Golden Gate University Law Review

Volume 6 | Issue 3 Article 1

January 1976

# Redlining: Why Make A Federal Case Out of It

Elaine M. Andrews

Matthew J. Shier

Follow this and additional works at: http://digitalcommons.law.ggu.edu/ggulrev

Part of the Law Commons

Recommended Citation

Elaine M. Andrews and Matthew J. Shier, *Redlining: Why Make A Federal Case Out of It*, 6 Golden Gate U. L. Rev. (1976).
http://digitalcommons.law.ggu.edu/ggulrev/vol6/iss3/1

This Article is brought to you for free and open access by the Academic Journals at GGU Law Digital Commons. It has been accepted for inclusion in Golden Gate University Law Review by an authorized administrator of GGU Law Digital Commons. For more information, please contact jfischer@ggu.edu.

# Redlining: Why Make A Federal Case Out of It

Elaine M. Andrews*
Matthew J. Shier**

## INTRODUCTION

Redlining is the practice of refusing to make secured loans to borrowers in a specific geographical area.[1] The result of this practice, commonly called "disinvestment," is that entire urban sectors are effectively denied access to funds necessary for neighborhood preservation.[2] Numerous legal theories may be available to

---

*Member, third year class.
**Member, third year class.

1. The term "redlining" is commonly used to denote

> the practice of denying mortgage financing on property located within certain geographical areas of a city. These areas are generally the older, run-down sections of the city—the ghetto and adjacent areas, and sections undergoing racial transition.

Duncan, Hood & Neet, *Redlining Practices, Racial Resegregation and Urban Decay: Neighborhood Housing Services as a Viable Alternative*, 7 URBAN LAW. 510, 513 (1975).

However, the term "redlining" is often more expansively applied to include such practices as

> denying mortgage loans, or approving them on terms less favorable than are usually offered because of the association's assessment of neighborhood factors which in the view of the association may affect present or future real estate value in the geographical area in which the property to be purchased is located.

Business & Transportation Agency, Proposals Concerning the Content of Sub-chapters 4 and 23, Chapter 2, Title 10, Administration Code § 245(b) (entitled Loans by Area). [This proposed legislation shall hereinafter be cited as California's Anti-Redlining Proposals]. A copy of the proposals, which are expected to be revised and enacted by summer, 1976, can be obtained from the Business and Transportation Agency, Office of the Secretary, 1120 "N" Street, P.O. Box 1139, Sacramento, Cal. 95805.

The term "redlining" has also been applied to describe "discrimination in lending on the basis of the racial or ethnic composition, age of homes, or income levels of the residents in an area." Center for New Corporate Priorities, Where the Money Is, Mortgage Lending, Los Angeles County 6 (1975). (Copies of this public interest report are available from The Center for New Corporate Priorities, 1516 Westwood Blvd., Suite 202, Los Angeles, CA 90024) [hereinafter cited as New Corporate Priorities Report].

2. *See generally* New Corporate Priorities Report, *supra* note 1, at 5; U.S. COMMISSION ON CIVIL RIGHTS, FEDERAL CIVIL RIGHTS ENFORCEMENT EFFORT—A REASSESSMENT (1973); Taggart, *Redlining: How the Bankers Starve the Cities to Feed the Suburbs*, 40 PLANNING 14 (1974); A. Rothenberg, The Impact of Real Estate Lending Biases on the Purchase and Rehabilitation of Older Urban Residences (1976).



Published by GGU Law Digital Commons, 1976

enjoin redlining by private lenders. The practice may violate the antitrust laws,[3] or constitute a breach of the lender's duty to its depositors to make funds available for local home finance.[4] The

3. *See* Comment, *Redlining: Potential Civil Rights and Sherman Act Violations Raised By Lending Policies*, 8 IND. L. REV. 1045, 1053-62 (1975) [hereinafter cited as *Redlining, Civil Rights and the Sherman Act*]. Redlining may constitute a violation of section 1 of the Sherman Act, 15 U.S.C. § 1 (1970), which prohibits a combination or conspiracy in restraint of trade. Where lenders uniformly refuse to make loans in an area, or make them on more onerous terms, an illegal price-fixing arrangement may be inferred. This conduct may be labeled a "group refusal to deal," which is also actionable under section 1. Finally, the imposition of more onerous terms may constitute an illegal "tying" arrangement under section 1. Nevertheless, it will be difficult to show the requisite concerted action among lenders since each could independently justify their disinvestment policies. *See* notes 160-65 *infra* and accompanying text on the "business necessity doctrine."

4. "From their earliest days, savings and loans have been thought of as neighborhood credit pooling arrangements for home finance." W. Smith, "Redlining," Current Urban Land Topics, No. 1, at 7 (Oct., 1975) (published by the Center for Real Estate and Urban Economy, University of California, 2420 Bowditch Street, Berkeley, Cal. 94720 [hereinafter cited as CREUE Report]. A savings and loan (s & l) is a corporation formed in accordance with a statutorily defined corporate purpose, *see, e.g.*, 12 U.S.C. § 1464(a) (1970); CAL. FIN. CODE § 5503(c) (West 1968); ILL. ANN. STAT. § 702 (Smith-Hurd 1970), or a similar judicially defined corporate purpose, *see* Warsofsky v. Sherman, 326 Mass. 290, 93 N.E.2d 612 (1950); People *ex rel.* Fairchild v. Preston, 140 N.Y. 549, 35 N.E. 979, 101 N.Y.S. 1168 (1894). That purpose is to allow individuals to accumulate savings and to provide for the financing of their homes. *See* 12 U.S.C. § 1465 (1970); CAL. FIN. CODE § 5503(c) (West 1968), 32 ILL. ANN. STAT. § 702 (Smith-Hurd 1970); North American Building Loan Ass'n v. Richardson, 6 Cal. 2d 90, 56 P.2d 1221 (1936); Warsofsky v. Sherman, 326 Mass. 290, 93 N.E.2d 612 (1950).

To the extent that a s & l fails to return a fair proportion of the amount of deposits received from a given neighborhood, credit-worthy depositors residing in that neighborhood and credit-worthy depositors wishing to move there, who are denied loans because the collateral is located in that neighborhood, may have a cause of action against the s & l based on any one of the following theories.

First, all depositors of mutually owned s & ls (88% of all s & ls in the United States, and all federally chartered s & ls, are mutually owned. ABA COMMITTEE ON SAVINGS AND LOAN ASSOCIATIONS, SECTION OF CORPORATE BANKING AND BUSINESS LAW, HANDBOOK OF SAVINGS AND LOAN LAW 12 (1973)) are members with rights similar to those of shareholders of any corporation. *See, e.g., In re* Guaranty Building & Loan Ass'n, 49 F.2d 776 (S.D. Cal 1931); 12 C.F.R. § 544.1 (1975). It may therefore be argued that since an s & l is created to perform two distinct functions—to accumulate depositor savings and to finance depositor's homes—the refusal to loan to a credit-worthy depositor solely because of the location of the collateral seems to be a failure of the s & l to adhere to its required corporate purposes. This failure contributes to neighborhood decline and harms all depositors residing in redlined areas (*see* note 128 *infra* on standing). All depositors, like corporate shareholders, should have a cause of action to compel the s & l to make loans in these areas.

A second theory is that credit-worthy individuals who deposit their savings in an s & l reasonably expect to obtain home financing. CREUE Report, *supra* at 7. This is based on the contractual notion that part of the bargained for exchange when an individual deposits money in an s & l is access to a pool of credit for home finance. Such an expectation derives from the historical role played by s & ls in the financing of depositors' homes. *Id.* Under this theory, the depositor's cause of action is based on the

thesis of this article is that redlining is a racially discriminatory practice directly encouraged by the federal government.[5]

The article will suggest two ways in which this practice can be successfully attacked. First, to the extent the federal government is or has engaged in racially discriminatory redlining, such conduct is unconstitutional under the due process clause of the fifth amendment, and in violation of the Fair Housing Act of 1968.[6] Second, redlining by private lenders is in violation of the Fair Housing Act if such practices have a disproportionate effect on racial minorities which cannot be justified by a business necessity. Despite the presence of a business necessity, a lender may still be liable if its discrimination in the past has given rise to the business necessity today.

---

implied promise to loan which arises when the savings are deposited, and it is breached when the s & l refuses to loan money to the depositor because of the location of the collateral.

The third theory is that an s & l's license to do business is granted on the condition that the s & l perform its corporate purpose of accepting deposits to provide for local home finance. If an s & l fails to fulfill its state-imposed corporate purpose, it should be denied the right to do business until it complies. Since depositors are directly injured by such action, they should have standing to challenge the s & l's corporate status. *See generally* Alexander v. Atlanta & W. Point R.R., 113 Ga. 193, 38 S.E. 772 (1901).

In response to the foregoing theories, it has been suggested that s & ls have a primary duty to safeguard depositor's funds by providing the best return with the least risk. CREUE Report, *supra* at 8. Thus, the neighborhood exclusion is justified because of the so-called "high risk" involved. But this suggestion completely ignores the equally important statutory purpose of an s & l—the financing of members' homes. By refusing to loan money in a given locale, lenders contribute to the inevitable economic decline of the depositor's property. *Id.* at 3. This property devaluation is at least as detrimental to a potential borrower/depositor as the risk to his savings, were the s & l to make loans in the area.

Further, the presumption that an area is "high risk" is overbroad, since there is a good possibility a loan in such an area would be profitable if the applicant was evaluated individually. Moreover, such a loan would tend to maintain the area's economic viability. Finally, once lenders decide to disinvest, the decline, and hence loss to the depositor, is unavoidable. CREUE Report, *supra* at 7. Thus, the decision to disinvest adversely effects the area, and is unjustified unless the individual depositor is not credit-worthy.

The foregoing indicates that depositors may have a cause of action against an s & l merely by virtue of depositing savings in a corporation which is historically, statutorily and/or judicially required to use such funds for the financing of members' homes.

5. At least two writers have discussed the feasibility of using the Civil Rights statutes to attack the practice, but both have failed to fully assess the extent of their applicability. *See* Duncan, Hood & Neet, *supra* note 1; *Redlining, Civil Rights and the Sherman Act*, *supra* note 3. Neither article addressed the issue of what to do if a lender shows a "business necessity" for its redlining practices, a likely possibility in many contemporary cases.

6. 42 U.S.C. §§ 3600-31 (1970).



Published by GGU Law Digital Commons, 1976

## I. OVERVIEW

The evidence documenting redlining is ample and growing.[7] These patterns of disinvestment are often more subtle than an outright refusal to lend in specific geographical areas.[8]

> Most institutions rely on . . . subtle practices, rather than openly declaring a policy of not lending in certain communities, simply to avoid negative public reaction and whatever legal or administrative action they may be subject to.[9]

7. Studies documenting the existence of redlining are too numerous to summarize here. For a brief listing of available studies see Duncan, Hood & Neet, *supra* note 1, at 513 nn.6 & 11; *Redlining, Civil Rights and the Sherman Act*, *supra* note 3, at 1045 n.2.

Recent additions to this growing list should include the New Corporate Priorities Report, *supra* note 1, at 5. This report summarizes a five month study of mortgage lending in the Los Angeles area. The report documents a great disparity in allocation of mortgage funds. The results indicate that over 14 percent of the population received less than one percent of the single family loan dollars, and that savings and loans in these mortgage-starved communities listed deposits of more than $700,000,000 during the applicable study period. The summary indicated that "[p]eople in East Los Angeles saw only $1 in mortgage lending per capita . . . while Beverly Hills residents received $617 per capita." *Id.* A study of Northern California mortgage lending practices was conducted by Dr. Robert Wong of the California Department of Savings and Loans. The study is summarized in the form of color coded maps, copies of which are not available to the public. (These maps are located at the Office of the Business and Transportation, 1120 "N" Street, Sacramento, Cal. 95814.) However, a statement summarizing the results was read into the record of special hearings held on redlining practices:

> The combined population of the low volume loan areas [comprising seven counties] . . . is roughly five hundred thousand people. This population, twelve percent of the [total] Bay Area population, is receiving .6% of the total . . . mortgage financing. The population in these areas is fifty-one percent Black or Spanish heritage.

