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TESTING FANNIE MAE'S AND FREDDIE MAC'S POST-CRISIS SELF-PRESERVATION POLICIES UNDER THE FAIR HOUSING ACT

SHELBY D. GREEN*

ABSTRACT

Beginning in the 1930s, the federal government adopted programs and policies toward safe and decent housing for all. The initiatives included the creation of the Federal Housing Administration that, among other things, spurred mortgage lending by guaranteeing mortgage loans to low- and moderate-income borrowers. The creation of the secondary mortgage market by Fannie Mae and Freddie Mac (“GSEs”) helped provide more liquidity for loan originators. However, somewhere along the way, these GSEs lost their way, as they pursued profitability without regard to risk and heedlessly bought mortgages without considering quality.

The overabundance of poor quality mortgages led to the housing market crisis in 2008, and the GSEs faced ruin when the millions of mortgagors who took out loans defaulted. When the federal government intervened to rescue the GSEs, a new mission and attitude emerged—not one of furthering housing, but of self-preservation. This new attitude was revealed in heavy-handed policies calculated to recoup losses, but not to keep borrowers in their homes. Legislation enacted in the wake of the crisis invested a federal conservator with draconian powers, seemingly unchecked by state law constraints on lenders’ remedies or notions of fairness. The mission became reducing portfolios by auction sales of the properties to investors, while the foreclosed owners had to pay the amounts owed on the mortgages to keep their homes. The impacts of these policies were felt disproportionately by minority borrowers who originally had been offered more onerous mortgage terms on the basis of inflated appraisals. Early attempts by state and local authorities to temper the GSEs’ hard march toward solvency were met with successful assertions of federal preemption. This Article explores these rulings and asserts that, rather than base challenges on subordinate state or local laws, a better and more viable course of action is through the assertion of co-equal federal laws.

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I. INTRODUCTION

Déjà vu all over again!¹ The parallels between the Great Depression of the 1930s and the Great Recession of the 2000s are striking. In the events leading up to both

¹ A phrase commonly attributed to the late great professional baseball catcher, Yogi Berra. Scott Stump, *'It's Déjà Vu All Over Again': 27 of Yogi Berra's Most Memorable 'Yogi-isms'*, TODAY (Sept. 23, 2015), <https://www.today.com/news/its-deja-vu-all-over-again-27-yogi-berras-most-t45781>.

economic crises, Wall Street collapsed,² banks failed,³ and the economy plunged into an abyss. As businesses closed,⁴ industrial production fell,⁵ unemployment rose to double-digits,⁶ and the economy shrunk in real terms. At the height of the Great Depression, the agricultural economy collapsed as farm prices plummeted by more than half.⁷ Home foreclosures occurred at an alarming rate; nearly one-half of urban houses with an outstanding mortgage were in default,⁸ equating to ten defaults per every one thousand mortgages.⁹ Approximately one thousand home loans were foreclosed every day.¹⁰ Homes with a second or third mortgage fared even worse, with more than 50% in default.¹¹ One historian, Alan Brinkley, was sanguine about the crisis. He observed:

[The crisis] began unexpectedly, with a sudden and sickening stock market crash And as the economy began to slide slowly . . . , the inherent structural weaknesses of the New Era economy began to reveal themselves. There was the excessive dependence upon a few large industries, notably auto manufacturing and construction. Both had already begun to decline before [the fateful event]. There was the weakness of the banking and credit system, which began to collapse quickly at the first signs of economic trouble. There was the rickety system of international debt. Above all, there was the inadequate distribution of purchasing power within the United States itself. The American economy had become the most productive in the world, but the American people could not afford to buy its products. The result of all this was a long deflationary spiral that dragged the nation into crisis.¹²

² See Robert J. Samuelson, *Revisiting the Great Depression*, WILSON Q., Winter 2012, at 36, 38, 41 [hereinafter Samuelson, *Revisiting the Great Depression*], <http://archive.wilsonquarterly.com/essays/revisiting-great-depression>; *Timeline: Key Events in Financial Crisis*, USA TODAY (Sept. 8, 2013), <https://www.usatoday.com/story/money/business/2013/09/08/chronology-2008-financial-crisis-lehman/2779515/>.

