pay the rent all are legitimate business reasons to deny an apartment to a prospective tenant regardless of his or her race or family status or any other factor, they said.

"The landlord has the right to pick the best possible tenant, as long as they can prove they are making choices based on legitimate business reasons," Ms. Johnson said.

Contact Thomas Caywood by e-mail at tcaywood@telegram.com

GRAPHIC: GRAPHS; CHARTS
(PHOTO) Jane L. Edmonstone is project attorney for the Worcester Fair Housing Project, and Jonathan L. Mannina is executive director of the Legal Assistance Corporation of Central Massachusetts. Worcester Fair Housing Project is a joint project between LACCM and the city of Worcester. (GRAPH 1) U.S. housing discrimination complaints filed (GRAPH 2) Local housing discrimination complaints (CHART 1) Breakdown of complaints (CHART 2) Breakdown of complaints (PHOTO) T&G Staff/TOM RETTIG (GRAPHS, CHARTS) T&G Staff/DON LANDGREN JR.

LOAD-DATE: June 10, 2008

Housing complaints increase, but fewer charges are filed USA TODAY May 27, 2008 Tuesday

1.

USA TODAY

May 27, 2008 Tuesday
FINAL EDITION

SECTION: NEWS; Pg. 1A

LENGTH: 464 words

HEADLINE: Housing complaints increase, but fewer charges are filed

BYLINE: Donna Leinwand

BODY:

WASHINGTON -- The federal government is filing fewer housing discrimination charges even as consumer complaints against landlords, real estate agents and mortgage brokers have risen steadily.

Most renters and buyers who seek help from the U.S. Department of Housing and Urban Development are unlikely to get relief for their complaints, which can include alleged discrimination by landlords and sellers based on race, religion, sex or disability. The agency is throwing out a growing number of complaints, federal data show.

The housing agency, responsible for investigating and prosecuting cases under the Federal Fair Housing Act, filed 31 discrimination charges in 2007 and 36 in 2006. Charges for those two years combined dropped 65% from the last two years of the Clinton administration -- 111 charges were filed in 1999; 82 in 2000.

Complaints during the same period rose from fewer than 7,100 in both 1999 and 2000 to more than 10,000 in both 2006 and 2007.

The agency settles most of its discrimination cases out of court, but the percentage of cases settled also is down.

This year, the housing agency has charged 12 housing providers with discrimination and referred two cases to the Justice Department because of an alleged pattern of discrimination, agency data show.

The National Fair Housing Alliance, a housing rights group, says HUD and Justice do not vigorously enforce fair housing laws. "It's a drop in the bucket for the number of complaints that happen annually," CEO Shanna Smith says.

Federal housing officials say cases may take years to resolve in court, so they prefer to negotiate settlements for victims.

"We're obtaining the comparable relief that we would obtain in the court, and we're doing it faster," says Bryan Greene, HUD deputy assistant secretary for enforcement.

The agency is settling more cases overall than during the previous administration, but the percentage of settled cases has declined. In 1999, HUD settled 778 cases, 42% of the total investigated. In 2007, it settled 948 cases -- 36.5% of the total investigated.

HUD dismissed nearly two-thirds of the 2,595 investigated complaints last year. The agency closes cases for reasons such as failure to locate the alleged victim, or for lack of evidence. The remaining 7,000 complaints go to HUD-certified and -funded local and state agencies.

Housing cases at the civil rights division of the Justice Department, which prosecutes cases in which investigators find patterns of discrimination, also have dropped. The department filed 35 civil lawsuits in 2007, marking a steady decrease since 1999.

A Senate committee held a confirmation hearing last week for Steven Preston, President Bush's nominee to replace Alphonso Jackson as HUD secretary. Jackson resigned April 18 amid allegations of misconduct.

NO ROOM FOR YOU?Last year, 10,000 people filed complaints claiming housing discrimination, HUD says. Orlando Sentinel (Florida) May 5, 2008 Monday

1.

Orlando Sentinel (Florida)

May 5, 2008 Monday
FINAL

SECTION: GOOD LIVING; FLORIDA; THE LAW & YOU; Pg. C1

LENGTH: 1310 words

HEADLINE: NO ROOM FOR YOU?
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BYLINE: Steven D. Barnes, Sentinel Staff Writer

BODY:

Forty years after the passage of the Civil Rights Act of 1968, an African-American is leading in the race to become the next presidential nominee of the Democratic Party. It's a long way from the days when blacks in the South were turned away from "white only" restaurants, told they couldn't live in certain communities or denied a loan because of the color of their skin.

Or is it?

Lewarna Williams, who in December was allegedly denied an apartment at the Fountain View complex in Orange City because of her race, might think otherwise. So might black guests who were forced to wear wrist bands, pay extra deposits and endure other slights at the former Adam's Mark Hotel during the 1999 Black College Reunion in Daytona Beach. And the black Maryland lawmaker who in 2001was told he would only be served in the back room of the Perry Package Store and Lounge in North Florida might also have some doubts.

In fact, the U.S. Department of Housing and Urban Development reported that last year more than 10,000 people nationwide filed complaints of housing discrimination based on race, disability and other factors.