*Hearings on Redlining, State of California Business & Transportation Agency*, San Francisco, 47 (June, 1975). These hearings, which were held in Los Angeles on June 16th and in San Francisco on June 23rd, have been combined in a single volume and transcripts of the Hearings are available from the Office of the Secretary, Business & Transportation Agency, 1120 "N" Street, Sacramento, Cal. 95814) [hereinafter cited as *California Redlining Hearings*]. A recently revised publication, by A. Rothenberg, *supra* note 2, explores the problem from the perspective of a bank officer concerned with urban renewal.

8. *See* Community Information Project, Regulating Redlining: Recommendations to the State Savings and Loan Commissioner and Superintendent of Banks 3 (July, 1975) [hereinafter cited as Redlining Recommendations]; *Ad Hoc Congressional Hearings on the U.S. Dep't of Housing and Urban Development Policies and Their Implementation in the City of Oakland, California* (Oct., 1974) (Congressmen Dellums and Stark presiding) [hereinafter cited as *Oakland Hearings*]. *See also* Clark v. Universal Builders, Inc., 501 F.2d 324 (7th Cir.), *cert. denied*, 419 U.S. 1070 (1974), Love v. DeCarlo Homes, Inc., 482 F.2d 613 (5th Cir.), *cert. denied*, 414 U.S. 1115 (1973).

9. Redlining Recommendations, *supra* note 8, at 3.

Lenders can effectively redline by underappraising property,[10] shortening payment terms,[11] refusing refinancing,[12] and shifting loan portfolios.[13] The results of these redlining practices have tragic consequences for the qualified borrower, the neighborhood in which the borrower seeks to live, and the greater urban sector which is made up of mortgage-starved neighborhoods.

Underappraisal has a dual effect:

> On the one hand it is an easy device for reducing the demand for conventional mortgage loans as owners will be increasingly unwilling to sell their properties at such deflated values. On the other hand, this practice artificially depresses property values especially in neighborhoods where owners are desperate to sell.[14]

Continued underappraisal can panic remaining owners who see their equity evaporating. In an attempt to minimize their increasing loss, residents then sell to speculators.[15]

Shortening the payment terms of mortgages also has a two-edged effect: it injures the owner by limiting the number of potential purchasers to those who can meet the increased payments, and it injures the purchaser by decreasing the available capital

10. It has been generally recognized that an area can be redlined in several different ways which result in increased burden to the borrower and a greater possibility of foreclosure in the neighborhood. For a general overview of these processes see Redlining Recommendations, *supra* note 8, at 4-7; Duncan, Hood & Neet, *supra* note 1, at 513-14 & nn.12-16; *Redlining, Civil Rights and the Sherman Act*, *supra* note 3, at 1045 n.2, *citing* information obtained from the Housing Training and Information Center (4207 West Division St., Chicago, Ill. 60651) which suggests

> redlining . . . include[s] requiring higher down payments, . . . interest rates or closing costs, fixing earlier maturity dates, . . . stalling on appraisals, setting appraisals below actual market value, [and] applying more rigid appraisal standards . . . .

*See also* A. Rothenberg, *supra* note 2, at 24-26.

11. Redlining Recommendations, *supra* note 8, at 4-7.

12. *Id.* at 4-7.

13. This phenomenon involves a process whereby lenders begin to substitute conventional loans (loans made by private lenders which are neither insured nor guaranteed by the federal government) with those insured by the government through the Federal Housing Administration (FHA) or guaranteed by the Veterans Administration (VA). *See* Nourse & Phares, *The Impact of FHA Insurance Practices on Urban Housing Markets in Transition–The St. Louis Case*, 9 URBAN LAW ANNUAL 111 (1975). *See also California Redlining Hearings*, Los Angeles, *supra* note 7, at 18-19.

14. Redlining Recommendations, *supra* note 8, at 4.

15. *See id. See also* CREUE Report, *supra* note 4, at 3.



Published by GGU Law Digital Commons, 1976

necessary for proper home maintenance.[16] Lenders, by refusing refinancing to faithful borrowers who encounter temporary financial difficulty, increase the numbers of foreclosures.[17] This in turn further destabilizes transitional neighborhoods.[18]

Finally, redlining can be accomplished by "shifting loan portfolios."[19] This shift in the source of lending is not a neutral shift, rather, it can be a temporary compromise position in the process toward total disinvestment.[20] That is, the lender is willing to remain in an area for a period of time processing risk-free loans.[21] In this manner the Federal Housing Administration (FHA)[22] has been used by private lenders as a vehicle to diminish conventional lending in designated areas.[23] This transitional period is often profitable for the lender. Since the maximum allowable interest on an FHA-insured loan is usually less than that charged by the lender on a conventional loan, the lender compensates for this difference by charging the seller "points."[24] Thus, by receiving this differential at the outset, the lender obtains the interest equivalent to a conventional loan, and, at the same time, bears no risk.[25] Ordinarily, the lender immediately sells the loan

---

16. Redlining Recommendations, *supra* note 8, at 4.

17. *Id.* at 5.

18. *Oakland Hearings*, *supra* note 8, at 46-47.

19. *See* note 13 *supra*.

20. *California Redlining Hearings*, Los Angeles, *supra* note 7, at 18.

21. For a complete understanding of this financial paradox see Hood & Kusher, *Real Estate Finance: The Discount Point System and its Effect on Federally Insured Home Loans*, 40 U.M.K.C. L. Rev. 1, 14-21 (1971).

> Under [FHA financing], it is a happy mortgagee who makes bad loans and a successful one who has a high foreclosure rate. There are definite advantages to financing substandard inner-city properties over blue-chip suburban homes with federally insured funds.

*Id.* at 14.

22. The FHA was created by 12 U.S.C. §§ 1701-50jj (1970). Although the term Federal Housing Administration has been officially substituted by the term Department of Housing and Urban Development, *see* 42 U.S.C. §§, 3531 *et seq.* (1970), the term FHA is usually preferred and will be used throughout the article because frequent historical reference is made to FHA. The FHA is

> a government created and controlled insurance company functioning to insure certain kinds of loans made by private lenders.

Bartke, *The Federal Housing Administration: Its History and Operations*, 13 Wayne L. Rev. 651, 653 (1967).

23. *California Redlining Hearings*, Los Angeles, *supra* note 7, at 19.

24. "[P]oints are money paid to the lender to induce him to make a loan at the FHA-approved interest rate. They are computed as a percentage of the face amount of the mortgage note. For example, a 10 point charge on a $10,000 note would be $1,000." Hood & Kusher, *supra* note 21, at 5.

25. *Id.*

Andrews and Shier: Redlining



to the Federal National Mortgage Association, a federal corporation created to purchase insured loans from private lenders.[26] The Federal National Mortgage Association, commonly known as "Fannie Mae," pays the lender a small percentage of the loan value to continue to service the loan.[27] Foreclosure in such a risk-free cycle presents less concern for the lender that has already obtained through points and insurance the available economic advantages that flow from such a process. Foreclosure rates tend to increase because the lenders shift their emphasis from making loans that are secure on the basis of credit and collateral to processing and servicing loans that may not be carefully evaluated, but are profitable nonetheless because they are insured.[28] An increased incidence of foreclosures in a neighborhood accelerates the downward spiraling of a "transitional" neighborhood[29] since foreclosed properties are often abandoned and vandalized.[30] As crime increases and public services decline,[31] it becomes impossible for residents to sell their homes. Such economically stagnant neighborhoods are often targets for urban renewal demolition.[32] This destructive cycle need not continue. The following sections will explore the legal theories currently available to attack redlining.

## II. GOVERNMENTAL REDLINING

In order to determine exactly who initiates and perpetuates redlining, a rudimentary understanding of the home finance industry is prerequisite.[33] The private lender is clearly the most vis-

26. 12 U.S.C. § 1716 (1970). For a very readable overview of the secondary mortgage market see Bartke, *Fannie Mae and the Secondary Mortgage Market*, 66 Nw. U.L. Rev. 1 (1971). The secondary mortgage market is defined as

> the ability of mortgage investors, in an organized fashion either to dispose of mortgages in their portfolios through sale or to convert such mortgages into securities acceptable to other members of the investing public, directly or indirectly.

*Id.* at 8.

27. Bartke, *supra* note 26, at 7-8.

28. *California Redlining Hearings*, San Francisco, *supra* note 7, at 83-84.

29. *Id. See Oakland Hearings*, *supra* note 8, at 44-48; CREUE Report, *supra* note 4, at 3-4.

30. G. Sternlieb & R. Burchell, Residential Abandonment: The Tenement Landlord Revisited (1973); Weinstein, *Abandoned Housing: Cities Consuming Themselves*, 3 Real Estate Rev. 108 (1973); Comment, *Property Abandonment in Detroit*, 20 Wayne L. Rev. 845 (1974).

31. For a discussion of this phenomenon see CREUE Report, *supra* note 4, at 4.

32. Redlining Recommendations, *supra* note 8, at 4-5.

33. A thorough exploration and analysis of the mortgage investment industry is beyond the scope and purpose of this article. For a more in-depth discussion see Bartke, *supra* note 22; Bartke, *supra* note 26; Hood & Kusher, *supra* note 21; Nourse & Phares,



Published by GGU Law Digital Commons, 1976

ible actor in the redlining process, though, as will be shown, not the only or necessarily the most culpable one. The remaining three entities involve but one actor—the federal government—occupying three different positions. In its tripartite role of regulator, insurer and market maker, the government's past and present influence over the private lender becomes apparent. The following sections will trace the past discrimination of the governmental entities that are important in the mortgage finance field, and explore the manner in which their present policies perpetuate the intentional racial discrimination of the past.

### A. The Federal Government as Mortgage Insurer

The federal government, as a mortgage insurer, has occupied a powerful position in the mortgage industry. Through programs operated by FHA and the Veterans Administration (VA) the federal government assures private lenders that the money lent on residential mortgages through these programs will be repaid if the borrower should default.[34] Arguably, FHA and VA, through their underwriting and insurance standards, have encouraged disinvestment in certain neighborhoods on racial grounds since prior standards and guidelines were racially discriminatory per se.[35]

From the outset it was FHA's policy to encourage exclusion of racial minorities in an attempt to maintain neighborhood stability:[36]

> If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial groups.[37]

Toward this goal, the FHA recommended the use of racially restrictive covenants:[38]

> [I]nclusion of the restrictive covenant in real estate sales contracts became almost a prerequisite of FHA mortgage insurance. When

*supra* note 13; *Monetary Policy and the Residential Mortgage Market*, 53 Fed. Res. Bull. 718 (1967).

34. *See* Bartke, *supra* note 22.

35. *See* A. Rothenberg, *supra* note 2, at 10-13; notes 36-44 *infra* and accompanying text.

36. *See* CREUE Report, *supra* note 4, at 3, *citing* Home Owners Loan Corporation, Mortgage Risk Areas in Oakland and Berkeley (1936).

37. Federal Housing Administration, Underwriting and Appraisal Manual § 937 (1938).

38. *Id.*

> land was sold to Negroes or Mexican-Americans, under FHA policy, adjoining land would generally be classified as undesirable.[39]

In 1936, lenders joining the newly established FHA insurance program were counseled to avoid lending in "hazardous" areas.[40] The central criterion used to classify an area as hazardous for home loans was the proportion of "undesirable population."[41] By 1948, FHA had modified the form, but not the effect of its racially restrictive insurance requirements.[42] The open occupancy policy of FHA during the 1950s was little more than a step from explicit encouragement of racial discrimination to a position of implicit approval of such practices.[43] In fact, in its appraisal practices FHA rated loans according to the racial composition of the neighborhood.[44]

The present underwriting standards of FHA perpetuate the past racially motivated refusal to insure. Although FHA has changed its blatantly racial appraisal criteria,[45] the innocuous language of the current underwriting manual[46] still allows the appraiser to take into account such criteria as "whether . . . the property will be subject to unusual, extraordinary and excessive

---

39. UNITED STATES COMMISSION ON CIVIL RIGHTS, REPORT 4, HOUSING 16 (1961) [hereinafter cited as HOUSING].

40. CREUE Report, *supra* note 4, at 1.

41. *Id.*

42. In its 1947 Underwriting Manual, the FHA ceased to recommend the use of racially restrictive covenants. This change in posture was probably made in anticipation of the 1948 Supreme Court decision in Shelley v. Kraemer, 334 U.S. 1 (1948), which declared racially restrictive covenants unconstitutional and unenforceable. The blatantly racist language of the 1938 Manual was replaced with more restrained language—"inharmonious racial groups" became "user groups" and "incompatible groups." HOUSING, *supra* note 39, at 24.

