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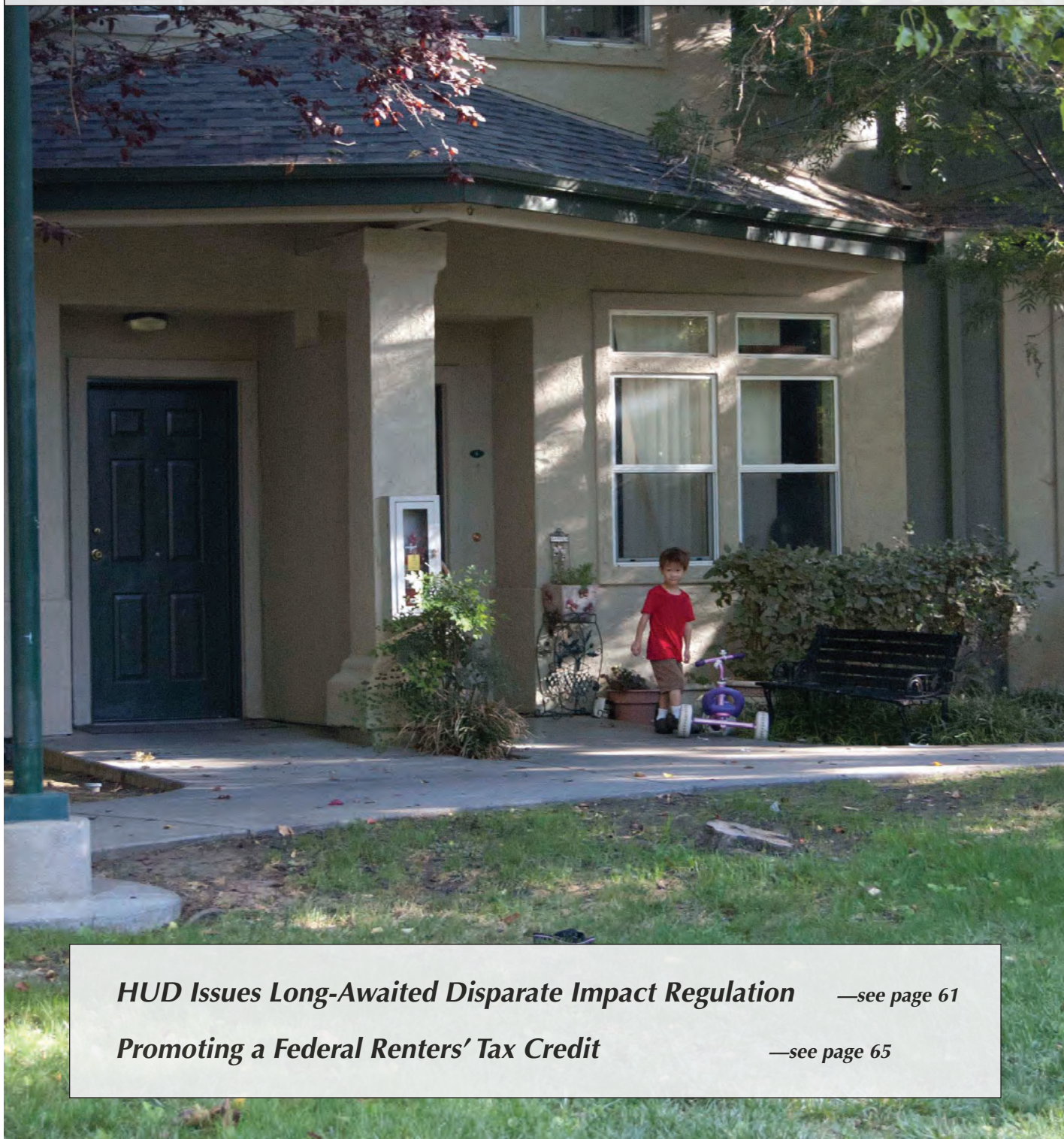


advancing housing justice

Housing Law Bulletin

Volume 43 • March 2013

Published by the National Housing Law Project



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Promoting a Federal Renters' Tax Credit —see page 65

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Housing Law Bulletin

Volume 43 • March 2013

Published by the National Housing Law Project
703 Market Street, Suite 2000, San Francisco, CA 94103
Telephone (415) 546-7000 • Fax (415) 546-7007

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Cover: Windmere I, a 48-unit affordable housing development built in Davis, California by nonprofit Community Housing Opportunities. Units are two- or three-bedroom townhomes affordable for families with incomes from 50-80% of AMI.