³ See *Timeline: Key Events in Financial Crisis*, *supra* note 2; see also Samuelson, *Revisiting the Great Depression*, *supra* note 2, at 40.

⁴ Steve Lohr, *Something to Fear, After All*, N.Y. TIMES, Jan. 27, 2009, B1.

⁵ *Id.*

⁶ *Id.*

⁷ Alan Brinkley, *Prelude*, WILSON Q., Spring 1982, at 51, 52.

⁸ David C. Wheelock, *The Federal Response to Home Mortgage Distress: Lessons from the Great Depression*, 90 FED. RES. BANK ST. LOUIS REV. 133, 139 (2008) [hereinafter Wheelock, *The Federal Response*].

⁹ *Id.* at 138.

¹⁰ *Id.* (citing FED. HOME LOAN BD., FIFTH ANN. REP. 4 (1937)).

¹¹ *Id.* at 139.

¹² Brinkley, *supra* note 7, at 58–59 (footnote omitted).

Brinkley's narrative about the Great Depression echoes the same hallmarks of the more recent Great Recession.¹³ During the Great Recession, the Gross Domestic Product ("GDP") fell a total of 5% from its peak to its trough, manufacturing output declined nearly 20%, new home construction plummeted 80%, more than "[e]ight and a half million people lost their jobs[,] and unemployment rose to 10%."¹⁴ Stock markets faced similar declines.¹⁵

In both economic crises, the housing market felt the devastation most acutely.¹⁶ The shrinking economy led to mounting loan delinquencies and soaring foreclosures.¹⁷ The rapidly rising unemployment rate led to lower household incomes—reducing the demand for housing, among other goods and services—and precipitous drops in property values.¹⁸ Yet the differences in the structure of the housing market during these two monumental events were more than superficial. In the era of the Great Depression, home loans generally matured in five years or less; typically, the individual made no or only a partial payment of the principal during the term prior to a balloon payment at maturity.¹⁹ Before the Great Recession, although most loans had

¹³ On the Great Depression, Steve Lohr writes:

The . . . day [after his inauguration on March 4, 1933], [President Roosevelt] declared a national bank holiday, and set the Federal Reserve and the [Department of] Treasury to work on a phased program to sort [out] good banks from bad ones, provide financing[,] and restore confidence in the banking system."

Lohr, *supra* note 4.

Lohr notes that measures were carried out by the "Reconstruction Finance Corporation, . . . established in 1932. The agency made loans to troubled banks, and seized and sold off distressed assets at others. After government inspections, many . . . banks never reopened, with more than 4,000 closed in 1933." *Id.*

Historians have speculated that had the government intervened sooner, recovery would have been quicker. As it stood, the economy did not fully revive until a decade after the crash, in great measure as a consequence of the military escalation for World War II. Most historians still recognize the need for massive governmental spending—"[b]y 1942, [the] total government spending as a share of the economy rose to 52[%], and peaked at nearly 70[%] in 1944, when unemployment finally fell to 1[%]."

Shelby D. Green, *Disquiet on the Home Front: Disturbing Crises in the Nation's Markets and Institutions*, 30 PACE L. REV. 7, 35 n.130 (2009) [hereinafter Green, *Disquiet on the Home Front*] (quoting Lohr, *supra* note 4).

¹⁴ BEN S. BERNANKE, *The Federal Reserve's Response to the Financial Crisis*, in THE FEDERAL RESERVE AND THE FINANCIAL CRISIS 64, 87 (2013); see Robert Rich, *The Great Recession December 2007–June 2009*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/great_recession_of_200709.

¹⁵ BERNANKE, *supra* note 14, at 87.

¹⁶ For comparison, in the fourth quarter of 2007, 3.6% of all United States residential mortgages and 20.4% of adjustable-rate subprime mortgages had been delinquent for at least ninety days. Wheelock, *The Federal Response*, *supra* note 8, at 138–39.

¹⁷ *Id.* at 138.