43. The FHA continued to insure FHA applicants regardless of their discriminatory practices. Huge white-only housing developments were financed across the nation with federal funds. In Johnson v. Levitt & Sons, 131 F. Supp. 114, 116 (E.D. Pa. 1955), the court held that even though it was probably within FHA's power to prevent discrimination, it was not required to do so, thus allowing the defendant, a major developer, to refuse to sell his FHA and VA financed housing to blacks. As late as 1961, FHA maintained its fundamental position that developers and lenders could allocate federal mortgage funds in any manner they found profitable and proper. Non-discrimination was not one of the criteria considered in approving an institution for FHA dealings. Although "a non-discrimination requirement could be accomplished without additional legislation, FHA would not contemplate adopting such a requirement without a policy directive from the Congress or the Executive." HOUSING, *supra* note 39, at 24-26.

44. *California Redlining Hearings*, San Francisco, *supra* note 7, at 33.

45. *See* note 42 *supra* and accompanying text.

46. United States Dep't of Housing and Urban Development, Circular #4150.1, entitled "Subject: Valuation Analysis for Home Mortgage Insurance." (May, 1973).

loss of desirability, such as would occur if the district experienced a transition . . . from occupancy by people with high incomes to people with low incomes."[47] FHA also requires that attention be given to "trend and rate of changes of characteristics of the neighborhood and their effect upon land values."[48] Other components entering into valuation of property are "annual family income in the neighborhood,"[49] "population change,"[50] "neighborhood character"[51] and "probability of change in occupancy . . . which would tend to change desirability."[52] These vague guidelines allow appraisers to devalue property (potentially to a non-lendable category) on criteria which may be distinguishable in form but not in substance from FHA's racially restrictive standards of 1938.

### B. The Federal Government as Market Maker

Another role which the federal government has assumed, which is inextricably tied to its role as a mortgage insurer, is its role as a market maker. In this role, the federal government, through several federally created corporations, purchases long-term mortgage loans from private lenders, thereby releasing the banks' assets from long-term commitments. Stated in another manner, it provides liquidity for the lender which is then free to use the money to make other loans.[53]

The Federal National Mortgage Association (Fannie Mae) purchases only FHA and VA mortgages or mortgages conforming to FHA-VA requirements.[54] Thus, Fannie Mae's purchasing standards are tied to the insurance standards of FHA and VA. Therefore, to the extent that FHA and VA have utilized racially discriminatory underwriting standards, Fannie Mae has perpetuated and facilitated such discriminatory practices.

The other major federally chartered mortgage purchasing corporation, the Federal Home Loan Mortgage Corporation (Freddie Mac),[55] serves the savings and loan industry by purchas-

47. *Id.* § 1-17(c), at 1-11.
48. *Id.* § 1-19(b)(4), at 1-13.
49. *Id.* § 3-5(h), at 3-3.
50. *Id.* § 2-6, at 2-2.
51. *Id.* § 2-8(d), at 2-5.
52. *Id.* § 3-5(b), at 3-2.
53. *See* Bartke, *supra* note 26, at 6.
54. 12 U.S.C. § 1717(b)(1) (1970).
55. Freddie Mac was created by *id.* §§ 1451 *et seq.*

ing conventional loans made by such institutions.[56] Freddie Mac is authorized to purchase only

> residential mortgages which are deemed by the Corporation to be of such quality, type, and class as to meet generally the purchase standards imposed by private institutional mortgage investors.[57]

Accordingly, in order to maintain maximum flexibility, lenders will only make loans which meet Freddie Mac criteria.

The above discussion reveals the significance of the government's influence over private lenders. The federal government, through Freddie Mac and Fannie Mae, has encouraged underwriting practices which perpetuate redlining.[58] This is accomplished by providing federal funds to purchase mortgages that are themselves the product of past racially discriminatory underwriting standards.[59]

### C. The Federal Government as a Regulator

The federal government, through the Federal Home Loan Bank System (FHLBS),[60] either directly or indirectly (through its insurance of deposits) regulates 97 percent of all the nation's savings and loan institutions.[61] The Federal Home Loan Bank (FHLB)

---

56. *Id.* § 1454(a)(1).

57. *Id.*

58. For supportive commentary see A. Rothenberg, *supra* note 2, at 13-15.

59. Lenders have acknowledged that while

> Freddie Mac was not and is not a subsidy program . . . [its] underwriting practices have a great influence on what lenders do and don't do in the area of loan underwriting and, while Freddie Mac is a very new entity, a little more than 5 years old, it's very big. Around 7 billion dollars worth of loans have come into the mortgage market as a result of its activities.

*California Redlining Hearings*, Los Angeles, *supra* note 7, at 25-26. Thus, lenders are implicitly encouraged to maintain their present lending practices. Private lenders, accused of redlining, have demanded that the minimum property standards and family income requirements of Fannie Mae and Freddie Mac be reviewed.

> [T]he savings and loans must bear the brunt of lending responsibilities in these [declining] areas, but if it [is] good enough for us it . . . better be good enough for the two major national secondary mortgage market makers. If it is not, . . . their managements [should be] changed or their charters amended by Congress.

*California Redlining Hearings*, Los Angeles, *supra* note 7 at 24.

60. 12 U.S.C. §§ 1421 *et seq* (1970).

61. 1974 Savings and Loan Fact Book 112 (1974) (U.S. League of Sav. Ass'ns publication).



Published by GGU Law Digital Commons, 1976

has therefore been the most important regulator in the residential mortgage lending field.[62] It, too, has engaged in racial discrimination in promulgating its regulations. In 1961, the consensus of the nation's lending regulators was that race had a negative impact in neighborhood values and thus was a legitimate factor to be considered by mortgage lenders.[63] In providing guidance for the appraisers of its member institutions, the FHLB created a neighborhood rating scale which suggested lower appraisal values for an integrated neighborhood.[64]

Evidence suggests that the FHLB perpetuates and encourages redlining by its failure to rectify the results of its past discriminatory guidelines and to exercise its regulatory power to prohibit discrimination in lending. Not only has the FHLB contributed to the practice of redlining by its failure to carefully enforce its own mandates,[65] but it also has taken affirmative steps which aggravate disinvestment in declining neighborhoods. By liberalizing the geographic bounds of a lender's service area,[66] and by not requiring savings and loans to provide home financing to areas

62. Eighty percent of all savings and loans, which hold 97.7 percent of all the industry's assets, are members of the Federal Home Loan Banking System.

63. HOUSING, *supra* note 39, at 49.

64. Review of the Society of Residential Appraisers, "Neighborhood Rating," (Aug., 1940).

65. The FHLB Board recognizes that there is a real lack of sufficient mortgage capital in low-income areas and that "adequate mortgage financing is a necessary element in preventing or retarding decline." Federal Home Loan Bank of San Francisco, Information Bulletin: Statement of Dr. Maurice Mann, President, before the State of California Business and Transportation Agency, at 10 (June 18, 1975) [hereinafter cited as Federal Home Loan Bank Information Bulletin]. The power of the FHLB over its member institutions is plenary. The Board has the power through several of its regulatory provisions to exclude lending institutions from membership if the "character of its management or its home financing policy is inconsistent with sound and economical home financing," 12 U.S.C. § 1424(a) (1970), or with the purposes of this chapter which are "to provide local mutual thrift institutions in which people may invest their funds in order to provide for the financing of homes . . . ." *Id.* § 1464(a). It even has a mechanism for investigating practices, such as redlining, which are inconsistent with fair lending practices and in violation of recently enacted federal statutes prohibiting discrimination based on considerations such as the racial make-up of the neighborhood. Federal Home Loan Bank Information Bulletin, *supra* at 6. Even with these explicit guidelines and various mechanisms available to investigate and sanction violations, the president of one of the twelve regional banks has declared, "We do not have any positive proof of redlining practices in California by savings and loan associations or other financial institutions . . . but neither do we deny that such a practice may exist." *Id.* at 4. The FHLB has therefore perpetuated and encouraged redlining by its failure to perform its role of regulator in the lending industry.

66. 12 C.F.R. § 563.9 (1975). For relevant commentary see Wall St. Journal, Jan. 20, 1971, at 4.

from which they obtain their deposits,[67] federal regulators have created the conditions which allow lenders to disclaim any social or financial responsibility to lend in any one area. It has also been suggested that examination procedures which penalize a lender for over-appraising property[68] discourage lending on properties which require special familiarity to appraise correctly. Lenders, unfamiliar with such neighborhoods, either avoid lending in them altogether or tend to underappraise these "non-standard" properties to avoid examination penalties.[69]

## III. LEGAL THEORIES TO PROHIBIT GOVERNMENTAL REDLINING

The foregoing section has suggested that federal agencies practice or have practiced racially discriminatory redlining. Such practices arguably deprive individuals of rights guaranteed by Title VIII of the 1968 Civil Rights Act (Fair Housing Act)[70] and the due process clause of the fifth amendment. Thus, relief may be available either under the Consititution or through application of remedial federal statutes.[71]

### A. VIOLATION OF DUE PROCESS

The fourteenth amendment to the Constitution requires that "[n]o State shall. . . deny to any person within its jurisdiction the

67. Federal Home Loan Bank Information Bulletin, *supra* note 65, at 3.

68. Dean Cannon, Executive Vice-President of the California Savings and Loan League, a statewide trade association, testified:

> [R]egulatory officials from FHLBB [and other agencies] and the examiners who come in regularly . . . look at the high risk loans on their [s & l] portfolios . . . . [T]hey can spot appraise, and if in fact in their appraisal the properties do not equal the value for which they are on the books, or for which the loan was made, they are required to write those loans down and the state, in some cases, is required to place specific loss reserves against those balances. So the best way for the institution to avoid the restraints of the requirements of regulatory bodies is to make the majority of loans in housing areas where property values are going up, not down.

*California Redlining Hearings*, Los Angeles, *supra* note 7, at 3. For a discussion concerning lenders and appraisers resistance to inner-city lending see A. Rothenberg, *supra* note 2, at 17-24.

69. *Id.*

70. *See* note 117 *infra* and accompanying text.

71. The purpose of the following sections is to highlight possible avenues of relief under the federal constitution and various statutes. An in-depth analysis of each of these possible remedies is beyond the scope and purpose of the article. The information provided is intended as a general guide to the reader in assessing the potential and limitations of the proposed remedial tools.



Published by GGU Law Digital Commons, 1976

equal protection of the laws."[72] That a state may not engage in racial discrimination without a compelling state interest is well established.[73] This prohibition includes laws which are racially discriminatory either on their face[74] or as applied.[75] Finally, it is clear that the due process clause of the fifth amendment imposes no less a duty on the federal government than the due process and equal protection clauses of the fourteenth amendment impose on the states.[76] Thus, to the extent the federal government or its agencies have engaged in racially discriminatory redlining without a compelling governmental interest, individual rights guaranteed by the fifth amendment have been denied.[77] Victims of this type of activity may therefore have a cause of action for damages or injunctive relief requiring affirmative governmental action to remedy the present effects of its past discrimination.

### B. Remedial Federal Statutes

There are several statutory schemes which arguably provide relief from direct or indirect redlining by federal agencies. Some forms of relief available under these statutes may be more effective than others depending on the circumstances of the particular case and the actions of the defendant agency or entity.[78]

#### *The Administrative Procedure Act*

The Administrative Procedure Act (APA)[79] may provide equitable relief for those injured by redlining practices encouraged by federal policies.[80] The APA is a statutory scheme for judicial review of any final agency action, or inaction, for which there

---

72. U.S. Const. amend. XIV, § 1.

73. *See, e.g.*, Loving v. Virginia, 388 U.S. 1 (1967); Takahashi v. Fish & Game Comm'n, 334 U.S. 410 (1948); Strauder v. West Virginia, 100 U.S. 303 (1880).

74. *See* Loving v. Virginia, 388 U.S. 1 (1967).