The *Housing Law Bulletin* is published 10 times per year by the National Housing Law Project, a California nonprofit corporation. Opinions expressed in the *Bulletin* are those of the authors and should not be construed as representing the opinions or policy of any funding source.

A one-year subscription to the *Bulletin* is \$175.

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HUD Issues Long-Awaited Disparate Impact Regulation

by Scott Chang
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In a major step forward for equal opportunity in housing, the U.S. Department of Housing and Urban Development (HUD) issued its long-awaited disparate impact regulation on February 8, 2013.¹ The regulation, which goes into effect on March 18, 2013, reaffirms the well-established views of HUD and 11 federal Courts of Appeals that disparate impact claims are cognizable under the Fair Housing Act (FHA) and establishes a nationwide burden-shifting standard for establishing a disparate impact claim under the FHA.

The implementation of the regulation provides civil rights and low-income housing advocates with a powerful new tool to enforce fair housing laws. The regulation sets forth consistent standards for proving disparate impact claims that will apply in the HUD administrative process and federal courts. The regulation also adds discriminatory land use rules and policies, as well as discriminatory loan servicing, to the list of specific unlawful practices prohibited under HUD's regulations.

Background

In the preamble to the final rule, HUD states that "[t]his regulation is needed to formalize HUD's long-held interpretation of the availability of 'discriminatory effects' liability under the Fair Housing Act, 42 U.S.C. 3601 *et seq.*, and to provide nationwide consistency in the application of that form of liability."²

HUD explained that the adoption of a discriminatory effects test is consistent with the purpose and the plain text of the FHA. The FHA was enacted "to combat and prevent segregation and discrimination in housing, including in the sale or rental of housing and the provision of advertising, lending, and brokerage services related to housing."³ The "broad and inclusive" language of the FHA indicates that liability may be established under a discriminatory effects test.⁴ The term "otherwise make unavailable" "focuses on the effects of a challenged action rather than the motivation of the actor."⁵ Similarly, the inclusion of the term "discriminate" encompasses actions that have a discriminatory effect.⁶

¹Implementation of the Fair Housing Act's Discriminatory Effects Standard: Final Rule, 78 Fed. Reg. 11,460 (Feb. 15, 2013) (to be codified at 24 C.F.R. Part 100), hereinafter "HUD Final Disparate Impact Rule."

²*Id.*

³*Id.* at 11,461.

⁴*Id.* (citing *Trafficante v. Metro. Life Ins. Co.*, 409 U.S. 205, 209 (1972)).

⁵*Id.* at 11,466.

⁶*Id.*

The regulation “embodies law that has been in place for almost four decades and that has consistently been applied, with minor variations, by HUD, the Justice Department and nine other federal agencies, and federal courts.”⁷ For example, HUD “has long interpreted the Act to prohibit practices that have an unjustified discriminatory effect, regardless of intent.”⁸ HUD administrative law judge decisions, policy statements and internal guidance all have recognized a disparate impact theory of liability under the FHA.⁹ And, all federal Courts of Appeals that have addressed the issue agree that liability under the FHA may be established under a disparate impact theory.¹⁰

Overview of the Regulation

Under the three-part burden shifting test adopted by HUD, the plaintiff or charging party first bears the burden of establishing a prima facie case by showing that a practice “results in, or would predictably result in, a discriminatory effect” upon a protected class.¹¹ Second, if the plaintiff or charging party establishes a prima facie case, the burden of proof shifts to defendant or respondent to prove that the practice “is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests.”¹² Third, if the defendant or respondent satisfies its burden to justify the practice, the plaintiff or charging party may still establish liability “by proving that the substantial, legitimate, nondiscriminatory interest could be served by a practice that has a less discriminatory effect.”¹³

The basic provisions of the regulation are set forth in 24 C.F.R. § 100.500, a new section of HUD’s FHA regulations which provides that “[l]iability may be established under the Fair Housing Act based on a practice’s discriminatory effect...even if the practice was not motivated by a discriminatory intent. The practice may still be lawful if supported by a legally sufficient justification....”¹⁴ Subsequent subsections of the regulation define “discriminatory effect” and “legally sufficient justification,” and specify the burdens of proof.¹⁵

Discriminatory Effect

The regulation defines “discriminatory effect” to encompass both disparate impact and perpetuation of segregation and includes practices that predictably result in a discriminatory effect. HUD’s regulation states that “[a] practice has a discriminatory effect where it actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segre-

gated housing patterns because of race, color, religion, sex, handicap, familial status, or national origin.”¹⁶