¹⁸ *Id.*

¹⁹ *Id.*

a maturity of thirty years, these investments were risky because they either carried adjustable interest rates or were taken out by borrowers whose creditworthiness was marginal at best.²⁰ Also, in many cases, predatory lending practices induced borrowers to take out risky home loans, such as “interest only” mortgages that did not amortize the principal.²¹ Although mortgage-backed securities, based on pools of mortgages, had been safely sold for half a century, they became increasingly risky as lenders failed to apply safe underwriting standards in originating loans.²² In both the Great Depression and the Great Recession, lenders offered the prospect of refinancing to borrowers; however, when the Great Recession happened, refinancing became nearly impossible,²³ and high rates of commercial and investment bank failures contributed to the difficulty of refinancing.²⁴ Moreover, strong evidence suggested that appraisals were routinely overinflated during the Great Recession.²⁵

Between these two historic events, the federal housing agencies, including the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac” or “FHLMC”)—collectively referred to as government-sponsored enterprises (“GSEs”)—pursued goals that were heedless and not well-calculated for the long-term creation of housing opportunities and their own survival. Originally, the housing agencies’ role was to make housing available after the Great Depression, and their prudent practices worked to increase homeownership.²⁶ However, in the years leading up to the Great Recession, the

²⁰ FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT 12 (2011).

²¹ The Financial Crisis Inquiry Commission found

[n]early one-quarter of all mortgages made in the first half of 2005 were interest-only loans. During the same year, 68% of ‘option ARM’ loans originated by Countrywide and Washington Mutual had low- or no-documentation requirements. . . . [Originators] believed they could off-load their risks [inherent in these devices] to the next person in line.

Id. xxiii–iv.

²² BERNANKE, *supra* note 14, at 67.

²³ David C. Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, 90 FED. RES. BANK ST. LOUIS REV. 569, 572 (2008) [hereinafter Wheelock, *Changing the Rules*].

²⁴ *Id.*

²⁵ Wheelock, *The Federal Response*, *supra* note 8, at 142. “[There was] an erosion of standards of responsibility and ethics that exacerbated the financial crisis.” FIN. CRISIS INQUIRY COMM’N, *supra* note 20, at xxii. The rate of “borrowers who defaulted on their mortgages within . . . months after [closing] . . . nearly doubled from the summer of 2006 to late 2007.” *Id.* This meant borrowers likely took out loans that they neither could nor intended to repay. *Id.* “[M]ortgage brokers . . . were paid ‘yield spread premiums’ by lenders” as rewards for “put[ting] borrowers into higher-cost loans . . .” *Id.* Mortgage fraud thrived in the absence of sound “lending standards and [on the platform of] lax regulation.” *Id.* Creditors made improvident “loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities.” *Id.* Yet all the while, creditors were selling securities based on these loans. *Id.*

²⁶ FIN. CRISIS INQUIRY COMM’N, *supra* note 20, at 38 (noting that GSE stands for “government-sponsored enterprises”).

housing agencies' improvident practices in the secondary markets provided the platform for the excesses that led to the economic crisis.²⁷ While the names of the actors and the government's acts in the way of rescue and inventions to heal²⁸ were

²⁷ *Id.* at 418.

²⁸ See Robert J. Samuelson, *Rethinking the Great Recession*, WILSON Q., Winter 2011, at 16 [hereinafter Samuelson, *Rethinking the Great Recession*]. Samuelson offers an insightful analysis of the causes and a prescription for averting a similar event. He believes that the economic conditions created in the early 1980s—double digit inflation, with “steady and dependable prosperity,” and soaring stock market values after inflation fell—contributed to the economic bust. *Id.* Rising house prices led to more borrowing and spending, which served as a catalyst for more economic activity. *Id.* Everyone suspended belief that the prosperity could end, and a “get-rich-quick climate” emerged. *Id.* But, prevailing economic theory was flawed to the extent that it ignored the basic proposition that “too much prosperity enjoyed for too long tends to destroy itself. . . . [P]eriodic recessions and burst bubbles—at least those of modest proportions—serve a social purpose by reminding people of [the] economic and financial hazards and by rewarding prudence.” *Id.* at 17–18 “[G]reed, deregulation, misaligned pay incentives and mindless devotion to ‘free markets’ and ‘efficient markets’ theory” created an “orgy of risk taking, unrestrained either by self-imposed prudence or sensible government oversight.” *Id.* at 18.

