

Affirmatively Furthering Fair Housing in REO-to-Rental Programs

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In July of 2013, the Department of Housing and Urban Development (HUD) released a new proposed regulation entitled “Affirmatively Furthering Fair Housing” (AFFH). The purpose of the proposed regulation is to modernize and clarify a component of the 1968 Fair Housing Act, which requires the government to avoid policies that perpetuate or increase residential segregation, and to undertake affirmative steps to promote residential integration and fair housing choice. At their core, the Fair Housing Act and the obligation to affirmatively further fair housing were designed to undo the government sponsored segregation that had emerged in the years after World War II.

Since its passage, HUD has implemented the AFFH provision with varying levels of enthusiasm, depending on the Administration in power. But it has consistently recognized the obligation in the law and its applicability to all HUD programs. However, in contrast to HUD, the Treasury Department, the Internal Revenue Service (IRS), and the Federal Housing Finance Agency (FHFA) have not formally acknowledged their civil rights responsibilities under the Fair Housing Act, despite the fact that they oversee many important housing initiatives, including the Low Income Housing Tax Credit (LIHTC), Government Sponsored Enterprise (GSE) receivership and reform, the Home Affordable Modification Program, and the Real Estate Owned (REO)-to-Rental program.

The REO-to-Rental program is particularly intriguing from a fair housing perspective. In January 2012, the FHFA launched its REO-to-Rental program, which converts pools of foreclosed REO properties held by the government-sponsored enterprises into affordable rental properties.¹ The program targets metropolitan areas hard hit by foreclosure and requires investors to rent them out for a specified number of years. Fair housing advocates viewed this program as a new opportunity for affordable rental properties in less-segregated, low-poverty communities—that is, until they discovered that the FHFA and the Department of the Treasury had made no effort to conform the new program to the requirements of the federal Fair Housing Act. This article discusses how the federal agencies responsible for the REO-to-Rental program can take advantage of this opportunity in the future, even if it has so far eluded them.

The “Affirmatively Furthering Fair Housing” Regulation

The stated purpose of the proposed “Affirmatively Furthering Fair Housing” regulation is to “improve fair housing choice through fair housing planning, strategies and actions.” It sets forth a regulatory framework designed to clarify and systematize the standards for identifying and addressing patterns of housing segregation, provides uniform national data and improved technical assistance to grantees, and strengthens the role of community and resident input into the fair housing planning process.

The new HUD proposal is grounded in the 1968 Fair Housing Act, the legislative capstone on a series of extraordinary civil rights laws that included Title VI and Title VII of the Civil Rights Act of 1964, as well as the Voting Rights Act of 1965. The Fair Housing Act (also known as Title VIII) not only banned private discrimination but it also sought to undo patterns of racial segregation that had emerged in the years after World War II, driven largely by government policy. The Act thus emerged as a response to what the Kerner Commission famously described as “two societies, one black, one white—separate and unequal.”

The provision of the Act that addressed the government’s role and responsibility for undoing segregation was Section 3608, which provides that “all executive departments and agencies shall administer their programs and activities relating to housing and urban development (including any Federal agency having regulatory or supervisory authority over financial institutions) in a manner affirmatively to further the purposes of this subchapter.”² The courts and HUD have consistently interpreted this provision—the duty to affirmatively further fair housing—as requiring federal, state, and local governments to avoid policies that perpetuate or increase residential segregation and to undertake affirmative steps to promote residential integration and fair housing choice.³ The new proposed regulation is HUD’s latest effort to modernize and clarify the AFFH obligation.⁴

AFFH at the Department of the Treasury

The Department of the Treasury, through the IRS, administers the LIHTC, the nation’s largest low-income housing development program.⁵ Since the beginning of the foreclosure crisis, the Department of Treasury, in conjunction with HUD, has also overseen two new housing initiatives designed to reduce the number of foreclosed properties: the Home Affordable Modification Program (HAMP) and the REO-to-Rental Program (also in conjunction with the FHFA). HAMP, which began in 2009, offers reduced monthly mortgage payments to homeowners who are at risk of foreclosure. Since its inception, more than 1.2 million homeowners successfully modified the terms of their mortgages to reduce their monthly payments.⁶ The REO-to-Rental Program is designed to reduce the number of vacant, foreclosed properties by enabling investors to purchase pools of these properties for rental housing.⁷