75. *See* Yick Wo v. Hopkins, 118 U.S. 356 (1886).

76. *See* Weinberger v. Wiesenfeld, 420 U.S. 636, 638 n.2 (1975); Bolling v. Sharpe, 347 U.S. 497 (1954).

77. Very few cases involving a classification based on race have survived court scrutiny. These cases suggest that only where national security, *see* Korematsu v. United States, 323 U.S. 214 (1944), or public security, *see* Lee v. Washington, 390 U.S. 333 (1968), are threatened will the Court uphold a racial classification. It is therefore unlikely that the Federal National Mortgage Association, FHA or FHLB could assert an interest which would justify their discriminatory practices.

78. *See* notes 33-69 *supra* and accompanying text.

79. The Administrative Procedure Act is codified at 5 U.S.C. §§ 551-59, 701-06, 1305, 3105, 3344, 4301, 5335, 5362, 7521 (1970).

80. *See id.* § 702. The purpose of this statute is to provide for judicial review of agency action which causes a person to suffer a "legal wrong." A "legal

is no other adequate court remedy.[81] Although the APA forbids review of administrative decisions which are in the sole discretion of the agency,[82] it does not preclude review of discretionary decision-making which is allegedly arbitrary, capricious or contrary to a constitutional right.[83] If the court determines that the

---

wrong" has been variously defined by several cases decided under the Act. *See* Gonzalez v. Freeman, 334 F.2d 570 (D.C. Cir. 1964) (invasion of a legally protected right); Descomp, Inc. v. Sampson, 377 F. Supp. 254 (D. Del. 1974) (injury in fact, economic or otherwise). Economic injury in fact has been found to be an increase in cost and lower quality of medical care due to a proposed expansion of hospital facilities financed by a federally guaranteed loan. *See* Carman v. Richardson, 357 F. Supp. 1148 (D. Vt. 1973).

81. 5 U.S.C. § 704 (1970), which reads in part, "[a]gency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review." Section 704 has been interpreted to require that plaintiff exhaust available administrative remedies before invoking the jurisdiction of the court under this section. *See* American Fed'n of Gov't Employees, Local 1904 v. Resor, 442 F.2d 993 (3rd Cir. 1971); Casey v. Schlesinger, 382 F. Supp. 1218 (N.D. Okla. 1974); Hills v. Eisenhart, 156 F. Supp. 902 (N.D. Cal. 1957), *aff'd*, 256 F.2d 609 (9th Cir.), *cert. denied*, 358 U.S. 832 (1958).

However, the court has expressed its concern that the APA remain a flexible form of relief; hence, an aggrieved party is not required to exhaust administrative remedies which would be inadequate or ineffective. *See* Marsh v. County School Bd., 305 F.2d 94 (4th Cir. 1962); Oil Shale Corp. v. Udall, 235 F. Supp. 606 (D. Col. 1964). In the recent case of Bailey v. Romney, 359 F. Supp. 596 (D.D.C. 1972), in which the plaintiffs sought to challenge an administrative regulation, the court declared that plaintiffs need not exhaust their administrative remedies since the remedies were inherently inadequate and were applied to deny plaintiffs' rights. *Id.* at 598-99.

82. Section 701(a) states that

> [Judicial review] applies . . . except to the extent that—
> (1) statutes preclude judicial review; or
> (2) agency action is committed to agency discretion by law.

5 U.S.C. § 701(a) (1970). Thus in the absence of some statutory directive, courts determine on a case-by-case basis exactly what decisions made within the concerned agency are within their unfettered discretion and which are subject to judicial review. Approval by HUD of rent increases for federally subsidized housing was a matter found to be committed by law to the agency's discretion, thus not subject to review under section 701. *See* Hahn v. Gottlieb, 430 F.2d 1243 (1st Cir. 1970); Dew v. McLendon Gardens Associates, 394 F. Supp. 1223 (N.D. Ga. 1975).

83. *See* 5 U.S.C. §706(2)(A) (1970). Courts have determined that actions by the FHLB and FHA are subject to judicial review. *See* Elliott v. Federal Home Loan Bank Bd., 233 F. Supp. 578 (S.D. Cal. 1964), *rev'd on other grounds*, 386 F.2d 42 (9th Cir. 1967), *cert. denied*, 390 U.S. 1011 (1968) in which the United States District Court for the Southern District of California declared the APA "applicable to the Bank Board, and its actions to be judicially reviewable, and it [did] not have 'uncontrolled discretion.' " 233 F. Supp. at 588, *citing* Home Loan Bank Bd. v. Malonee, 196 F.2d 336 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953); Federal Home Loan Bank Bd. v. Long Beach Fed. Sav. & Loan Ass'n, 295 F.2d 403 (9th Cir. 1961). The courts have also determined that FHA's decision to insure a project was properly subject to review under the APA. In Harms v. Federal Housing Administration, 256 F. Supp. 757 (D. Md. 1966), a federal district court claimed jurisdiction over an action against the FHA and its area director in which the plaintiff challenged the agency determination that plaintiff engineer in a proposed project constituted an unreasonable risk and thus FHA was entitled to deny mortgage insurance to the project. A more recent decision held that FHA's decision to insure

administrative agency transgressed appropriate decisional standards, it can either "compel agency action unlawfully withheld or unreasonably delayed"[84] or "set aside [the] actions, findings and conclusions" found to have been illegal.[85] While the APA provides federal courts with a wide range of equitable remedies,[86] it may not empower courts to award damages against the government.[87]

It is argued that provisions of the APA[88] can be invoked by an individual or group of individuals whose constitutional rights[89] are violated and whose freedom from racial discrimination in obtaining home finance[90] is impaired by FHA and FHLB[91] practices. Courts have been willing to confer standing upon groups

---

housing which did not meet local building code requirements was agency action which was within the jurisdictional power of the district court to review. Jackson v. Lynn, 506 F.2d 233 (D.C. Cir. 1974).

The standard applied in reviewing administrative decisions is embodied in section 706(2)(a) and (b) recently articulated in the decision of Sierra Club v. Lynn, 502 F.2d 43 (5th Cir. 1974), *cert. denied*, 421 U.S. 994 (1975).

> [T]he appropriate standard of review is whether the . . . action was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." Under this standard the appellate court must determine whether the agency considered all relevant factors in reaching its decision, or whether the decision itself was a clear error of judgment.

Sierra Club v. Lynn, *supra* at 51 (citations omitted).

84. 5 U.S.C. § 706(1) (1970).

85. *Id.* § 706(2) includes a listing of methods which if used in reaching an administrative decision will allow the court to set it aside. In addition to those already mentioned, agencies may not act

> (c) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right
> (d) without observance of procedure required by law
> (e) unsupported by substantial evidence . . .
> (f) unwarranted by facts to the extent that the facts are subject to trial de novo by the reviewing court.

86. *Id.* § 703. Declaratory judgments, writs of prohibitory and mandatory injunction as well as mandamus are all considered to be available. Kristensen v. McGrath, 179 F.2d 796 (D.C. Cir. 1949), *aff'd*, 340 U.S. 162 (1950).

87. The APA is not deemed to be a waiver of all governmental immunity from suit. *See* Blackmar v. Guerre, 342 U.S. 512, 516 (1952) (dictum). However, recent cases have held that this chapter (7) does constitute a waiver of sovereign immunity concerning those claims that come within its scope. Kingsbrook Jewish Medical Center v. Richardson, 486 F.2d 663 (2d Cir. 1973); Kletchska v. Driver, 411 F.2d 436 (2d Cir. 1969); Krawez v. Stans, 306 F. Supp. 1230 (E.D.N.Y. 1969).

88. Administrative Procedure Act §§ 702, 706, 5 U.S.C. §§ 702, 706 (1970).

89. For a discussion of the general constitutionally based approach see notes 72-77 *supra* and accompanying text.

90. 42 U.S.C. § 3605 (1970).

91. It is not clear whether the Federal National Mortgage Association, or its conventional loan counterpart, Federal Home Loan Mortgage Association, are "agencies"

claiming to be adversely affected by illegal or arbitrary agency decisions, but a showing of direct injury to members of the interested group may be required before jurisdiction is invoked.[92] For example, an unsuccessful loan applicant must allege that the refusal to lend was a deprivation of a statutory[93] or constitutional right,[94] and that the neighborhood, as well as the applicant, was adversely affected by the agency's decision.[95]

### *Federal Tort Claims Act*

The Federal Tort Claims Act (FTCA)[96] grants jurisdiction to the federal courts over claims against the United States founded upon the Constitution or any act of Congress. The FTCA is not a blanket waiver of sovereign immunity,[97] and it contains numer-

---

within the jurisdiction of the Act. Section 701 defines agencies as "each authority of the government of the United States."

92. The issue of standing under this statute is not settled although recent cases display a more flexible approach to the problem. Courts have displayed an unwillingness to find that interested groups adversely affected by agency action had suffered the requisite legal wrong necessary to invoke jurisdiction. *See* Gart v. Cole, 166 F. Supp. 129 (S.D.N.Y. 1958), *cert. denied*, 359 U.S. 978 (1959); Green Street Ass'n v. Daley, 250 F. Supp. 139 (N.D. Ill. 1966), *aff'd*, 373 F.2d 1 (7th Cir.), *cert. denied*, 387 U.S. 932 (1967). *See also* Sierra Club v. Morton, 405 U.S. 727, 734-35 (1972), in which the Court determined that the "injury in fact" test requires that the party seeking review of agency action affecting rights of a non-economic nature be himself injured. It is not sufficient to merely show that a concerned group's interest be injured. However, the court declared that "[i]t is clear that an organization whose members are injured may represent those members in a proceeding for judicial review." *Id.* at 739. As to injury in fact of an economic nature see Association of Data Processing Serv. Organizations, Inc. v. Camp, 397 U.S. 150 (1970) and Barlow v. Collins, 397 U.S. 159 (1970), which appear to have applied more liberal standing requirements.

In California courts "[i]n recent years there has been a marked accommodation of formerly strict procedural requirements of standing to sue . . . [in] matters relating to the 'social and economic realities of the present-day organization of society . . . .' " Residents of Beverly Glen, Inc. v. City of Los Angeles, 34 Cal. App. 3d 117, 122, 109 Cal. Rptr. 724, 727 (1973), *citing* Professional Fire Fighters, Inc. v. City of Los Angeles, 60 Cal. 2d 276, 384 P.2d 158, 32 Cal. Rptr. 830 (1963). *See also* County of Alameda v. Carleson, 5 Cal. 3d 730, 737, 488 P.2d 953, 957, 97 Cal. Rptr. 385, 389 (1971).

93. 5 U.S.C. § 706(2)(a) (1970).

94. *Id.* § 706(2)(b).

95. Since the applicant is usually denied a loan by a private lending institution, the argument is somewhat attenuated. If FHA refuses to insure and Fannie Mae refuses to buy a loan because the area in which the collateral is located is "declining," (and declining becomes synonymous with large percentage high risk minority population) then banks will not make the loan. Thus the private lender becomes the vehicle by which the federal agencies adversely affect the constitutionally protected interests of the borrower.

96. 28 U.S.C. §§ 1346(b), 2671-80 (1970).

97. *See* United States v. Sherwood, 312 U.S. 584, 590 (1941). *Contra*, United States v. Emery, Bird, Thayer Realty Co., 237 U.S. 28 (1915).



Published by GGU Law Digital Commons, 1976

ous limitations and safeguards.[98] The major limitation in the present context is that the Act does not apply to a

> claim based upon . . . the failure to exercise or perform a discretionary function or duty on the part of a federal agency . . . whether or not the discretion involved be abused.[99]

While it can be argued that insuring, regulating or purchasing mortgages is a discretionary duty or function within the ambit of the foregoing exception, redlining victims could argue with equal force that the federal government, having made the initial decision to assume such activities, cannot now claim that a failure to perform such activities for a select segment of the population is "discretionary."

While the FTCA was not intended to be a flexible and wide-ranging tool for compensation,[100] it was meant to provide relief for those injured by government action. Further, the Fair Housing Act of 1968[101] has created a new legal duty to refrain from racial discrimination in housing, breach of which entitles victims to compensation.[102] Thus, redlining as a breach of the duties created by Title VIII may indeed be rectified under FTCA.

