

Federal Court Finds Texas Tax Credit Allocation System Violates Fair Housing Act

Following a bench trial, a federal district court has ruled that a Texas housing agency's method of allocating Low-Income Housing Tax Credits has a disparate racial impact in violation of the federal Fair Housing Act (FHA).¹ The court earlier had ruled that the plaintiff Inclusive Communities Project (ICP) had stated a prima facie case of disparate impact discrimination, granting partial summary judgment for ICP.² That ruling set the stage for a trial on whether the Texas Department of Housing and Community Affairs (TDHCA) could demonstrate a legally sufficient justification for the policy and that there were no less discriminatory alternatives. The court's most recent decision holds that TDHCA failed to carry its burden and finds in favor of ICP's disparate impact claim.

Background

Through the qualified allocation plan (QAP) process used for competitively allocating credits, state tax credit allocation agencies can influence the location of housing built under the LIHTC program. In Texas, and likely many other states,³ LIHTC developments serving families are disproportionately located in areas with high concentrations of both poverty and people of color.

ICP assists low-income families, primarily African-American, in finding housing in high-opportunity, racially integrated areas. After unsuccessful attempts to change TDHCA's tax credit allocation policies, ICP sued TDHCA. In its 2008 complaint, ICP alleged that TDHCA had violated the FHA, the Equal Protection Clause of the Fourteenth Amendment, and 42 U.S.C. § 1982, which gives all U.S. citizens the same right to lease property as Caucasian citizens. ICP asserted that TDHCA used race as a consideration in siting LIHTC properties, and disproportionately allocated tax credits in areas primarily comprised of people of color while denying credits in predominantly Caucasian neighborhoods. ICP alleged that these practices made housing unavailable based on race, color and national origin.⁴ TDHCA's earlier attempts

to dismiss the case, based on alleged lack of standing and joinder issues, failed.⁵ In September 2010, the court ruled that ICP established a prima facie case of racial discrimination under a disparate impact theory, and that ICP demonstrated standing.⁶

The Prior Ruling on ICP's Prima Facie Case

The court's 2010 decision held that ICP established a prima facie case for its claims under the FHA, 42 U.S.C. § 1982 and the Equal Protection Clause (actionable through § 1983).⁷ On the FHA disparate impact claim, ICP showed that the TDHCA's practice had an adverse impact on a protected class and produced a segregative effect. ICP relied on statistical evidence showing that TDHCA approved LIHTC developments for families in areas of high minority concentration at significantly greater rates than in predominantly Caucasian areas. On its § 1982 and Fourteenth Amendment claims alleging intentional discrimination by TDHCA, the court found a prima facie case (establishing an inference of discrimination) based on both statistical evidence and various TDHCA policy changes and actions.

In the proceedings surrounding the 2010 ruling, TDHCA sought to rebut ICP's prima facie case by arguing that its actions furthered a compelling government interest and that it had a legitimate nondiscriminatory reason for its inequitable allocation. It had pointed primarily to the tax credit statute,⁸ which requires that credit allocation agencies use criteria that favor projects that serve the lowest-income families and are located in designated low-income neighborhoods. However, because TDHCA presented no evidence that it could not comply with both the tax credit statute and the FHA, the court rejected the sufficiency of TDHCA's rebuttal contention for the FHA disparate impact claim,⁹ and denied it summary judgment. On ICP's § 1982 and Equal Protection claims involving intentional discrimination, TDHCA offered a similar justification based on the LIHTC statute, which the court found sufficient to satisfy the agency's burden of production with regard to providing a legitimate, nondiscriminatory reason for its actions. However, because ICP had presented enough evidence concerning the pretextual nature of TDHCA's reasons, the court denied TDHCA's motion for summary judgment on these claims.¹⁰ Because these rulings did not resolve the ultimate merits of ICP's claims, a trial on these issues was necessary.

¹Inclusive Communities Project v. Texas Dep't. of Hous. & Cmty. Affairs, 2012 WL 953696 (N.D. Tex. March 20, 2012) [hereinafter *ICP III*].

²Inclusive Communities Project v. Texas Dep't. of Hous. & Cmty. Affairs, 749 F. Supp. 2d 486 (N.D. Tex. 2010) [hereinafter *ICP II*]. See NHLP, *Advocates Win Partial Summary Judgment in Tax Credit Siting Case*, 41 HOUS. L. BULL. 1, 8 (Jan.-Feb 2011).