In contrast to HUD, however, the Treasury has not yet officially acknowledged its civil rights responsibilities under Section 3608 of the Fair Housing Act.⁸ Treasury’s housing

programs are clearly “programs and activities relating to housing and urban development,” and the Department has been put on notice of its obligations repeatedly,⁹ yet it has continued to postpone compliance. Fair housing advocates have argued that in many states, the failure of the Treasury to adopt fair housing rules has contributed to a pattern of segregated development in the LIHTC program, administered by the Treasury and the IRS in cooperation with state housing finance agencies.¹⁰ The lack of civil rights guidance for the LIHTC program has led to litigation in several states, including cases in South Dakota, New Jersey, Connecticut, and Texas. Most recently, a federal district court in Dallas ruled that a civil rights organization had established a prima facie case of discrimination in the tax credit allocation practices of the Texas Department of Housing and Community Affairs.¹¹

AFFH in the Federal Housing Finance Agency and the REO-to-Rental Program

Similarly, the FHFA has no rules or procedures to affirmatively further fair housing. The FHFA, created by the Housing and Economic Recovery Act of 2008, is the regulator and conservator of Fannie Mae and Freddie Mac and the regulator of the 12 Federal Home Loan Banks. The FHFA is advised by the Federal Housing Finance Board, composed of the secretaries of Treasury and HUD, the chair of the Securities and Exchange Commission, and the FHFA director.¹² As a federal agency “administer[ing]...programs and activities relating to housing and urban development (including any Federal agency having regulatory or supervisory authority over financial institutions),”¹³ the FHFA is clearly covered by the affirmatively furthering fair housing obligation.

In January 2012, the FHFA launched the REO-to-Rental Program, which was jointly developed and implemented by the Department of the Treasury and HUD.¹⁴ Under the program, qualified investors would bid and purchase pools of foreclosed properties from Fannie Mae or Freddie Mac or the FHA, located in areas with high foreclosure rates that would be rented for a specified number of years. The goals were to reduce the inventory of unsold homes, help stabilize housing prices, support neighborhoods, and provide sustainable rental housing.

Ideally, REO-to-Rental programs could acquire properties for low-income rental in high-opportunity communities that would provide new, racially integrated housing choices for low-income families currently living in high-poverty, segregated neighborhoods. However, the current policy approach auctions single-family properties in higher-income areas for homeownership, while single-family properties in lower-income neighborhoods are directed towards affordable rentals. This approach reinforces existing patterns of segregation and contributes to the lack of affordable rental properties in economically diverse neighborhoods.

Prior to the launch of the federal REO-to-Rental program, fair housing groups had documented disparate maintenance and marketing practices between privately held REO homes in white neighborhoods and those in communities of color. The National Fair Housing Alliance conducted an examination of more than 1,000 REO properties and found that those in African American and Latino neighborhoods were more consistently vacant and in substan-

dard condition than those in white neighborhoods, resulting in further harm to communities of color.¹⁵ The failure of lenders and servicers to provide equal maintenance and marketing practices to their portfolio of REO properties is also an act of housing discrimination and a violation of federal law. There was hope that the launch of the REO-to-Rental program would enable mission-driven nonprofit organizations to both acquire and improve properties in distressed communities and acquire properties for low income rental in thriving middle-class communities to promote fair housing goals.

When FHFA and HUD issued a “Request for Information” to solicit ideas for disposition of REO properties held by Fannie Mae, Freddie Mac and the Federal Housing Administration, fair housing advocates across the country submitted their proposals in a letter to Edward DeMarco, acting director of the FHFA.¹⁶ The Housing Partnership Network also submitted a detailed proposal, and several national civil rights groups submitted a supplemental statement on the request for information in February 2012.¹⁷

The key concern among advocates was that the request for information did not include any aspect of the AFFH mandate in the goals and objectives of the disposition strategy.¹⁸ This AFFH obligation involves not only protecting vulnerable communities of color; it also requires the federal government to expand housing opportunities for low-income families of color in higher-opportunity communities outside traditional “areas of minority concentration.” The absence of any mention of this obligation is indicative of the approach of both the Treasury and FHFA to date. While REOs are disproportionately located in minority communities, a significant number of properties are located in job-rich communities with low poverty rates and high-performing schools. Maps prepared by the Kirwan Institute in four metropolitan areas demonstrate the enormous fair housing potential of FHFA’s REO inventory.¹⁹

The key elements of the civil rights groups’ proposal included:

- ***Geographical distribution.*** Pools of rental properties in the auction should not be concentrated primarily in low-income neighborhoods and should include properties throughout a metro area with at least an equal number of properties in communities of opportunity.
- ***Improving the bidding process to empower nonprofits.*** Currently, Fannie Mae and Freddie Mac “First Look” programs provide select nonprofits the opportunity to purchase REO homes during the initial 15 days of a property’s listing. The proposed REO-to-Rental program should extend this time period to 45 days for REO properties in low-poverty, high-opportunity communities. The right of first refusal should be extended to qualified nonprofit organizations and public housing authorities in high-opportunity areas, as well as other entities that commit to maintaining the property as long term, income-targeted rental housing.
- ***Bulk purchase program.*** The Administration’s plan should include an aggressive pre-retail bulk purchase program limited to the acquisition of properties for rental in low-poverty, high-opportunity communities. These properties should be prioritized

for families using Section 8 vouchers to cover the higher purchase price and to ensure strong affirmative fair housing marketing goals.

- ***Nonprofit partnerships.*** Incentives should encourage partnerships with nonprofits that have experience in affordable housing development and management.
- ***Scattered-site property and asset management.*** Disposition of REO properties through bulk sales will create some economies of scale and potentially lower management costs. However, too much aggregation of properties may make it difficult for nonprofits to compete. There must be a balance between volume and feasibility for nonprofit partners.
- ***Financial incentives.*** The government should offer financial structures like seller financing and joint venture arrangements that increase the ability of nonprofits to participate in the purchase of the properties.
- ***Affirmative marketing.*** REO properties and property managers should be subject to affirmative marketing requirements to ensure that families living in segregated, high-poverty neighborhoods have priority access to units in safer and higher-opportunity areas. This program should be viewed by the government as an opportunity to expand opportunity for low-income families, particularly through the use of both tenant-based and project-based vouchers in REO properties in high-opportunity, low-poverty communities. A strict source-of-income nondiscrimination policy should be established for REO rental properties (similar to requirements in the HOME and LIHTC programs)²⁰ to ensure that Section 8 voucher holders have access to REO rental units in high-opportunity areas. Affirmative fair housing marketing should target households least likely to apply in the area where each property is located and ban discriminatory local residency preferences.²¹

The first bulk sale began in February 2012 with 699 Fannie Mae–owned properties in Florida. Two other bulk sales—one in the Chicago area and one in the Southwest, including Arizona, California, and Nevada—resulted in 1,763 properties sold through this pilot program.²² The disposition of this inventory represented a once-in-a-generation opportunity to advance fair housing goals. This opportunity was lost in the first round of the REO-to-Rental program because of the absence of affirmative fair housing goals; we hope that low-income renters get another chance in the next round.²³

Conclusion

The foreclosure crisis was built on a segregated housing market, and had a disproportionate impact on families of color.²⁴ The government has an obligation to ameliorate these disparities in its disposition of government-owned foreclosed homes. The REO-to-Rental program provides an opportunity to add thousands of additional rental housing units that are particularly well suited for families. Many of these units are located in lower-poverty, low-crime neighborhoods with above-average schools. If the Treasury and the FHFA had been conforming their policies and practices to their basic legal obligations under the Fair

Housing Act, patterns of segregation in government-supported housing would be noticeably different today. We hope that the federal Administration, including the Treasury Department and the FHFA, recognize that there is still time to act in support of fair housing goals.

Diane Glauber, Director of Community Development at the Lawyers' Committee for Civil Rights Under Law, has twenty-five years of affordable housing experience. She is collaborating with the Ford Foundation and PRRAC to identify innovative approaches to and best practices for integrating community development & fair housing activities and articulate a shared vision and strategy for work at the sectors' intersection. As Director of Human Services for the City of Baltimore, Diane oversaw programs designed to provide housing and services to Baltimore's most vulnerable populations. As Syndication Counsel at Enterprise Community Investment, Diane led national initiatives to create and preserve affordable housing. Diane has a J.D. from the University of Maryland and an M.P.A. from New York University.

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Endnotes to article: Affirmatively Furthering Fair Housing in REO-to-Rental Programs