The plaintiff or charging party has the burden of “proving that a challenged practice caused or predictably will cause a discriminatory effect.”¹⁷

The preamble makes clear that any facially neutral action including “laws, rules, decisions, standards, policies, practices or procedures” that may have a discriminatory effect may be challenged.¹⁸ Practices that may be challenged as having a discriminatory effect include those that allow for the use of discretion or subjective criteria.¹⁹ By including “decisions” in the type of neutral actions that may have a discriminatory effect according to the preamble, HUD appears to have adopted an expansive view of the practices that may have a discriminatory effect and rejected the cases holding that a single act or decision cannot be challenged under the disparate impact theory.²⁰

HUD also rejected any general requirement that the plaintiff or charging party be required to identify the specific practice that caused the discriminatory effect as part of its prima facie case.²¹ HUD reasoned that such a requirement may vary from case to case and the elements of the relevant decision-making process may not be capable of separation, in which case it “may be appropriate to challenge the decision-making process as a whole.”²²

HUD similarly decided against adopting any specific standard for showing that members of a protected class are disproportionately burdened by a practice.²³ The agency again explained that the standard for showing a disparate impact may vary from case to case given the wide range of practices that may have a discriminatory effect and the varied private and governmental entities covered under the FHA.²⁴

The preamble to the proposed regulation contains examples drawn from cases of the types of housing-related policies and practices that may have a disparate impact or may perpetuate segregation, including land use and zoning policies and practices, the provision and pricing of homeowner’s insurance, discretionary mortgage pricing policies, credit scoring overrides, residency preferences, and the demolition of low-income housing.²⁵

¹⁶*Id.* (to be codified at 24 C.F.R. § 100.500(a)).

¹⁷*Id.* at 11,482 (to be codified at 24 C.F.R. § 100.500(c)(1)).

¹⁸*Id.* at 11,468.

¹⁹*Id.*

²⁰*See, e.g.,* *Simms v. First Gibraltar Bank*, 83 F.3d 1546, 1555 (5th Cir. 1996) (“The relevant question in a discriminatory effects claim against a private defendant, however, is not whether a single act or decision by that defendant has a significantly greater impact on members of a protected class, but instead the question is whether a policy, procedure, or practice specifically identified by the plaintiff has a significantly greater discriminatory impact on members of a protected class.”).

²¹HUD Final Disparate Impact Rule at 11,469.

²²*Id.*

²³*Id.* at 11,468.

²⁴*Id.*

²⁵Implementation of the Fair Housing Act’s Discriminatory Effects Standard, 76 Fed. Reg. 79,021, 79,024-25 (Nov. 16, 2011).

⁷*Id.* at 11,462.

⁸*Id.* at 11,461.

⁹*Id.* at 11,461-62.

¹⁰*Id.* at 11,462.

¹¹*Id.* at 11,460.

¹²*Id.*

¹³*Id.*

¹⁴*Id.* at 11,482 (to be codified at 24 C.F.R. § 100.500).

¹⁵*Id.* (to be codified 24 C.F.R. § 100.500(a),(b) & (c)).

For a full regulatory history and insight into HUD's reasoning concerning the final rule, a close reading of the preamble to the final rule is recommended.

Legally Sufficient Justification

Although it used different regulatory language, HUD's final rule adopts a rebuttal burden for defendants amounting to "business necessity." Under the regulation, "[a] legally sufficient justification exists where the challenged practice: (i) Is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent...or defendant...; and (ii) Those interests could not be served by another practice that has a less discriminatory effect."²⁶ "A legally sufficient justification must be supported by evidence and may not be hypothetical or speculative."²⁷

Once a plaintiff or the charging party establishes a prima facie case, "the respondent or defendant has the burden of proving that the challenged practice is necessary to achieve one or more substantial, legitimate, nondiscriminatory interests of the respondent or defendant."²⁸

Housing and civil rights advocates, including the National Housing Law Project (NHLP), submitted comments on the proposed regulation, requesting that HUD adopt the "business necessity" test as the rebuttal standard. Although HUD did not adopt the term "business necessity" in the final regulation, the preamble makes clear that the "substantial, legitimate non-discriminatory interest" standard is "equivalent" to business necessity and "is not to be interpreted as a more lenient standard than 'business necessity.'"²⁹