Moreover, in *Shannon v. HUD*,[103] the Court of Appeals for the Fifth Circuit declared that administrative decision-making which fails to assess all relevant considerations in light of the national policy against discrimination in housing[104] may in fact be a

---

98. The various exceptions are codified in 28 U.S.C. §§ 2860(a)-(n) (1970). Further limitations and safeguards are codified in sections 2401(b) (statute of limitations), 2402 (denial of jury trial), 2672 (administrative adjustment of claims less than $2,500), 2674 (no liability for punitive damages or for interest prior to judgment), 2675 (disposition by federal agency prerequisite to suit when claim is filed), 2677 (compromise), and 2679 (exclusiveness of remedy).

99. *Id.* § 2680.

100. "We find no parallel liability before, and we think no new one has been created by, this Act. Its effect is to waive immunity from recognized causes of action and was not to visit the government with novel and unprecedented liabilities." Feres v. United States, 340 U.S. 135, 142 (1950).

101. 42 U.S.C. §§ 3607-31 (1970).

102. Curtis v. Loether, 415 U.S. 189, 195 (1973). The court suggests that such a cause of action is analogous to and should be viewed as an extension of recognized common law torts such as defamation and intentional infliction of emotional distress. *Id.* at 195-96 nn.9 & 10, *citing* Rogers v. Loether, 467 F.2d 1110, 1115-16 (7th Cir. 1972); C. GREGORY & H. KALVEN, CASES AND MATERIALS ON TORTS 961 (2d ed. 1969).

103. 436 F.2d 809 (3d Cir. 1970).

104. *Id.* at 819.

wrongful breach of the federal duty to provide for fair housing.[105] Under this analysis, a federal agency's decision not to buy or insure loans in declining areas may not be exempted from liability as a discretionary function, but rather constitutes a breach of an affirmative duty capable of being remedied under the Act.[106]

## IV. PRIVATE LENDERS

Private lenders are an obvious target of redlining accusations since they are in a position to evaluate the credit worthiness of the borrower and the value of the property offered as security. Savings and loans supply the greatest source of home mortgages[107] and have grown into huge, nationwide financial institutions.[108]

Evidence suggests that private lenders have redlined along racial lines[109] to such an extent that "[b]anks [have] dictate[d]

105. 42 U.S.C. § 3608(d)(5) (1970) provides

> (d) The Secretary of Housing and Urban Development shall—
> (5) administer the programs and activities relating to housing and urban development in a manner affirmatively to further the policies of this subchapter [(to provide, within constitutional limitations, for fair housing throughout the United States)].

106.

> Read together, the Housing Act of 1949 and the Civil Rights Acts of 1964 and 1968 show a progression in the thinking of Congress as to what factors significantly contributed to urban blight and what steps must be taken to reverse the trend or to prevent the recurrence of such blight. In 1949 the Secretary, in examining whether a plan presented by a [local public agency] included a workable program for community improvement, could not act unconstitutionally, but possibly could act neutrally on the issue of racial segregation. By 1964 he was directed, when considering whether a program of community development was workable, to look at the effects of local planning action and to prevent discrimination in housing resulting from such action. In 1968 he was directed to act affirmatively to achieve fair housing. Whatever were the most significant features of a workable program for community improvement in 1949, by 1964 such a program had to be nondiscriminatory in its effects, and by 1968 the Secretary had to affirmatively promote fair housing.

Shannon v. HUD, 436 F.2d 809, 816 (3d Cir. 1970).

107. *See* notes 60-61 *supra* and accompanying text.

108. *See id.*

109. For recent documentation of such practices see the authorities cited at note 7 *supra*.

where Negroes can live."[110] A recent survey indicates that a lender's determination that a neighborhood is "turning sour" or shows "no growth potential" is often premised in part on the racial composition of the neighborhood.[111]

> In 1972, the Department of Housing and Urban Development, in a preliminary report covering more than 16,000 lending institutions in the country, found that fully 17 percent openly admitted that they considered the racial or ethnic character of neighborhoods in evaluating loan applications.[112]

Appraisal forms currently in use by state and federal lenders and regulators include sections on "neighborhood data" which require the appraiser to determine if the neighborhood is "improving," "stable," "declining" or "in transition."[113] The "neighborhood" section of the appraisal form supplied by Freddie Mac requires the appraiser to determine whether "property values" are increasing, stable, weak or declining, and to evaluate "neighborhood compatibility" on a scale of good to poor.[114] Fannie Mae requires the appraiser to indicate whether the "immediate neighborhood trend" is "improving, stable or declining."[115] Such evaluative criteria tend to encourage redlining. They require that property be evaluated in terms of "neighborhood trends," thereby perpetuating the circular process of devaluation and decline. The result of such discriminatory disinvestment practices

---

110. HOUSING, *supra* note 39, at 28. It has also been noted that a common approach to lending is based on

> the primary philosophy . . . to make loans in areas we wish to serve on high quality real estate most likely to remain in demand for the term of the loan . . . . [N]ew homes in conforming neighborhoods of high income level occupants are the most desirable. I cannot deny to anyone that it has been the intent of our lending policy to pass that test.

*California Redlining Hearings*, Los Angeles, *supra* note 7, at 5.

111. *See* U.S. Dep't of Housing & Urban Development, Office of Equal Opportunity, Private Lending Institution Questionnaire, Initial Report on Returns 9 (1972).

112. *Id.*

113. California Dep't of Savings & Loan, "Appraisal Report." (this is an appraisal information form currently in use and available from the Dep't of Savings and Loan, 450 Sansome Street, San Francisco, Ca.)

114. *See* Federal Home Loan Mortgage Corporation Form RE6C 5/74, entitled Residential Appraisal Report. *See also* Federal Home Loan Mortgage Corporation Underwriting Guidelines, "Single Family Loans," which is an explanatory guide to the appraisal report.

115. Federal National Mortgage Association Form 1004, revised Oct., 1972, entitled Appraisal Report, Single Family Residence.

has been and continues to be an increased disparity between the living conditions of white and minority populations.[116]

## A. Legal Theories to Prohibit Private Redlining

Redlining by lending institutions can be challenged under two provisions of Title VIII of the 1968 Civil Rights Act (Fair Housing Act)[117] and a third provision of Title VI of the 1964 Civil Rights Act.[118] Section 804(a) of Title VIII makes it unlawful to "refuse to sell or rent . . . or otherwise make unavailable . . . a dwelling to any person because of race . . . ."[119] Section 805 of Title VIII makes it unlawful for "any bank, [or] building and loan association, . . . to deny a loan . . . to a person applying therefore . . . because of the race . . . of such person . . . or of the present or prospective owners . . . or occupants of the dwelling or dwellings in relation to which such loan . . . is to be made or given . . . ."[120]

---

116. *See* Housing, *supra* note 39, at 17.

117. The Civil Rights Act of 1968 is codified at 42 U.S.C. §§ 3601-31 (1970).

118. *Id.* §2000d. It has been argued that redlining may be prohibited by *id.* § 1982, as well. Duncan, Hood & Neet, *supra* note 1, at 523-27; *Redlining, Civil Rights and the Sherman Act, supra* note 3, 1050-52.

119. Section 804(a), which is codified at 42 U.S.C. § 3604(a) (1970), provides:

> Discrimination in the Sale or Rental of Housing:
>
> As made applicable by section 3603 of this title and except as exempted by sections 3603(b) and 3607 of the title, it shall be unlawful—
>
> (a) To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, *or otherwise make unavailable* or deny, a dwelling to any person because of race, color, religion, or national origin.

*Id.* (emphasis added). The "otherwise make unavailable" language has been given a broad reading by the courts and applied specifically to a number of cases involving discriminatory conduct having nothing to do with refusal to sell or rent. *See* United States v. City of Black Jack, 508 F.2d 1179 (8th Cir. 1974) (municipal zoning ordinance which prohibited the construction of low to moderate income housing developments found to be in violation of Title VIII), *cert. denied* 422 U.S. 1042 (1975); Cornelius v. City of Parma, 374 F. Supp. 730 (N.D. Ohio 1974) (an ordinance requiring a referendum vote before certain kinds of low income housing could be built found to be in violation of Title VIII); Zuch v. Hussey, 366 F. Supp. 553 (E.D. Mich. 1973) (racial "steering" of homebuyers to particular neighborhoods found to be in violation of Title VIII). The foregoing phraseology has been described as "broad as Congress could have made it, and all practices which have the effect of denying dwellings on prohibited grounds are therefore unlawful." United States v. Youritan Constr. Co., 370 F. Supp. 643, 648 (N.D. Cal. 1973).

Since a buyer is not likely to be able to obtain housing without a mortgage loan, and if the effect of redlining is to "deny dwellings on prohibited grounds," there would be a violation of section 804(a).

120. Section 805, which is codified at 42 U.S.C. § 3605 (1970), provides:

> Discrimination in the Financing of Housing:
>
> After December 31, 1968, it shall be unlawful for any bank,



Published by GGU Law Digital Commons, 1976

Section 601 of Title VI of the Civil Rights Act of 1964 provides that "[n]o person . . . shall, on the ground of race . . . be subjected to discrimination under any program . . . receiving Federal financial assistance."[121] Additionally, redlining may be prohibited by regulations issued by the Federal Home Loan Bank Board which prohibit member institutions from denying loans "because of the race . . . of an applicant for any such loan . . . or the present or prospective owners . . . or occupant of other dwellings in the vicinity of the dwelling . . . in relation to which such loan . . . is to be made . . . ."[122]

*Applicability of Civil Rights Statutes to Discriminatory Effect*

Title VIII, Title VI and the federal regulations cited above prohibit racial discrimination. The practice of redlining by private lenders is not racially discriminatory per se. Although it is not clear

---

> building and loan association, insurance company or other corporation, association, firm or enterprise whose business consists in whole or in part in the making of commercial real estate loans, to deny a loan or other financial assistance to a person applying therefore for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling, or to discriminate against him in the fixing of the amount, interest rate, duration, or other terms or conditions of such loan or other financial assistance, because of the race, color, religion, or national origin of such person or of any person associated with him in connection with such loan or other financial assistance or the purposes of such loan or other financial assistance, or of the present or prospective owners, lessees, tenants, or occupants of the dwelling or dwellings in relation to which such loan or other financial assistance is to be made or given: *Provided*, that nothing contained in this section shall impair the scope or effectiveness of the exception in section 3603(b) of this title.

121. Section 601, which is codified at *id.* § 2000d, provides:

> Prohibition against exclusion from participation in, denial of benefits of, and discrimination under Federally assisted programs on ground of race, color, or national origin:
>
> No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.

Under Title VI, programs or activities that receive financial assistance "by way of grant, loan, or contract other than a contract of insurance or guaranty" are within the scope of protection of the Act. *Id.* § 2000d(1).

This section would thus be applicable to at least all members of the Federal Home Loan Bank System who receive grants or loans in the form of advances.

122. 12 C.F.R. § 528.2 (1975).

that race is the motivating factor in the practice,[123] it is clear that redlining has a disproportionate effect on racial minorities.[124] To invoke the foregoing provisions, it is necessary to show that Congress meant to proscribe action which, although racially neutral on its face, operates to discriminate against racial minorities.[125] Whether the Civil Rights Acts were intended to prohibit action resulting in discriminatory effect depends in part on the congressional purpose and policy underlying their conception. By its terms, section 3601 of Title VIII expresses a broad legislative intent:

> It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States.[126]

In *Trafficante v. Metropolitan Life Insurance Co.*,[127] the United States Supreme Court emphasized that Title VIII expresses "a policy that Congress considered to be of the highest priority," and directed that the Act be given "a generous construction."[128] It would seem that construing discriminatory effect as sufficient to establish a case

123. Nothing contained in current loan applications indicates that racial classifications are operative in the consideration of whether or not the loan will be granted.

124. *See* note 7 *supra*.

125. Where it could be shown that a lender explicitly discriminated on the basis of race, each statute by its terms would be violated. *See* notes 119-22 *supra* and accompanying text.

126. 42 U.S.C. § 3601 (1970).

127. 409 U.S. 205 (1972).