- 1 The REO-to-Rental program included properties held by the GSEs under the receivership of the FHFA (Fannie Mae and Freddie Mac), as well as properties held by the Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development. See www.fhfa.gov/webfiles/22367/FHFARFIReleaseFinal.pdf.
- 2 42 USC §3608(d).
- 3 The AFFH obligation was expressly extended to state and local grantees in 1983 in an amendment to the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633, consistent with court precedent interpreting the Fair Housing Act. See *Otero v. New York City Housing Authority*, 484 F.2d 1122 (2d Cir 1973). Congress also required that state and local grantees certify their compliance with the AFFH obligation in the Cranston-Gonzalez National Affordable Housing Act of 1990, 42 USC §12705(b)(15)-(16) (2006).
- 4 The AFFH proposed regulation is also a response to a report of the Government Accountability Office critical of HUD's oversight of the AFFH process, though HUD had begun the development of the rule well before the GAO Report was issued. See US Government Accountability Office, "Housing and Community Grants: HUD Needs to Enhance Its Requirements and Oversight of Jurisdictions' Fair Housing Plans," report to congressional requesters, September 2010. www.gao.gov/assets/320/311065.pdf.
- 5 26 USC §42. Between 1987 and 2011, there were 37,506 projects and almost 2,318,000 housing units placed in service (see HUD USER at <http://www.huduser.org/portal/datasets/lihtc.html>).
- 6 12 U.S.C. §5219(a)(1). See also number of homeowners assisted at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2013/HUDNo.13-139.
- 7 <http://www.fhfa.gov/Default.aspx?Page=360>.
- 8 To date, the only step taken in any Treasury housing program related to fair housing is the so-called general public use rule at work in the Low Income Housing Tax Credit program. The rule imposes penalties for acts of discrimination against individual renters of tax credit units. It fails to address the obligation of the IRS to take steps and to require housing credit agencies to take steps to avoid racial segregation and promote integrated housing choices for low-income families of color. In 2000, the Treasury also

entered into a “memorandum of understanding” with HUD and the Department of Justice to explore the implementation of fair housing standards, but to date, little has emerged from this collaboration beyond the original memorandum.

- 9 For a sample of civil rights coalition letters directed at the Treasury, see www.prrac.org/projects/lihtc.php. In addition to its failure to adopt rules to implement the AFFH obligation, the Treasury does not have the basic nondiscrimination rules required of all federal agencies under Title VI, which explicitly directs all federal agencies to adopt regulations barring discrimination and segregation based on race and disability in programs of federal financial assistance (and an administrative complaint process to be followed in cases where discrimination is alleged). 42 USC §200d-1 (Title VI); 29 USC §794 (§504). The Department of Justice is charged with the responsibility of coordinating agency compliance with this mandate by executive order (Executive Order 12250, Leadership and Coordination of Nondiscrimination Laws). To our knowledge, neither the Treasury, the IRS, nor the FHFA have adopted rules, policies, or procedures complying with the rulemaking mandate of Title VI for recipients of assistance under the programs they administer. It seems clear that the Treasury’s housing programs are subject to Title VI and §504 as “federal financial assistance” under the act. The Low Income Housing Tax Credit-enabling statute, §42 of the Internal Revenue Code, allocates credits equal to a specified financial value to state credit agencies within an annual housing credit ceiling. State agencies then grant credits to project owners who sell them to raise capital to pay for construction costs. Low Income Housing Tax Credits are a “thing of value . . . extended by the grant statute” and are thus governed by Title VI and §504 (U.S. Department of Transportation v. Paralyzed Veterans of America, 477 U.S. 597, n. 11 [1986]). The few courts that examine this issue within a tax context distinguish between deductions generally available to taxpayers and tax benefits that provide direct subsidies in order to carry out regulated public purposes. See, e.g., *McGlotten v. Connally*, 338 F. Supp. 448 (D.C., 1972). However, regardless of the Treasury’s obligations under Title VI in regard to “federal financial assistance,” it is bound by the AFFH requirements of the Fair Housing Act, which have no such limiting language.
- 10 See generally publications and advocacy documents collected at www.prrac.org/projects/lihtc.php. Research documenting the extent of racial segregation and concentration of Low Income Housing Tax Credit units in high poverty locations includes, among other studies, Ingrid Gould Ellen and Keren Mertens Horn, Poverty and Race Research Action Council, “Do Federally Assisted Households Have Access to High Performing Public Schools?” *Civil Rights Research*, November 2012, www.prrac.org/pdf/PRRACHousingLocation&Schools.pdf; “Are States Using the Low Income Housing Tax Credit to Enable Families with Children to Live in Low Poverty and Racially Integrated Neighborhoods?” (Abt Associates, 2006), and “Assessment of the Economic and Social Characteristics of LIHTC Residents and Neighborhoods” (Abt Associates, February 28, 2000). For additional research, see, e.g., William Callison, “Achieving Our Country: Geographic Desegregation and the Low-Income Housing Tax Credit,” *Southern California Review of Law & Social Justice* 19 (Spring 2010): 213; Myron Orfield, “Racial Integration and Community Revitalization: Applying the Fair Housing Act to the Low Income Housing Tax Credit,” *Vanderbilt Law Review* 58 (November 2005): 1747; Florence Roisman, “Mandates Unsatisfied: The Low Income Housing Tax Credit Program and the Civil Rights Laws,” *Miami Law Review* 52 (1998): 1011; PRRAC and Lawyers’ Committee for Civil Rights, “Building Opportunity: Civil Rights Best Practices in the Low Income Housing Tax Credit Program,” 2008, www.prrac.org/projects/LIHTC.php. Some defenders of the program’s demographic characteristics argue unconvincingly that because the LIHTC program is “less” segregated than other segregated housing, it is not perpetuating segregation—even when most family units are being placed in higher poverty, racially concentrated neighborhoods. See, e.g., Keren Horn and Katherine O’Regan, “The Low Income Housing Tax Credit and Racial Segregation,” *Housing Policy Debate* 21 (3) (2005): 443–473.
- 11 *Inclusive Communities Project v. Texas Dept. of Housing and Community Affairs*, 2010 WL 3766714 (N.D. Tex., September 28, 2010).
- 12 See Federal Housing Finance Agency, Strategic Plan 2009–2014. www.fhfa.gov/webfiles/14476/FHFA_StrategicPlan_2009-2014n.pdf.
- 13 42 USC §3608(d).
- 14 See Federal Housing Finance Agency, US Department of the Treasury, and US Department of Housing and Urban Development, “FHFA, Treasury, HUD Seek Input On Disposition Of Real Estate Owned Properties.” Press release (Washington, DC, August 10, 2011). fhfa.gov/webfiles/22367/FHFARFIREleaseFinal.pdf.