[Lenders] relaxed lending standards for home mortgages because they were not holding them but passing them on to investment bankers, who packaged them in increasingly arcane securities, which were then bought by other investment entities (pension funds, hedge funds, foreign banks). These investors were . . . reassured . . . [by the] high ratings from agencies such as Moody's, Standard & Poor's, and Fitch.

Id. “The result was a mountain of bad debt that had to collapse, to the great peril of the entire financial system and the economy.” *Id.* Many blamed the government as it encouraged risk “through a series of interventions in financial markets” (e.g., rescuing Long Term Capital Management) and by “keeping interest rates too low” *Id.* In answering the question, “[w]hy did the system spin out of control,” he shows that there were many to blame: the regulators—including the Federal Reserve and the Office of Thrift Supervision—did not see the over extension by Citigroup and Bank of America or Washington Mutual, which famously imploded. *Id.* at 19. “Fannie [Mac] and Freddie [Mac] were [also] regulated,” but on loose leashes. *Id.* Although greed was widespread, greed is always present and is not a crime. *Id.* While many banks offloaded bad mortgages, many kept them (Merrill Lynch, Bear Stearns, Wachovia, Lehman Brothers) and were done in by them. *Id.* The “moral hazard” was not a significant factor, as there was no way for any actor to know who would be helped; Lehman Brothers was allowed to fail and share prices declined precipitously. *Id.*

In the end, he believes that irrational optimism is largely to blame:

[P]aradoxically, the reduction of risk [such as lower inflation, declining interest rates, increasing share prices, and job stability] prompted Americans to take on more risk. From 1995 to 2007, household debt grew from 92[%] to 138[%] of disposable income. Bear Stearns, Lehman Brothers, and other[s] . . . became heavily dependent on short-term loans that underpinned leverage ratios of 30 to 1 or more.

Id. at 22. That is, “\$30 of loans for every \$1 of shareholder capital.[] Economists and government regulators became complacent and permissive. Optimism became self-fulfilling and self-reinforcing.” *Id.* At the same time, “wealth expanded so rapidly that their net worth . . . increased . . . from \$11 trillion to \$53 trillion.” *Id.* “[F]inancial positions looked stronger.” *Id.* There were higher loan values because of high home values. But the “system became more fragile and vulnerable.” *Id.* In his view, the idea that bubbles and cycles can be avoided is a myth. The tools to avert another economic crisis include more regulation: banks should be

slightly different, the mien of the GSEs underwent a transmogrification—from solicitude to punishing for the less well-off homeowner.²⁹

When the GSEs faced collapse, a new overseer, the Federal Housing Finance Agency (“FHFA”), corralled them.³⁰ The Housing and Economic Recovery Act of 2008 (“HERA”) created the FHFA.³¹ HERA invested FHFA with expansive powers over the GSEs’ purchasing power to stop the accumulation of new debt³² and to limit their liability exposure by shielding them from foreclosure or levy.³³ While FHFA publicly assured the markets of the continuation of policies calculated to preserve homeownership, it quietly adopted severe policies that were inimical to that end.³⁴ The GSEs moved to get rid of troublesome non-performing loans, thereby leaving foreclosed homeowners at the mercy of investor purchasers.³⁵ Further, the GSEs refused to resell foreclosed properties to their former owners for less than amounts owed from the original loan.³⁶

These self-preservation measures are disturbing, not only on account of the duplicity of the government agencies created to promote homeownership opportunities while simultaneously adopting policies that impaired such opportunities, but also because the measures evince an abandonment of the historical mission of the GSEs. In the end, the housing agencies were not interested in preserving housing; instead, the goal was to protect the federal fiscal status. While the policies adopted by an agency are largely left to its discretion, the judiciary or the legislature can check these agencies’ policies when they transgress the law,³⁷ such as when the housing agencies’ policies violate the equal protection clause of the United States Constitution and the Fair Housing Act.

“required to hold more capital as a cushion against losses”; the government should be allowed “to shut large failing financial institutions . . . without resorting to the disruptive bankruptcy”; and, there must be fewer bailouts. *Id.* at 23–24. The overall prescription is to move away from “unfettered competition [in the marketplace] toward more government oversight,” contain greed, and tax the greedy. *Id.* at 24.

²⁹ *See id.* at 16–24.

