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BUSINESS LITIGATION

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Disparate Impact Liability Under the Fair Housing Act:
A Potential Pitfall for Municipalities, Quasi-Governmental Agencies, Banks and Other Entities Involved with Residential and Mixed-Use Projects

On June 25, 2015, the Supreme Court issued its opinion in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc.,* 576 U.S. __ (2015), affirming the continuing viability of "disparate impact" liability under the Fair Housing Act ("FHA"). Justice Kennedy authored the narrow 5-4 decision.

The FHA prohibits discrimination in the sale, rental and financing of housing. Under a disparate impact theory of liability, a plaintiff need not prove a defendant's discriminatory intent with respect to a challenged policy. Instead, a plaintiff can show a violation of the law merely by alleging that a law or policy has a discriminatory impact, even though the discriminatory impact may have been the unintended result of an otherwise facially neutral policy. Thus, benign or even altruistic motives can cause liability if the actions or policies are found to discriminate against a protected class. Protected classes are defined under the FHA as race, color, religion, sex, handicap, familial status and national origin. (Note: While age, sexual orientation and marital status are not protected classes under the FHA, they may be protected under state or local fair housing laws such as, for example, the New York State Human Rights Law.)

Lower federal courts have uniformly interpreted the FHA to encompass disparate impact claims for over 30 years. Thus, when the Supreme Court indicated that it would hear the *Texas Department of Housing* case challenging the application of disparate impact liability under the FHA, many commentators speculated that the Supreme Court was prepared to overrule the lower courts and hold that the text of the FHA does not permit disparate impact claims.

Ultimately, the five-justice majority of the Court was heavily influenced by the long-standing interpretation of the FHA in the federal circuit courts of appeal, as well as the Supreme Court's own prior precedents interpreting similar "disparate impact" provisions in Title VII of the Civil Rights Act of 1964 and the Age Discrimination in Employment Act of 1967. The Court had previously held that both statutes – which were enacted shortly before the FHA and employ similar language – embraced disparate impact claims. Additionally, Congress's amendment of the FHA in 1988, without indicating any disapproval of earlier court interpretations of the statute, was also a factor in the Supreme Court's decision.

Despite affirming the continuing viability of disparate impact liability, the Court established important limitations to the doctrine. The majority cautioned that disparate impact liability poses "special dangers" that must be limited to avoid serious constitutional questions that might arise under the FHA if, for example, such liability were imposed based *solely* on a showing of a statistical disparity. Thus, defendants must be given the opportunity to proffer valid interests that their policies serve. The Court emphasized that policies resulting in a disparate impact do not run afoul of the FHA unless such policies are "artificial, arbitrary, and unnecessary barriers." Thus, under the FHA, a plaintiff must establish a causal link between a statistical disparity and the defendant's challenged policy; such a requirement is necessary to ensure that defendants and courts applying the law do not resort to the use of racial quotas to remedy statistical disparities.

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The *Texas Department of Housing* case involved a decision on the use of federal tax credits for low-income housing. The plaintiff alleged that the defendant's system for distributing the low-income tax credits had a disparate impact on minorities and furthered racial segregation because the defendant agency allocated too many tax credits to housing in predominantly black inner-city areas and too few in predominantly white neighborhoods.

Local residency requirements also face scrutiny under the disparate-impact doctrine, because a community that limits access to affordable housing may be seen to be preventing residents of higher-minority areas from equal access. Just as this article was going to press, a lawsuit was commenced in New York City based upon allegations of discrimination in lotteries for affordable housing units within different communities of the City. Those living "outside" the community were denied equal access to the affordable units, which could have the effect of perpetuating racial segregation where one community had more or less minorities than another. *See Winfield v. City of New York* (S.D.N.Y. Civ. No. 15-5236).

In another recent case, a federal district in Connecticut held that an insurer that charges higher premiums or denies coverage to landlords who rent apartments to tenants receiving Section 8 housing assistance could be held liable under the FHA because of disparate impact. In *Viens v. America Empire Surplus Lines Ins. Co.*, 2015 WL 3875013 (D. Conn. June 23, 2015), the federal district court held that based on the facts the plaintiff had alleged, it could plausibly be inferred that the defendant's conduct had a disparate racial impact on housing opportunities.

Another example representative of a policy prohibited under the FHA is "redlining," or making mortgage financing or insurance unavailable in certain communities. Although redlining cases often are premised on intentional discrimination, neutral policies can also have a disparate impact on protected classes, resulting in de-facto redlining. For example, in *Hirschfeld v. Metlife Bank, N.A.*, 2012 WL 3240669 (E.D.N.Y. July 31, 2012), the plaintiff sought mortgage financing for a vacation home in a community populated almost entirely by Orthodox Jews. The properties in the community typically were sold through word of mouth, rather than through public listings, making it difficult for the bank to review comparable sales and conduct a mortgage appraisal; as a result, the bank declined to underwrite the loan. The court stated that "insofar as defendants' outwardly neutral practice of extending mortgages only for homes that can be appraised by typical methods could be expected to have a predictably disproportionate impact on members of religious communities whose homes are predominantly sold by word of mouth," the policy would violate the FHA.

What does all this mean for municipalities, or entities like community development agencies (CDAs), industrial development agencies (IDAs) or banks involved in financing, or otherwise providing assistance to, projects that may have a residential component? Although such entities do not directly involve themselves in the operations of the projects they serve, and thus do not participate in reviewing or approving applications for housing, a plaintiff might assert a claim against a party providing financial or tax assistance to a housing developer where the proposed development could result in a disparate impact. No court has yet ruled on a disparate impact claim against an IDA or CDA, but IDAs, CDAs, banks and other entities that provide financing or other forms of assistance for residential projects may face such claims if the project developer or the local authorities unwittingly establish policies that have a disparate impact on a protected class of citizens, such as local residency requirements.

An agency also could face a claim under the FHA based on the projects it *declines* to support. For example, in *United States v. Massachusetts Industrial Finance Agency*,

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910 F. Supp. 21 (D. Mass. 1996), a state industrial finance agency faced claims under the FHA for declining to provide financial assistance to a project that would develop a residential school for adolescents with mental illnesses; disabled people are a protected class under the FHA.

In light of the foregoing, there are steps that a bank or other entity providing financing or other assistance to housing developers can take to limit the risks of, or to prepare for a claim under, the FHA, including:

- Certifications and Covenants: Require business partners to certify their own compliance with fair housing laws. While many contracts may include boilerplate language requiring the other party to comply with all laws, when engaging in a project with a residential component, consider including terms specific to fair housing laws. Require an applicant to covenant that they will obey all current and future fair housing regulations and not discriminate on any basis.

- Legal Opinions: Insist that the applicant know the municipality in which they will be conducting business. Require an applicant with a residential project to certify that they have reviewed the municipality's zoning code and other relevant statutes, codes or rules for any laws or policies that may be discriminatory or which may have an unintended disparate impact based on a protected characteristic, such as race, age or family status. Furthermore, require applicants to provide an appropriate legal opinion.

- Indemnification: Back up contractual requirements with a strong indemnification provision. Require applicants to agree to defend and indemnify your entity in the event of a claim of discrimination under state or federal law – whether that entity is charged with intentional discrimination or neutral conduct that has a disparate impact. Look closely at any available insurance policies to ascertain whether the applicant's defense and indemnity obligations are backed up by coverage that will include such claims.

Additional Assistance

For more information regarding disparate impact liability under the Fair Housing Act, please contact Alan J. Bozer at (716) 504-5700, abozer@phillipslytle.com, or Ryan A. Lema at (716) 504-5790, rlema@phillipslytle.com. ■

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