- 15 See National Fair Housing Alliance, *The Banks Are Back—Our Neighborhoods Are Not* (Washington, DC: National Fair Housing Alliance, April 4, 2012). www.nationalfairhousing.org/LinkClick.aspx?fileticket=sNHLaQE4WSw%3d&tabid=3917&mid=9405.
- 16 Philip Tegeler et al., “Re: Affirmatively furthering fair housing in the disposition of REO properties,” letter to Edward DeMarco, acting director of the Federal Housing Finance Agency, September 15, 2011. www.prrac.org/pdf/REO_civil_rights_comments_9-15-11.pdf.
- 17 National Urban League et al., “Proposal to Incorporate an Opportunity Framework to Transition REO Property into Rental Housing,” February 2012. www.prrac.org/pdf/AFFH_in_REO_properties_Feb_2012.pdf.
- 18 See also Stella J. Adams, “The Fair Housing Act Implications of the Emerging REO-to-Rental House Market,” August 13, 2013. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2309182. Adams discusses concerns about compliance with other nondiscriminatory laws, such the Equal Credit Opportunity Act and Unfair and Deceptive Practices laws.
- 19 See maps of Cleveland, Columbus, Cincinnati, and Seattle at the Poverty & Race Research Action Council. www.prrac.org/full_text.php?item_id=13398&newsletter_id=0&header=Current%20Projects.
- 20 42 USC 12745 (a)(1)(D); 24 CFR 92.252(d) (HOME); 26 USC §42(h)(6)(B)(iv) (LIHTC).
- 21 For an overview of affirmative marketing requirements and best practices, see Megan Haberle et al, *Accessing Opportunity: Affirmative Marketing and Tenant Selection in LIHTC and Other Housing Programs* (PRRAC, December 2012), at www.prrac.org/pdf/affirmativemarketing.pdf.
- 22 Federal Housing Finance Administration, “Fannie Mae SFR REO 2012-1: Highlights of the REO Pilot Transactions,” November 2012. www.fhfa.gov/webfiles/24720/SFREO2012DealTermF0.pdf.
- 23 This proposal has taken on additional urgency now that President Obama has called for the eventual winding down of Fannie Mae and Freddie Mac as quasi-public agencies. See White House, Office of the Press Secretary, “Remarks of President Barack Obama on Responsible Home Ownership—as Prepared for Delivery.” Press release (Phoenix, AZ, August 6, 2013). www.scribd.com/doc/158529513/Remarks-of-President-Barack-Obama-on-Responsible-Homeownership.
- 24 See Jacob Rugh and Douglas Massey, “Racial Segregation and the American Foreclosure Crisis,” *American Sociological Review* 75 (2010): 629; see also Debbi Gruenstein Bocian et al., “Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures” (Center for Responsible Lending, 2011); Derek Hyra et al., “Metropolitan Segregation and the Subprime Lending Crisis,” *Housing Policy Debate* 23 (1) (2013).