128. *Id.* at 211-12. The Court emphasized that the whole community is the victim of racial discrimination and that the purpose of Title VIII was to replace the ghettos "by truly integrated and balanced living patterns." *Id.* at 211. The Court therefore concluded that it could give vitality to Title VIII only by "a generous construction which gives standing to sue to all in the same housing unit who are injured by racial discrimination in the management of those facilities within the coverage of the statute." *Id.* at 212.

Since racially discriminatory lending is similarly covered by the statute, 42 U.S.C. § 3605 (1970), the foregoing language suggests that all victims of discriminatory lending would have standing to sue. Victims would include residents of the redlined area since

> (1) properties in these areas become hard to sell and tend to fall into the hands of "slumlords" or speculators, so that homeownership in the area declines;
> (2) maintenance and rehabilitation are discouraged and deterioration speeds up;
> (3) owners not intending to move away may be forced to do so, particularly if home improvement financing is refused; and
> (4) residents may feel unfairly deprived of access to their pool of savings.

CREUE Report, *supra* note 4, at 3. Additionally, redlining injures those wishing to move into the area since they are denied the right to live where they choose, and thus they too should have standing to sue under Title VIII.



Published by GGU Law Digital Commons, 1976

of racial discrimination is consistent with the broad intent that both Congress and the courts have given Title VIII. This interpretation of Title VIII's broad legislative intent has been confirmed by the lower federal courts. In *Marr v. Rife*,[129] the Court of Appeals for the Sixth Circuit viewed Title VIII as a "broad legislative plan to eliminate all traces of discrimination within the housing field."[130] Similarly, it has been declared that "[l]ike other civil rights statutes, [Title VIII] is to be accorded a broad construction in accordance with the . . . purpose [stated in section 3601]."[131]

Numerous courts have held that a showing of discriminatory effect establishes a prima facie case of racial discrimination.[132] In a case involving violations of Title VIII by the Cleveland Metropolitan Housing Authority (CMHA),[133] defendant CMHA contended that plaintiffs (all blacks and nonwhite tenants in, and applicants for, federally assisted public housing), in order to establish their case, had to show that the CMHA had directly or indirectly intended to discriminate or that they had discrimination as a motive. The court rejected this contention concluding that "[i]f this standard were to be applied, it would be very difficult to prove a violation in a civil rights case."[134] Since the burden of proof in Title VIII cases is governed by the concept of the prima facie case,[135] "plain-

---

129. 503 F.2d 735 (6th Cir. 1974).

130. *Id.* at 740.

131. United States v. Real Estate Dev. Corp., 347 F. Supp. 776, 781 (N.D. Miss. 1972).

132. *See, e.g.*, Robinson v. City of Dallas, 514 F.2d 1271, 1272-73 (5th Cir. 1975); United States v. City of Black Jack, 508 F.2d 1179, 1184 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975); Williams v. Matthews Co., 499 F.2d 819, 826 (8th Cir.), *cert. denied*, 419 U.S. 1021 (1974); United States v. Pelzer Realty Co., Inc., 484 F.2d 438, 443 (5th Cir. 1973); United States v. Youritan Constr. Co., 370 F. Supp. 643 (N.D. Cal. 1973); United States v. Grooms, 348 F. Supp. 1130, 1133-34 (M.D. Fla. 1972); Banks v. Perk, 341 F. Supp. 1175, 1183 (N.D. Ohio 1972). Also see an opinion rendered by Charles E. Allen, the general counsel of the Federal Home Loan Bank Board, expressing the view that

> the practice by member institutions of refusing to extend credit, and the practice of extending credit on terms which are less favorable than those usually offered to borrowers whose security property is located within a predetermined geographic area or areas, because of the location of the property, violate . . . [Title VIII] if such practices have a racially discriminatory effect against members of racial, ethnic, or religious groups.

FHLB System-Comment Rulings U13-49.2, at 8173-3 (Mar. 21, 1974) (Opinion letter, General Counsel Federal Home Loan Bank Board).

133. Banks v. Perk, 341 F. Supp. 1175 (N.D. Ohio 1972).

134. *Id.* at 1183.

135. *See* Williams v. Matthews Co., 499 F.2d 819, 826 (8th Cir.), *cert. denied*, 419 U.S. 1021 (1974).

tiff need prove no more than that the conduct of the defendant actually or predictably results in racial discrimination . . . ."[136] As has been stated,

> [e]ffect, and not motivation, is the touchstone, in part because clever men may easily conceal their motivations, but more importantly because . . . [w]hatever 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.[137]

This view is buttressed by the landmark Supreme Court decision in the Title VII area involving employment discrimination.[138] In *Griggs v. Duke Power Co.*,[139] the Court stated that "[Title VII] proscribes not only overt discrimination but also practices that are fair in form but discriminatory in operation,"[140] and that "Congress directed the thrust of the Act to the *consequences* of employment practices, not simply the motivation."[141] Given the legislative intent of Title VIII, and the broad judicial interpretation of that intent, it is clear that a showing of discriminatory effect establishes a prima facie violation of Title VIII.[142]

---

136. United States v. City of Black Jack, 508 F.2d 1179, 1184 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975).

137. 508 F.2d at 1185.

138. Reliance is placed on Title VII decisions by the courts in the Title VIII area. *See* United States v. Northside Realty Associates, Inc., 518 F.2d 884, 888 (5th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3532 (U.S., Mar. 22, 1976) (No. 792), *citing* Rowe v. General Motors Corp., 457 F.2d 348, 358 (5th Cir. 1972), for the proper weight to be given statistical evidence in cases of racial discrimination; United States v. City of Black Jack, 508 F.2d 1179, 1184 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975), *citing* Griggs v. Duke Power Co., 401 U.S. 424, 430-31 (1971), for the notion that discriminatory effect is prohibited; United States v. Real Estate Dev. Corp., 347 F. Supp. 776, 782 (N.D. Miss. 1972), *citing* Parkham v. Southwestern Bell Tel. Co., 433 F.2d 421, 426 (8th Cir. 1970), for the proposition that statistical evidence can establish a prima facie case of discrimination which shifts the burden of proof to the defendant to prove non-discrimination. This reliance indicates that the principles involved are common to both statutes and that Title VII cases should provide guidance on questions of discrimination in housing.

139. 401 U.S. 424 (1971).

140. *Id.* at 431.

141. *Id.* at 432.

142. But note that a recent Supreme Court decision has indicated that the constitutional standard for adjudicating claims of invidious racial discrimination under the fifth and fourteenth amendments is more rigid than under Title VII. Washington v. Davis, 96 S. Ct. 2040 (1976). Thus, evidence of disproportionate impact on racial minorities, standing alone, "does not trigger the rule that racial classifications are to be subjected to the strictest scrutiny and are justifiable only by the weightiest of considerations." *Id.* at 2049 (citation omitted). A complainant alleging a constitutional violation must, there-

*Proof of Discriminatory Effect*

Several courts have held that numerical proof of racial imbalance establishes a prima facie case of racial discrimination which shifts the burden to the defendant to show nondiscrimination.[143] "In the problem of racial discrimination, statistics often tell much and Courts listen."[144] Specifically, in Title VII cases, the courts have relied on statistical evidence in which discrimination against racial minorities is alleged. When a plaintiff in a Title VII case establishes by the use of statistics that there is substantial disparity between the percentage of minority persons employed by a given employer and the percentage of such persons in the local population, a prima facie case of discrimination is made out which shifts the burden of proof to the defendant to prove the absence of discrimination.[145]

Cases arising under Title VIII have likewise relied on statistics in determining whether or not a given practice is discriminatory. In *United States v. Northside Realty Associates, Inc.*,[146] the defendant had sold more than 3000 homes since the effective date of the Fair Housing Act of 1968—none to a black. The Court of Appeals for the Fifth Circuit stated that "figures of this kind, while not necessarily satisfying the whole case, have critical, if not decisive, significance."[147] Similarly, in *United States v. Youritan Construction*

---

fore, produce evidence of racially discriminatory motivation in addition to evidence of discriminatory effect. *Id.* at 2048. There appears to be sufficient evidence indicating that prior discrimination of federal home financing agencies was racially motivated; *see* notes 34-69 and accompanying text. Accordingly, a constitutional assault on governmental redlining is still feasible under this newly articulated standard.

143. *See, e.g.*, United States v. City of Black Jack, 508 F.2d 1179, 1185 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975); Williams v. Matthews Co., 499 F.2d 819, 826 (8th Cir.), *cert. denied*, 419 U.S. 1021 (1974); United States v. Wood Lathers, Local 46, 471 F.2d 408, 414 n.11 (2d Cir.), *cert. denied*, 412 U.S. 939 (1973); United States v. Chesapeake & O. Ry., 471 F.2d 582, 586 (4th Cir. 1972), *cert. denied*, 411 U.S. 939 (1973); Rowe v. General Motors Corp., 457 F.2d 348, 357-58 (5th Cir. 1972); United States v. Youritan Constr. Co., 370 F. Supp. 643, 649 (N.D. Cal. 1973), *modified*, 509 F.2d 623 (9th Cir. 1975).

144. Alabama v. United States, 304 F.2d 583, 586 (5th Cir.), *aff'd* 371 U.S. 37 (1962).

145. *See, e.g.*, Robinson v. City of Dallas, 514 F.2d 1271, 1273 (5th Cir. 1975); United States v. Wood Lathers, Local 46, 471 F.2d 408, 414 n.11 (2d Cir.), *cert. denied*, 412 U.S. 939 (1973); United States v. Chesapeake & O. Ry., 471 F.2d 582, 586 (4th Cir. 1972), *cert. denied*, 411 U.S. 939 (1973); Bing v. Roadway Express, 444 F.2d 687, 689 (5th Cir. 1971).

146. 518 F.2d 884 (5th Cir. 1975), *cert. denied*, 44 U.S.L.W. 3532 (U.S. Mar. 22, 1976) (No. 792).

147. *Id.* at 888, *citing* Rowe v. General Motors Corp., 457 F.2d 348, 358 (5th Cir. 1972). This language strongly suggests that statistics of this kind establish at least a prima facie case.

*Co.*,[148] where there was evidence that roughly 70 percent of defendant's apartments had been in operation since 1961 without a single black tenant prior to the filing of suit, and that at the time of suit only 1.2 percent of all of defendant's units were occupied by blacks, the court held that such statistical evidence constituted "at least a *prima facie* case of racial discrimination, casting a burden upon the defendant to come forward with evidence to the contrary."[149] Thus, it is clear that if evidence shows that lenders refuse to make loans in areas inhabited largely by racial minorities, a prima facie case of racial discrimination would be established.[150]

### B. Business Necessity Doctrine

The Supreme Court in *Griggs v. Duke Power Co.*[151] warned that a practice that is unintentionally discriminatory in effect may nonetheless be lawful if the practice is a "business necessity,"[152] that is, if there is a showing of a "genuine business need."[153] The test is not whether there is *some* business purpose for adhering to a challenged practice, but rather, whether there is an "overriding legitimate business purpose such that the practice is necessary to the safe and efficient operation of the business."[154] Thus,

> the business purpose must be sufficiently compelling to override any racial impact; the

148. 370 F. Supp. 643 (N.D. Cal. 1973), *modified*, 509 F.2d 623 (9th Cir. 1975).

149. *Id.* at 649. Note that one case, Boyd v. LeFrak Organization, 509 F.2d 1110 (2d Cir.), *cert. denied*, 423 U.S. 896 (1975), contains dictum to the effect that a showing of disproportionate effect on racial minorities, while sufficient to require application of the compelling state interest standard in the context of an equal protection challenge to governmental action, is not sufficient in the context of a purely private action asserting a claim of racial discrimination. *Boyd* upheld a landlord's policy which required a prospective tenant to have a weekly income of at least 90 percent of the monthly rent, and which had the effect of excluding all welfare recipients, a large percentage of whom were racial minorities. The holding, however, is not surprising since the percentage of racial minorities in the landlord's apartment (about 19.8%) closely approximated the percentage of blacks in the city (21%). Thus, it could not logically be presumed that racial discrimination was taking place.

The distinction the court draws in dictum between an action asserting a violation of equal protection by the government and an action asserting private discrimination is unsupported and clearly against the weight of authority under Title VII and Title VIII. *See* notes 139-45 *supra* and accompanying text.