³⁰ *See* 12 U.S.C. § 1703 (2017).

³¹ Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (codified at scattered sections of 12, 15, 26, 37, 38, 42 U.S.C.).

³² This also meant lopping off the management heads of the GSEs.

³³ Housing and Economic Recovery Act, 122 Stat. at 2766.

³⁴ FIN. CRISIS INQUIRY COMM’N, *supra* note 20, at 518–19.

³⁵ Ken Xuhao Zhang, *GSE NPL Sales Programs: Five Questions to Ask Before Investing in Non-Performing Loans*, RISKSPAN (June 13, 2017), <https://www.riskspan.com/news-insight-blog/gse-npl-sales-programs-investing-in-non-performing-loans>.

³⁶ Iulia Filip, *MA Sues Fannie & Freddie over Foreclosures*, CFLA (June 8, 2014), <http://www.certifiedforensicloanauditors.com/articles/06.14/ma-sues-fannie-and-freddie-over-foreclosures.html>.

³⁷ JARED P. COLE, CONG. RESEARCH SERV., R44699, AN INTRODUCTION TO JUDICIAL REVIEW OF FEDERAL AGENCY ACTION summary (2016), <https://fas.org/sgp/crs/misc/R44699.pdf>.

This Article explores the impacts of the self-preservation policies adopted by the GSEs after the Great Recession, outlines the early constitutional challenges made to these policies, and suggests avenues for holding the GSEs accountable. Section II provides background on the events that led to the GSEs' near collapse and compares the events to those precipitating the Great Depression. Section III describes the retrenchment by the GSEs when the Great Recession set in. Section IV analyzes the challenges to the GSEs' new policies and advances possible avenues for successful challenges to these policies. Section V offers conclusions on going forward.

II. GOVERNMENT INTERVENTIONS AFTER THE FIRST CRISIS

During the Great Depression, federal, state, and local governments intervened in a myriad of ways to revive the ailing economic and housing markets.³⁸ President Franklin Roosevelt's "New Deal" aimed to create confidence in the markets to encourage entrepreneurs and individuals to venture back in.³⁹ Under the New Deal programs, industries produced goods bought by laborers who were hired to construct bridges and were paid a decent wage.⁴⁰ Artisans painted murals on government office buildings to inspire citizens and memorialize American history.⁴¹ Banks were monitored against risky investments.⁴² Mortgages were backed with a federal guarantee to encourage banks to lend, and markets developed to trade in these mortgages.⁴³ In this Article, I focus particularly on this last measure.

A. Moratoria, Mortgage Insurance, and Federal Banking

The seemingly implausible rate of foreclosures in the 1930s would surely have reached higher levels but for state-imposed moratoria and other limits on home foreclosures and the federal government's intervention to refinance delinquent mortgages.⁴⁴ Approximately twenty-eight states halted the remarkable rate of foreclosures through moratoria,⁴⁵ and the federal government interfered with the

³⁸ Bradford A. Lee, *The New Deal Reconsidered*, WILSON Q., Spring 1982, 62, 67.

³⁹ *Id.* at 65.

⁴⁰ RICHARD WALKER, *THE NEW DEAL IN BRIEF* (2012), <https://livingnewdeal.org/wp-content/uploads/2012/01/New-Deal-in-Brief.pdf>.

⁴¹ Lee, *supra* note 38, at 67.

⁴² Among other measures adopted to guard against risky banking practices was the Glass-Steagall Act. The Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162, *repealed by* Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338; *see* Julia Maues, *Banking Act of 1933 (Glass-Steagall)*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/glass_steagall_act.

⁴³ Wheelock, *The Federal Response*, *supra* note 8, at 133–34.

⁴⁴ *Id.* at 139.