Kim Kendrick, HUD's assistant secretary for Fair Housing and Equal Opportunity, said the most blatant examples of discrimination are on the decline. But cases such as Williams' -- in which she was allegedly told there were no apartments available when in fact they were -- remain common.

"It happens a lot," Kendrick said. "[But] today it's more subtle -- what we get is 'there is nothing available.' Most people know now that you can't say you won't rent to somebody because of their race."

HUD filed charges last week in the Fountain View case, after its investigation found reasonable cause to believe that apartment owner James Stevens of Orange City and manager Mildred Chastain of Deltona had violated the federal Fair Housing Act.

According to charging documents, Williams became suspicious after being told there were no vacancies and had a family friend call the complex a short time later. That friend was told there were apartments available. A subsequent undercover investigation by WKMG-Channel 6 news had similar results: When a black employee went in and requested an apartment, he was told there were no vacancies. A half-hour later, a white employee was told apartments were available and was given a tour of the complex, according to the station's broadcast.

If found guilty of violating the Fair Housing Act, Stevens and Chastain could each face fines of up to $16,000. A separate investigation by the Florida Attorney General's Office is ongoing. Williams' quick action and the subsequent video evidence helped the case move forward quickly. But Kendrick and others said most cases of discrimination go unreported.

Mike Williams, a real estate salesman and chairman of the housing committee for the West Volusia branch of the NAACP, said that's because people often don't know where to turn for help.

"A lot of times when they get mistreated they don't do anything about it," he said. "Some of it, from my experience, is that there is an ignorance of where to go or what to do."

The Florida Commission on Human Relations, a state agency that investigates discrimination cases, is trying to change that.

Spokesperson Leah Barber-Heinz said the agency should be the first stop for anyone who suspects they have been victimized. Calling a toll-free number or completing an online questionnaire is all that is needed to get the ball rolling. If the agency thinks there is something amiss, an investigator is assigned to look into the allegations. Depending on the findings, the case can then be pursued in-house or referred to the Florida Attorney General's Office or the appropriate federal agency.

Discrimination warning signs

*Gut check: Sometimes, just a feeling that something isn't quite right can be a signal.

*Inappropriate questions: Rental agents should not ask questions about your race, age, religion or disability. Neither should employers or lending agents.

*Blatant racism: Employers, rental agents, banks and other businesses may not charge additional fees or otherwise treat people differently because of their race, color, religion, sex, national origin, disability or marital or family status.

If you feel you have been a victim

*Call the Florida Commission on Human Relations at 1-800-342-8170 to discuss your concerns.

*Visit the commission's Web site at fchr.state.fl.us and fill out a questionnaire that will help the agency decide if there is enough evidence to begin an investigation. If there is, the agency will assign an investigator or refer the case to the Florida Attorney General's Office or federal authorities, depending on the circumstances.

*The commission is required to complete investigations within 100 days of a complaint being filed. Most cases are settled before they go to court, and remedies can include financial compensation for the victim and a requirement that the violator correct the situation. If a settlement cannot be reached in state cases, the complainant has the option of having either the commission or the Florida Attorney General's Office file suit. Federal cases are heard by an administrative law judge or in federal court.

*There is no cost to have a complaint investigated, nor do victims have to hire an attorney.

Seeking justice

State and federal officials have the authority to file civil suits against suspected offenders, with awards going to victims. Individuals may also elect to file a private lawsuit using their own attorney.

*The Florida Commission on Human Relations is often the first agency to investigate allegations of racism in Florida. The agency has the power to conduct investigations, sue or refer the case to another agency. Penalties can reach $10,000 for a first offense; 25,000 for a second offense within five years; and $50,000 for a third or subsequent offense within seven years: fchr.state.fl.us.

*The Florida Attorney General's office can also launch independent investigations. Most of the cases it handles deal with high-profile or egregious cases. Penalties are similar to those that may be imposed by the commission: myflorida legal.com.

*HUD, the U.S. Department of Housing and Urban Development, is the lead federal agency in housing-discrimination cases. HUD can conduct independent investigations and seek penalties of up to $16,000, for a first offense. That amount can more than double for a second offense within five years. The agency also uses local partners to conduct undercover "tests" of businesses suspected of violations. In extreme cases, such as intimidation, cross burning or threats, the agency can bring criminal charges: www.hud.gov.

*Individuals can also sue on their own. Awards can sometimes reach into the millions. The former Adam's Mark Hotel in Daytona Beach paid out $1.1 million in 2001 to settle a pair of suits related to the Black College Reunion event. Some attorneys will handle such cases on a contingency basis, meaning there is no cost if the case isn't won.

Help for businesses

Officials say even well-intentioned businesses can get into trouble if they or their employees don't know the law. To prevent that, the Florida Commission on Human Relations offers training and outreach programs to business and groups concerned with civil rights.

* The agency is planning a community event in Orlando in the coming months, but the date has not been set. It is also launching a program that will train individuals to educate business owners about fair housing and employment issues.

*For more information, call 850-488-7082 or visit the commission Web site at fchr.state.fl.us. The site contains an explanation and links to relevant statutes.

*The Equal Employment Opportunity Commission also offers an online primer that can help businesses understand employment laws at ada.gov.