150. There is presently available statistical evidence which may establish a prima facie case of racial discrimination. *See* note 7 *supra* and accompanying text.

151. 401 U.S. 424 (1971).

152. *Id.* at 431.

153. *Id.* at 432.

154. Robinson v. Lorillard Corp., 444 F.2d 791, 798 (4th Cir.), *cert. dismissed*, 404 U.S. 1006 (1971). *Accord*, United States v. St. Louis-S.F. Ry., 464 F.2d 301, 308 (8th Cir.

> challenged practice must effectively carry out the business purpose it is alleged to serve; and there must be available no acceptable alternative policies or practices which would better accomplish the business practice advanced, or accomplish it equally well with a lesser differential racial impact.[155]

Not surprisingly, business necessity is vigorously advanced as a justification for redlining. Lenders cite "increased risk" as the business necessity which justified their discriminatory lending practices. For example,

> [o]ne reason that certain neighborhoods suggest excessive "risk" to lenders is that the people living there often have unfavorable credit histories, usually traceable to their minority status and general financial insecurity—collection problems resulting from "credit jewelry" type stores, inability to cope with medical expenses in catastrophic illness, irregular employment, family dissolution occasioned by financial and credit problems, etc.[156]

An additional component of increased risk is the likelihood of vandalism should the property securing a loan become vacant.[157] Further, it has been suggested that lenders and potential borrowers have a communication problem in that lenders' unfamiliarity with older urban areas diminishes any potential for future lending.[158] Finally, lenders may attribute increased risk to the fact that many of these areas are inappropriately zoned or are lacking in

---

1972), *cert. denied*, 409 U.S. 1116 (1973). Also see 12 C.F.R. § 531.8(b) (1975), which states in part:

> The use of lending standards which have no economic basis and which are discriminatory in effect is a violation of law even in the absence of an actual intent to discriminate. However, a standard which has a discriminatory effect is not necessarily improper if its use achieves a genuine business need which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect.

155. Robinson v. Lorillard, 444 F.2d 791, 798 (4th Cir.) (footnotes omitted), *cert. dismissed*, 404 U.S. 1006 (1971).

156. CREUE Report, *supra* note 4, at 4.

157. *Id.* "Related to this is the reluctance of lenders to foreclose on loans in neighborhoods where vandalism, or at least community ill-will would likely be incurred." *Id.*

158. *Id.*

public services so as to render them relatively unattractive on the housing market.[159]

In applying the "business necessity" test to the asserted business purpose of avoiding increased risk, it is clear that a lender's reasonable fear of increased risk on loans made in certain areas may be found to be sufficiently compelling to override the racially discriminatory impact. This will occur if avoidance of that risk is "necessary to the safe and efficient operation of the business,"[160] though increase in dollar cost alone would not be enough.[161] Therefore, to establish a business necessity, a lender will have to justify its fear of increased risk and also show such risk seriously impairs its lending operations.[162]

To accomplish this a lender might first point to its previous experience in the neighborhood, showing that the lender had sustained a large number of foreclosures accompanied by a general decline in property values.[163] It would also argue that the administrative costs of evaluation of individual applicants within the neighborhood outweigh any expected profits. Additionally, it

---

159. *Id.* "Several residential areas in older parts of Oakland lack curbs or [have] only wooden curbs which [are] badly deteriorated, so that street cleaning could not be done efficiently, for example." *Id.*

160. Robinson v. Lorillard, 444 F.2d 791, 798 (4th Cir.), *cert. dismissed*, 404 U.S. 1006 (1971).

161. *See, e.g.*, Griggs v. Duke Power Co., 401 U.S. 424, 433 n.9 (1971), where the Court cites approvingly EEOC guidelines which require that employment tests be validated as specifically job-related or abandoned. Validation obviously requires some expenditure by the employer and the Court did not consider such an expense a "business necessity."

However, consider also a recent Supreme Court decision which contemplated a "much more sensible construction of the job relatedness requirement." Washington v. Davis, 96 S. Ct. 2040, 2053 (1976). In *Washington* the Court upheld a district judge's conclusion that the employment test in question "was directly related to the requirements of the police training program and that a positive relationship between the test and training course performance was sufficient to validate the former, wholly aside from its possible relationship to actual performance as a police officer." *Id.* at 2052-53.

It is thus indicated that, at least in Title VII cases, the burden of proving job-relatedness has been eased. This should not simplify a lender's task of making an analogous "business necessity" showing, for it may be quite difficult for a lender to associate an actual dollar cost to the perceived increased risk in a given neighborhood since other lenders are arguably redlining as well. The lender cannot thus point to what such risk costs in the market.

162. Such a showing is the lenders' equivalent of an employers' business necessity.

163. A lender may incure substantial administrative expenses from a large number of foreclosures. Moreover, if the collateral's value drops below the balance of the debt, the lender may sustain a loss since, in at least one state, it may not obtain a deficiency judgment. *See* Brown v. Jensen, 41 Cal. 2d 193, 259 P.2d 425 (1953) (interpreting California Code of Civil Procedure section 580(b)), *cert. denied*, 347 U.S. 905 (1954).



Published by GGU Law Digital Commons, 1976

might cite evidence from other parts of the country where neighborhoods possessing similar characteristics were found to be poor investment risks.[164] Furthermore, a lender would argue that, in order to retain sufficient liquidity to continue to make loans, it may have to sell its existing mortgages to Fannie Mae (which may be difficult if the loans were made in declining areas).[165] It can therefore be seen that a lender may well establish a compelling business justification for its redlining practices.

But redlining, insofar as it means denial of loan applications solely on the basis of the location of the property (and the attendant disregard for other relevant factors), may result in the denial of otherwise meretorious loan applications. Factors such as individual income, prior credit history and the condition of the collateral, which could conceivably outweigh the negative effects of the neighborhood, are ignored since the area is categorically excluded. However, upon evaluation of these individual factors, some borrowers within the area could conceivably qualify for loans. A less restrictive alternative to redlining is therefore needed. One alternative is evaluation of loan applications on a case-by-case basis regardless of the neighborhood. This alternative would prevent a lender from denying a loan where there was not in fact an increased risk. Nevertheless, many of the individual factors justifying a lender's exclusion of an entire neighborhood may operate to deny loans to individuals even if they were evaluated separately, thereby continuing the redlining effect. For example, the lender may conclude that a particular applicant's credit history and proposed collateral are quite favorable, but that the negative impact of neighborhood-wide risk factors, such as vandalism and crime, outweigh the merits of the application. Thus, denial of mortgage funds to entire neighborhoods would continue to occur, albeit on the basis of individual loan analysis.

Assuming that there is no alternative which significantly reduces the "redlining effect," it is argued that the lender must make loans in these "high risk areas" because lenders' past racially motivated disinvestment has contributed significantly to the present downward trend of these areas.[166] Such arguments have

164. For example, a lender may be able to cite a study which found that certain indicators exist which help determine when a given neighborhood represents high risk. A lender could then show that the same indicators are present in the neighborhoods it is allegedly redlining, thus justifying its categorical exclusion.

165. *See* notes 56-59 *supra* and accompanying text.

166. Cooper, *California to Crack Down on "Redlining" with Tough Rule For Mortgage Lenders*, Wall St. Journal, Aug. 26, 1975 at 1, col. 1.

merit; actions to enjoin lenders from denying loans in high risk areas should succeed if it can be shown that such present discriminatory effect is a result of the lenders' past discrimination. In *United States v. West Peachtree Tenth Corp.*,[167] the Court of Appeals for the Fifth Circuit held that where there was a finding of discrimination prior to the enactment of Title VIII, and little or no evidence indicated a post-Act change, there was a strong inference that the pre-Act practice continued after the effective date of the Act.[168] This conclusion is based on a series of labor discrimination cases.[169] A representative example, *United States v. Sheet Metal Workers Local 36*,[170] involved pre-Act exclusion of blacks from the union which directly resulted in blacks not being hired after the effective date of the Fair Employment Practices Act. After the passage of the Act, persons with union experience were given union hall hiring priority, thereby excluding blacks. Thus, the post-Act priority system, which on its face was racially neutral, operated to prevent blacks from being hired due to their race and, in effect, perpetuated the pre-Act discrimination. The Court of Appeals for the Eighth Circuit held such practices unlawful under Title VII and ordered that the defendant unions take affirmative action to remedy such effects.[171]

The United States Supreme Court has recently confirmed that racially neutral practices which perpetuate past racial discrimination are violative of Title VII. In *Albemarle Paper Co. v. Moody*,[172] the Court stated that

> [w]here racial discrimination is concerned, "the [district] court has not merely the power but the duty to render a decree which will so far as possible eliminate the discriminatory effects of the past as well as bar like discrimination in the future."[173]

Additionally, the Court noted that one of the purposes of Title VII was "to make persons whole for injuries suffered on account of

167. 437 F.2d 221 (5th Cir. 1971).
168. *Id.* at 277.
169. Local 189, United Papermakers & Paperworkers v. United States, 416 F.2d 980 (5th Cir. 1969), *cert. denied*, 397 U.S. 919 (1970); Local 53 Heat & Frost Workers v. Vogler, 407 F.2d 1047 (5th Cir. 1969); NLRB v. Local 269, IBEW, 357 F.2d 51 (3d Cir. 1966).
170. 416 F.2d 123 (8th Cir. 1969).
171. *Id.* at 140.
172. 422 U.S. 405 (1975).
173. *Id.* at 418, *citing* Louisiana v. United States, 380 U.S. 145, 154 (1965).



Published by GGU Law Digital Commons, 1976

unlawful employment discrimination,"[174] relying on the fact that "Congress took care to arm the courts with full equitable powers."[175] The Court thus held that claims for backpay under Title VII "should be denied only for reasons which, . . . would not frustrate the central statutory purposes of eradicating discrimination throughout the economy and making persons whole for injuries suffered through past discrimination."[176]

Analytically, the major difference between *Albemarle* and *Griggs v. Duke Power Co.* is the nature of the discriminatory practice. Both cases involved a present practice, neutral on its face, which operated to perpetuate overt past racial discrimination. In *Griggs*, however, the past discrimination was societal.[177] That is, blacks had long received inferior education in segregated schools,[178] and it was this discrimination which was perpetuated by the employer's standardized test.[179] The employer was therefore not instrumental in the past discrimination. In *Griggs*, the Court held that an employer may utilize standardized employment tests which operate to exclude a disproportionate number of minorities only if such tests are validated as job-related, that is, they constitute a business necessity.[180]

In *Albemarle*, on the other hand, the past discrimination was practiced directly by the employer in limiting minorities to only the lower paying job classifications.[181] After the passage of Title VII, seniority was determined departmentally,[182] that is, minorities had no seniority at the higher paying job classifications because they had been previously excluded from such departments. Hence they were "locked" in the lower paying classifications.[183] The Court concluded that such practices were violative of Title

174. 422 U.S. at 418.

175. *Id*. Congress gave the courts full equitable powers under Title VIII. *See* 42 U.S.C. § 3612(c) (1970). Thus, this purpose may be attributable to Title VIII as well.

176. 422 U.S. at 421.

177. 401 U.S. at 430.

178. *Id*. at 430.

179. *Id*.

180. *Id*. at 431.

181. 422 U.S. at 409.

182. *Id*.

183. *Id*. Since minorities had no seniority in any other than their own departments, it was impossible to move into any other department since all those already in the higher paying department had more seniority and hence were picked first. Additionally, if one did transfer, he or she would be the first to be laid off if there was a lay-off in the higher paying department.

VII,[184] without indicating that such a practice could be justified as a business necessity.[185] These cases suggest that the court will take a much stricter view of neutral practices which operate to perpetuate the past discrimination in which the particular defendant actively participated as distinguished from discrimination caused by general societal prejudice.[186] Specifically, a defendant may be estopped from arguing that a particular practice is a business necessity if the factors making it a business necessity were created by its own past overt discrimination.[187]

It seems probable that the Court will undertake a similar analysis in redlining cases arising under Title VIII.[188] There is ample authority that initial decisions to disinvest in redlined areas were racially motivated,[189] and that such disinvestment has contributed in large part to the economic decline in these areas.[190] Lenders maintain that this present state of decline prevents them from making loans in the area.[191] A lender's insistence today on "well-located" property discriminates against those wishing to borrow on property located in previously excluded areas.[192] Since the previous exclusion was a product of admitted racial discrimination, lenders' contentions that an area is in decline should not negate their duty to loan since they are, in large part, responsible for that situation.