³See Poverty & Race Research Action Council and Lawyers' Comm. for Civil Rights, *Civil Rights Mandates in the Low-Income Housing Tax Credit Program* (Dec. 2004), <http://www.prrac.org/pdf/crmandates.pdf>.

⁴Compl., Inclusive Communities Project v. Texas Dep't. of Hous. & Cmty. Affairs, No. 08cv0546 (N.D. Tex. Mar. 8, 2008).

⁵Inclusive Communities Project v. Texas Dep't. of Hous. & Cmty. Affairs, 2008 WL 5191935 (N.D. Tex. Dec. 11, 2008) [hereinafter *ICP I*]. For background information see NHLP, *Fair Housing Tax Credit Case Survives Motion to Dismiss*, 39 HOUS. L. BULL. 1, 10 (Jan. 2009) and NHLP, *Texas Group Files Suit Alleging LIHTC Program Perpetuates Segregation*, 38 HOUS. L. BULL. 135, 146 (July 2008).

⁶*ICP II*, 749 F. Supp. 2d at 497, 500.

⁷*Id.* at 500, 502.

⁸26 U.S.C. § 42 (Westlaw Apr. 18, 2012).

⁹*ICP II*, 749 F. Supp. 2d at 504.

¹⁰*Id.* at 506.

The Trial

ICP's case challenged TDHCA's disproportionate approval of LIHTCs for family developments in neighborhoods primarily occupied by people of color, and its disproportionate denial of family developments in predominantly Caucasian neighborhoods. ICP essentially asserted that, despite federal and state laws governing the QAP process, TDHCA had discretion in making final decisions regarding the allocation of both 4% and 9% tax credits.¹¹ ICP claimed that TDHCA uses this discretion to make housing and financial assistance for LIHTC housing unavailable because of race, in violation of the FHA.¹² ICP also claimed that TDHCA used race as a factor in allocating tax credits, in violation of the Fourteenth Amendment and § 1982.

ICP sought to prove the intentional discrimination claims, not by direct evidence, but by circumstantial evidence.¹³ At trial, the court's task was to determine whether ICP had proven intentional discrimination by considering the strength of the prima facie case and the defendant's explanation. Here, the court found ICP failed to carry its burden.¹⁴

TDHCA offered evidence of its duty to create selection criteria in accordance with federal and state laws and that its staff evaluated applications and recommended developments accordingly, for nondiscriminatory reasons and without discriminatory intent. The court did not credit ICP's efforts to prove that TDHCA intentionally discriminated when denying approval to proposed LIHTC developments in predominantly Caucasian areas, finding nondiscriminatory reasons for numerous decisions.¹⁵ The court also credited TDHCA's efforts to encourage development in high-opportunity areas, including urging the Texas legislature to revise statutes governing the QAP and implementing such changes, as well as granting more points and a basis boost to high-opportunity properties.¹⁶ Similarly, the court found that other TDHCA actions favoring areas predominantly populated by people of color were in fact supported by legitimate nondiscriminatory reasons, such as financial feasibility. Finally, the court found that ICP failed to prove that the state agency's justifications to rebut the prima facie case were pretextual, finding they were supported by sufficient nondiscriminatory reasons.¹⁷ The court therefore found in favor of TDHCA on the intentional discrimination claims.

However, because ICP had demonstrated a prima facie case on its FHA disparate impact claim, TDHCA had the burden to prove that its actions furthered a governmental interest that was bona fide and legitimate *and* that there were no less discriminatory alternatives to its policy.¹⁸ To make this determination, the court elected to weigh the adverse impact against the TDHCA's justification, rather than pursue a balancing approach.

TDHCA proffered an interest in awarding tax credits in an objective, transparent, predictable and race-neutral manner. It maintained that federal and state law left it with limited discretion, allowing it to modify only non-statutory criteria, and to "forward commit" credits to unsuccessful applications from those that would be made available in a subsequent year. To support its asserted interests, TDHCA also pointed to its efforts to award a "basis boost" in 2009 to developments in high-opportunity areas.¹⁹ The state agency essentially abandoned any effort to show less discriminatory alternatives to its scoring system and approval practices, simply asserting that none exists.

ICP responded that TDHCA must justify not just statutory requirements, but its practices of disproportionately approving family properties in neighborhoods predominantly occupied by people of color. ICP also probed the agency's failure to explore less discriminatory alternatives, including ICP's proposed remedy of setting aside credits for developments in high-opportunity areas.