The rule's preamble indicates that requiring a practice with a discriminatory effect to be *necessary* "best effectuates the broad, remedial goal of the Act."³⁰ HUD stated that it had consistently used the business necessity test in its investigative manual, administrative adjudications and policy statements, and that other federal regulatory agencies used that same standard in investigating lending discrimination cases.³¹ HUD chose not to use the term "business necessity" because the final rule seeks to apply uniform rules not just to businesses but also to individuals, nonprofit organizations and public entities.³²

HUD also agreed with the comments of NHLP and other advocates and required that any justification be "substantial" in addition to "legitimate" and "nondiscriminatory."³³ HUD defines the terms substantial, legitimate and nondiscriminatory in the preamble. "A 'substantial' interest is a core interest of the organiza-

tion that has a direct relationship to the function of that organization."³⁴ The term "legitimate" ensures that the justification is genuine and not false, fabricated or pre-textual.³⁵ Whether an interest is legitimate is determined under an objective test.³⁶ "Non-discriminatory" means that the justification does not itself discriminate based on a protected class.³⁷ The determination of whether a defendant or respondent has demonstrated a "substantial, legitimate, nondiscriminatory interest" is fact-specific and determined on a case-by-case basis.³⁸

The requirement that a legally sufficient justification be supported by evidence is intended to convey that defendants or respondents "be able to prove with evidence the substantial, legitimate, nondiscriminatory interest supporting the challenged practice and the necessity of the challenged practice to achieve that interest."³⁹

Less Discriminatory Alternative

HUD's regulation also requires a showing that a defendant or respondent's substantial, legitimate, nondiscriminatory interest "could not be served by another practice that has a less discriminatory effect."⁴⁰ Under the regulation, a plaintiff or charging party has the burden of proving a less discriminatory alternative.⁴¹

In the preamble to the regulations, HUD explained, "[A] less discriminatory alternative must serve the respondent's or defendant's substantial, legitimate, nondiscriminatory interests, must be supported by evidence, and may not be hypothetical or speculative."⁴² HUD rejected any requirement that the plaintiff or charging party show that prior to the litigation the defendant or respondent knew of and rejected the less discriminatory alternative.⁴³

HUD's allocation of the burden of proof to plaintiffs or the charging party to establish a less discriminatory alternative may be the most controversial aspect of the final regulation. The regulation provides that once a defendant or respondent meets its rebuttal burden, "the charging party or plaintiff may still prevail upon proving that the substantial, legitimate, nondiscriminatory interests supporting the challenged practice could be served by another practice that has a less discriminatory effect."⁴⁴

In response to HUD's request for comments on the proposed rule, NHLP and other housing and civil rights

³⁴*Id.*

³⁵*Id.* at 11,470-71.

³⁶*Id.* at 11,471.

³⁷*Id.* at 11,470.

³⁸*Id.* at 11,471.

³⁹*Id.* The final section of the regulation notes that the demonstration that a practice is supported by a legally sufficient justification cannot be used as a defense in an intentional discrimination case. *Id.* at 11,482 (to be codified at 24 C.F.R. § 100.500(d)).

⁴⁰*Id.* at 11,482 (to be codified at 24 C.F.R. § 100.500(b)(1)(ii)).

⁴¹*Id.* (to be codified at 24 C.F.R. § 100.500(c)(3)).

⁴²*Id.* at 11,473.

⁴³*Id.*

⁴⁴*Id.* at 11,482 (to be codified at 24 C.F.R. § 100.500(c)(3)).

²⁶HUD Final Disparate Impact Rule at 11482 (to be codified 24 C.F.R. § 100.500(b)(1)).

²⁷*Id.* (to be codified at 24 C.F.R. § 100.500(b)(2)).

²⁸*Id.* (to be codified at 24 C.F.R. § 100.500(c)(2)).

²⁹*Id.* at 11,470.

³⁰*Id.* at 11,471.

³¹*Id.* at 11,470.

³²*Id.*

³³*Id.*

advocates submitted comments requesting that HUD assign the burden of proof to defendants or respondents to demonstrate the absence of a less discriminatory alternative. In choosing to assign the burden of proof to plaintiffs or the charging party, HUD notes that the framework of the regulation “makes the most sense because it does not require either party to prove a negative;” the allocation of the burden is consistent with the allocation of burdens in Title VII and Equal Credit Opportunity Act cases; and plaintiffs and the charging party can obtain information about less discriminatory alternatives through discovery.⁴⁵