---

184. The Court assumed the practice was unlawful. The issue was framed as, "When employees or applicants for employment have lost the opportunity to earn wages because an employer has engaged in an unlawful discriminatory employment practice, what standard should a federal district court follow in deciding whether to award or deny backpay?" *Id.* at 408.

185. The possibility that the practice may have been justified as a business necessity may not have been raised by the employer or the court may have assumed that the practice was so blatantly discriminatory that the doctrine would not apply.

186. The Court emphasized that the purposes of Title VII included "eradicating discrimination throughout the economy and making persons whole for injuries suffered through past discrimination." 422 U.S. at 421. Forcing a defendant to make a person whole as a result of societal discrimination is much harsher than when the defendant was the past discriminator, *i.e.*, the latter defendant is much more culpable.

187. Estoppel in employment discrimination is found when the employer cannot point to the fact that minorities have no experience in the higher paying job classification since its overt discrimination prevented them from obtaining it. Similarly, in redlining situations, if a lender's discriminatory refusals to lend have caused a neighborhood to decline, then it should not be able to cite such decline as a business necessity since by so doing it is perpetuating its own past discrimination.

188. *See* note 138 *supra* and accompanying text.

189. *See* note 7 *supra* and accompanying text.

190. *See* note 2 *supra* and accompanying text.

191. *See* notes 156-59 *supra* and accompanying text.

192. A lender does have a present justification for its refusal to lend. An employer may not for its seniority system. *See* notes 163-65 *supra* and accompanying text.



Published by GGU Law Digital Commons, 1976

*Summary*

The practice of redlining may be successfully attacked as a violation of the Civil Rights Statutes prohibiting racial discrimination. Where a rejected loan applicant produces statistical evidence that lender's activities result in a racially discriminatory effect, the burden shifts to the lender to show non-discrimination, that is, a business necessity. In cases where the defendant fails to meet this burden, the plaintiff is entitled to relief. Moreover, in cases where the defendant successfully meets its burden by showing a business necessity, the plaintiff can still prevail if it can show that the present discriminatory effect is a result of past discrimination by the particular defendant.

## V. REMEDIES

Within Title VIII is a provision permitting a court to "grant as relief, as it deems appropriate, any permanent or temporary injunction, temporary restraining order, or other order . . . ."[193] There would thus appear to be sufficient flexibility with which a court can remedy violations of Title VIII.[194]

---

193. 42 U.S.C. § 3612(c) (1970).

194. For example, in United States v. West Peachtree Tenth Corp., 437 F.2d 221 (5th Cir. 1971), the court ordered that defendants adopt an affirmative program to correct the effects of its past discrimination by notifying previously refused minority applicants by registered mail that they could reapply for housing and would be considered without regard to color. *Id.* at 229. Additionally, the court ordered that defendants file with the court written standards for processing applications. *Id.* at 230. Finally, the court ordered defendants to file every 90 days for two years a report concerning the type of application received and its disposition. *Id.*

Cases under Title VII's similar general relief provision, 42 U.S.C. § 2000e-5(g) (1970), have comparable flexibility. *See* Franks v. Bowman Transp. Co., 495 F.2d 398 (5th Cir. 1974), where the court ordered, in the context of a discriminatory priority system much like that in *Abemarle v. Moody Paper Co.*, that "employees who [had] been discriminated against in the past and remained locked-in to the racial pattern by departmental seniority must be allowed to compete for jobs in other departments on the basis of full accumulated company seniority. *Id.* at 418.

The court also held that the employer had to take affirmative action to conduct an active recruitment campaign designed to attract black applicants in a manner designed to inform the black community of such job opportunities. *Id.* at 420. Additionally, the court authorized remedial training programs for those who were locked into racial pattern so that their newly acquired seniority will have meaning. *Id.* at 420-21. Moreover, the court authorized the district court to retain jurisdiction for two years, and instructed it to require periodic reports from the employers which will enable it to ascertain that the remedial measures it mandates are being carried into effect. Finally, the court authorized back pay where discrimination has suffered economic injury in the form of lost wages. For a discussion of similar issues see United States v. Local 189, United Papermakers and Paperworkers, 416 F.2d 980 (5th Cir. 1969); Local 53 Heat & Frost Workers v. Vogler, 407 F.2d 1047, 1052-53 (5th Cir. 1969) (court ordered immediate admission to union, immediate referral for employment, development of objective trade-related job

Since the remedial aspect of the redlining problem is one of first impression, the authors have outlined some practical guidelines that should be followed in framing an equitable decree. First, the goal of such a decree is to assure adequate mortgage funding in currently redlined areas—at least to the extent there are credit-worthy borrowers within them. Second, the decree must be directed at each of the principal actors in the redlining process. For example, a decree merely ordering private lenders to cease redlining would be unfair, since their practice has been largely determined by the various governmental functions described above.[195] Redlining must therefore be cut off at its source.

This can be accomplished by compelling each of the offending federal agencies to take affirmative action to correct past redlining practices. The FHA should be required to insure mortgages in redlined areas, and Fannie Mae and Freddie Mac must be prevented from discriminating against such mortgages by refusing to purchase them. Similarly, the FHLB should predicate renewal of members' licenses on their taking affirmative action to lend in presently redlined areas.

## A. Legislative Remedies

There has been recent legislative activity, on both state and federal levels, concerning redlining. On the federal level, the United States Senate recently passed the Home Mortgage Disclosure Act of 1975.[196] It is an anti-discrimination measure on housing mortgage credit requiring financial institutions with more than 10 million dollars in assets and situated in urban areas to disclose by census tract the amount of savings received and loans dispensed within its service area.[197] Although this regulation is helpful in that it requires the information necessary to monitor redlining practices, it does not go far enough. It is limited in applicability and scope. It is merely an information gathering requirement, and it fails to provide sanctions for those institutions which redline.

---

criteria to prevent further discrimination, and suspension of any new members until objective criteria developed).

Note finally that under section 3612(c) the court may award actual damages and "not more than $1000 punitive damages."

195. Redlining by private lenders has been encouraged by the various federal agencies. *See* notes 34-69 *supra* and accompanying text.

196. Federal Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, 89 Stat. 1124 (1975).

197. *Id.*

On the state level, California has enacted the most comprehensive anti-redlining regulations to date.[198] State chartered savings and loans will be required to disclose, on a monthly basis, the geographical sources of their deposits and loan distribution.[199] The Commissioner of Savings and Loans will be required to publish at least annually an analysis of statewide lending patterns gathered from these monthly reports and a summary of complaints alleging unfair lending practices.[200] The Commissioner will further be required to review the collected data before approving a savings and loan's application for a new branch, location change or merger.[201] A savings and loan desiring to change its present location or close a branch facility will have to file a neighborhood impact statement which must state: (1) the geographic sources of its deposits and geographic distribution of its mortgage loans over the past three years; (2) the effect the proposed change will have on that pattern; and (3) how the original location will continue to be adequately served.[202] Additionally, each savings and loan must submit a description of its Affirmative Marketing Program which "shall include mortgage counseling, educational, promotional and other appropriate activity designed to secure greater housing opportunities for members or groups."[203]

California's regulations go beyond the important information gathering and disclosure provisions. The most forceful regulations prohibiting redlining are contained in the newly adopted chapter entitled "Fair Lending."[204] The purposes of the chapter are stated to be "prevention of discrimination by associations in home mortgage lending because of the conditions, characteristics or trends in the neighborhood or geographic area

198. The regulations adopted by the Commissioner of Savings and Loans became effective July 1, 1976. These regulations are limited in applicability to state chartered savings and loans. However, they contain enforcement provisions which can serve as a model to other states and the federal Congress in helping to fashion an effective remedial solution to the redlining problem. Copies of the regulations are available from the Office of the Secretary, State of California Business and Transportation Agency, 1120 "N" Street, P.O. Box 1139 Sacramento, Cal. 95805. (Guidelines which are to assist in the interpretation of certain provisions of the "Fair Lending" regulations should become available by July 1, 1976.)

199. Title 10, California Administrative Code, § 242.2(t) (1976) (Loan Register Tapes).

200. *Id.* § 242.2(u) (Fair Lending Reports).

201. *Id.* § 145.7(a) (b) (Change of Location).

202. *Id.* § 145.7(c) (Neighborhood Impact Statement).

203. *Id.* § 245.5 (Marketing Policies and Programs).

204. *Id.* §§ 245 *et seq.*

surrounding the security property, consistent with sound business practice . . . [and] inducement of more lending in areas and to groups that have been deprived of lending."[205] Lending associations will be prohibited from denying a mortgage loan or granting a loan on unusually burdensome terms unless the association can demonstrate that it is required to do so to avoid an unsafe business practice.[206]

Lending associations will be obliged to inform loan applicants with a clear and meaningful statement of the reason their application has been denied.[207] If an applicant believes his or her loan has been denied in violation of the fair lending requirements, the applicant may file a complaint with the Savings and Loan Commissioner.[208] If the complaint is not resolved to the satisfaction of the complainant, an appeal may be taken to a Board of Inquiry which shall make a finding of fact regarding whether or not there has been a violation of the fair lending requirements. Such findings shall be reported to the Secretary of the Business and Transportation Agency and the Commissioner of Savings and Loan for appropriate action.[209]

As indicated by the promulgating agency, "these regulations are but a first step."[210] The second step is to require that these improperly denied loans be made. There are legislative proposals for 1977 that will empower the Board of Inquiry to allocate meritorious loan applicants to all savings and loans. Associations

---

205. *Id.* § 245(b).

206. *Id.* § 242.2(a). The regulations further explicate what constitutes a risk of an unsound practice and what lenders may do to alleviate that risk;

> If an association can document that one or more factors relating to the geographic area closely surrounding the security property are such that, even assuming the availability of nondiscriminatory financing in the geographic area, it is probable that such factors will cause the fair market value of the security property to decrease during the early years of the mortgage term, then the association, in determining whether and under what terms and conditions to grant a mortgage loan, may do either or both of the following:
> (1) make an adjustment in the loan to value ratio it considers appropriate for the property; or
> (2) require that a shorter term to maturity be used.

*Id.* § 245.3(b).

207. *Id.* § 245.4(h).

208. *Id.*

209. *Id.* §§ 245.7(b), 245.7(i).

210. *See* California Business & Transportation Agency, Proposed Redlining Regulations, Summary Introduction 3 (Aug., 1975) (available at address noted in note 198 *supra*).



Published by GGU Law Digital Commons, 1976

will be required to assume loans in proportion to their assets and associations which voluntarily invest in previously redlined areas will be allocated correspondingly fewer loans. Twenty percent of each loan which the Board of Inquiry allocates will be insured by a fund which will preliminarily capitalized by state funds but maintained by assessments from state chartered associations.[211] These proposed remedies are by no means a satisfying solution to the problem of neighborhood disinvestment. However, they may provide an impetus for renewed interest in the value and viability of urban neighborhoods.

## CONCLUSION

The foregoing discussion exposes the artifically narrow concept of redlining as a "lender's refusal to provide mortgage financing in declining neighborhoods." It is contended that such a definition is wholly inadequate and obscures the real complexity of the problem. Accordingly, an effort has been made to broaden the focus of the problem by explaining the various forces that contribute to redlining.

As demonstrated, the process of neighborhood disinvestment and decline is tremendously complex—involving not only lenders, but the federal government in its role as a mortgage insurer, creator of secondary mortgage markets and regulator of lending institutions. Further, redlining has been shown to be a racially discriminatory practice which has been fostered and maintained by present federal policies. The role of the individual lender has not been diminished by this analysis but rather placed in proper perspective. Admittedly, this conclusion of multiple causation does not lend itself to an easy problem solving analysis. However, the funding problems now confronting declining neighborhoods can be solved. If the evidence of redlining presented in the first part of this article is analyzed realistically, and if the proposed regulatory and legal remedies are carefully considered, then the cycle of lender disinvestment and neighborhood decline may be broken.

---

211. *Id.*