For ease of analysis, the court assumed that TDHCA's interests were legitimate, and focused its analysis on whether the agency had carried its burden to demonstrate the absence of any less discriminatory alternatives to advance them. After a searching inquiry, the court concluded that TDHCA had failed to demonstrate that alternatives with a less discriminatory impact would impair its asserted interests.

Piercing the agency's claims of limited discretion, the court identified substantial TDHCA discretion within the federal and state²⁰ statutory framework that could alleviate discriminatory impact while furthering the state's asserted interests. Although recognizing that the agency had taken some steps to modify its allocation system to provide points for criteria beyond the state's statutory priorities, the court determined that TDHCA could do much more. Specifically, the court found that TDHCA could:

¹¹Tax credits can be either 9% credits, which are competitively allocated under the QAP, or the less valuable 4% credits, which accompany bond financing provided by the state, under a less competitive or noncompetitive process. *ICP III*, 2012 WL 953696, at *1-2.

¹²42 U.S.C. §§ 3604(a), 3605(a).

¹³This approach is permitted by *Vill. of Arlington Heights v. Metro. Hous. Dep't*, 429 U.S. 252, 266-68 (1977).

¹⁴*ICP III*, 2012 WL 953696, at *4.

¹⁵*Id.* at *4 n. 11.

¹⁶*Id.* at *4-5.

¹⁷*Id.* at *5.

¹⁸*ICP II*, 749 F. Supp. 2d at 503. Although that prior ruling used the adjective "compelling" rather than "legitimate," the court in *ICP III* chose to use the latter in light of the lack of controlling authority. *ICP III*, 2012 WL 953696, at *6.

¹⁹The basis boost allows a 30% increase in the basis upon which the total amount of the credit is calculated. The Housing and Economic Recovery Act of 2008 gave credit allocation agencies greater discretion in determining which properties could receive this benefit. *ICP III*, 2012 WL 953696, at *7.

²⁰The decision does not clarify why any state-imposed criteria—whether imposed by statute, TDHCA policy, or gubernatorial approval—should require special deference in a disparate impact analysis under the federal FHA.

- change the scoring system for 9% credits by modifying and weighting various statutory and discretionary criteria differently, by revising definitions and shuffling required elements, and by separately specifying points for developments in high-opportunity areas;
- use forward commitments in furtherance of desegregation goals;
- more specifically define “high-opportunity areas” for locations where developments can receive the basis boost;
- exercise general discretion, outside of the point system, to reduce discriminatory impacts of its funding decisions.²¹

Because the agency failed to demonstrate that it used any of these means, the court found a discriminatory impact.

The court’s final task was to address TDHCA’s statute of limitations and Eleventh Amendment immunity defenses. Under judicial interpretations of the FHA’s two-year statute of limitations, the claim must be brought within the last asserted occurrence of the practice.²² Because evidence of discriminatory impact of tax credit approvals and denials was provided until immediately prior to the filing of the complaint in 2008, the court rejected the statute of limitations defense. The court also quickly dispatched TDHCA’s immunity claim, relying on a prior case finding that TDHCA’s predecessor agency was not an arm of the state for Eleventh Amendment purposes, based on specified criteria like independence and non-state funding.²³

TDHCA now must prepare and submit a remedial plan to the court by May 20, 2012.

Conclusion

Tax credits remain the primary vehicle for producing new affordable housing units for low-income families. Yet many states operate LIHTC programs in a similar fashion to Texas, with a disproportionate number of family properties located in high-poverty neighborhoods with significant concentrations of people of color and limited access to quality schools, jobs and social services. Almost any credit allocation agency can implement the kinds of policies identified in the ICP decision in order to change the outcomes of a project selection system that produces consistently discriminatory results.²⁴ Future policy advocacy in many states beckons. ■

²¹*ICP III*, 2012 WL 953696, at *9-*11.

²²*Id.* at *11-*12.

²³*Id.* at *12.

²⁴For best practices, see Poverty & Race Research Action Council & Lawyers’ Comm. for Civil Rights Under Law, *Building Opportunity: Civil Rights Best Practices in the Low-Income Housing Tax Credit Program: An Updated Fifty-State Review of LIHTC “Qualified Allocation Plans”* (Dec. 2008), <http://prrac.org/pdf/2008-Best-Practices-final.pdf>.