It remains to be seen whether the allocation of the burden to prove a less discriminatory alternative on plaintiffs will have a substantial effect on disparate impact litigation. At a minimum, in many cases plaintiffs will need to retain experts to prove less discriminatory alternatives pre-litigation or at a very early stage in the case. HUD’s view that information about less discriminatory alternatives can be obtained through discovery appears to assume that the defendant or respondent considered less discriminatory alternatives to the challenged practice before the litigation and likely underestimates the difficulty of obtaining full information about less discriminatory alternatives from recalcitrant defendants or respondents. Other questions may arise, including: whether plaintiffs can meet the pleading standard to allege less discriminatory alternatives with some specificity in the complaint; and whether courts and HUD administrative tribunals will routinely grant protective orders allowing plaintiffs/charging parties to access proprietary or confidential information that will permit them to prove a less discriminatory alternative.

Requiring plaintiffs to prove a less discriminatory alternative may have a significant effect on plaintiffs in disparate impact litigation in at least two circuits that place the burden of proof or production on defendants and possibly in affordable housing litigation under the FHA nationwide. Several courts have held that the defendant or respondent has the burden of proof or the burden of production to demonstrate that there is no less discriminatory alternative.⁴⁶ It is unclear how these courts will treat the conflict between prior precedent and HUD’s regulation but it appears likely that courts will afford deference to HUD’s regulation.⁴⁷

⁴⁵*Id.* at 11,474.

⁴⁶*See, e.g.,* *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 939 (2d Cir. 1988); *Mt. Holly Gardens Citizens in Action v. Township of Mt. Holly*, 658 F.3d 375, 384 (3d Cir. 2011) (holding that defendants have the burden of showing that there is no less discriminatory alternative and that “[o]nly when the defendants make this showing does the burden shift back to the plaintiffs—where it ultimately remains—to provide evidence of such an alternative”); *Inclusive Communities Project, Inc. v. Texas Dep’t of Hous. & Cmty. Affairs*, 749 F. Supp. 2d 486, 503 (N.D. Tex. 2010) (following *Huntington* and allocating burden of proof to defendant to prove a less discriminatory alternative); *Dews v. Town of Sunnyvale*, 109 F. Supp. 2d 526, 565 (N.D. Tex. 2000) (same).

⁴⁷*See* *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984) (holding that court of appeals erred

Retroactivity

HUD takes the position in the preamble that the regulation will apply to all pending and future cases because the regulation embodies HUD’s longstanding interpretation of the FHA,⁴⁸ but it remains to be seen whether courts will apply parts of the regulation to pending cases where precedent differs from the regulation.

New Discriminatory Practices

HUD added two new practices that fall within the discriminatory practices prohibited by the FHA in the regulation: discriminatory land use rules or policies and loan servicing. The new land use regulation provides that “[e]nacting or implementing land-use rules, ordinances, policies, or procedures that restrict or deny housing opportunities or otherwise make unavailable or deny dwellings to persons because of” a protected class violates the FHA.⁴⁹ HUD makes clear that the enactment as well as the implementation of discriminatory land use policies violates the FHA.⁵⁰ The regulation prohibits not only land use practices that deny housing opportunities but also those that restrict housing opportunities based on a protected class. By prohibiting land use policies that “otherwise make unavailable or deny” housing based on a protected class, the regulation also prohibits land use policies that discourage or delay housing opportunities.⁵¹

The new loan servicing provision provides that unlawful conduct includes “[s]ervicing of loans or other financial assistance with respect to dwellings in a manner that discriminates, or servicing of loans or other financial assistance which are secured by residential real estate in a manner that discriminates, or providing such loans or financial assistance with other terms or conditions that discriminate, because of” a protected class.⁵²

Conclusion

HUD’s disparate impact regulation represents a major step forward in the pursuit of the Fair Housing Act’s goals of advancing equal housing opportunity and attaining integration. Although the regulation embodies long-standing case law and HUD’s interpretations of the FHA, the implementation of the regulation provides housing advocates with a major new tool to use in the fight for obtaining equal housing opportunities and achieving truly integrated communities. ■

in following its own precedent rather than affording deference to the agency’s permissible construction of the statute).

⁴⁸HUD Final Disparate Impact Rule at 11,474.

⁴⁹*Id.* at 11,481 (to be codified at 24 C.F.R. § 100.70(d)(5)).

⁵⁰*Id.* at 11,478.

⁵¹The regulation appears to embody existing case law on this issue. *See, e.g.,* *South Middlesex Opportunity Council v. Town of Framingham*, 752 F. Supp. 2d 85 (D. Mass. 2010).

⁵²HUD Final Disparate Impact Rule at 11,482.