⁴⁵ *Id.* "There is much debate about the wisdom and efficacy of moratoria." Green, *Disquiet on the Home Front*, *supra* note 13, at 32–33. The opposing arguments were that "foreclosure moratoria make loans costlier" (higher interest rates "to compensate for the added risks associated with an inability to foreclose") and also "more difficult to obtain" (lenders restrict the supply of loans). *Id.* at 33 (emphasis added). At the same time, lenders benefit from moratoria because high foreclosure rates reduce property values, prompting still more foreclosures, that hurt lenders. A moratorium might halt the downward spiral in property values. Wheelock, *Changing the Rules*, *supra* note 23, at 580. Wheelock suggests that the states ignored

housing market in other ways. For example, to shore up housing markets, the Roosevelt-era Congress authorized the Reconstruction Finance Corporation (“RFC”)⁴⁶ to purchase stock in 6,000 banks at a cost of \$1.3 billion, which equates to roughly \$200 billion in today’s currency.⁴⁷ In addition, the government implemented other remedial measures, such as bank deposit insurance and disclosure requirements for securities issuers.⁴⁸ The Federal Home Loan Bank System established twelve regional Federal Home Loan Banks to provide a ready source of funds to member firms for residential-mortgage and economic-development loans.⁴⁹ The government entered the housing market directly through the Home Owners’ Loan Corporation (“HOLC”), which purchased and refinanced distressed mortgages on family homes that were subject to income and loan qualifications.⁵⁰ Between August 1933 and June 1936, HOLC issued over one million loans.⁵¹ However, HOLC was liquidated in 1951.⁵²

The National Housing Act of 1934 created the Federal Housing Administration (“FHA”) to encourage the making of home loans by providing mortgage insurance.⁵³ The program required mortgage loan terms that were longer—e.g., thirty years—and did not involve a balloon payment after only five years.⁵⁴ This made loan servicing more predictable and manageable.⁵⁵ The program required mortgage loans to be fully

this reality on the belief that unrestricted foreclosures would have resulted in many people becoming homeless simultaneously. And these moratoria were also an expedient to buy time while the economy recovered. *Id.* at 580–81.

⁴⁶ Wheelock, *The Federal Response*, *supra* note 8, at 140.

⁴⁷ Green, *Disquiet on the Home Front*, *supra* note 13, at 35.

⁴⁸ Wheelock, *The Federal Response*, *supra* note 8, at 140.

⁴⁹ *Id.*

⁵⁰ *Id.* The HOLC is revered as highly successful, and it achieved this success at low taxpayer cost—only an “initial \$200 million capitalization, which it eventually repaid.” *Id.* at 146. “HOLC purchased some one million loans [from their originators], which it refinanced as long-term, fixed rate, [fully] amortizing loans payable in monthly installments.” *Id.* Although it purchased only delinquent loans, it “ended up foreclosing on fewer than 20[%] of the loans it refinanced.” *Id.*; *see id.* at 134. “The HOLC was not quick to foreclose on delinquent loans, being ‘as considerate of delinquent but deserving borrowers as its responsibility to the Federal Government and the taxpaying public [would] permit.’” *Id.* at 142 (quoting FED. HOME LOAN BD., THIRD ANN. REP. 600 (1935)). “The HOLC often counseled delinquent borrowers and readjusted payment schedules rather than moving quickly to foreclosure when borrowers fell behind on their payments. On average, HOLC loans were delinquent for two years before foreclosure.” *Id.* (citing FED. HOME LOAN BD., 1951 ANN. REP. 73 (1951)).

⁵¹ Wheelock, *The Federal Response*, *supra* note 8, at 140.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Federal National Mortgage Association Charter Act, Pub. L. No. 83–560, tit. II, 68 Stat. 590, 612–22 (1954) (codified as amended at 12 U.S.C. §§ 1716–23(j) (2017)) (creating “Fannie Mae” and defining its functions); *see* 12 U.S.C. §§ 1451–59 (2017) (defining “Freddie Mac”); Shelby D. Green, *The Search for a National Land Use Policy: For the Cities’ Sake*, 26 FORDHAM URB. L.J. 69, 85 n.103 (1998) [hereinafter Green, *The Search*] (“Fannie Mae was established to draw more funds into the residential housing market, to redistribute these funds

amortizing and set a maximum allowable interest rate of 5%.⁵⁶ At first, FHA-insured loans had to be \$16,000 or less (at a time when the median house price was \$5,304) and had to have a maximum loan-to-value ratio of 80%.⁵⁷ But in 1938, FHA raised that loan-to-value ratio to 90% for new homes with mortgages of no more than \$5,400.⁵⁸ The FHA had authorization to charge an annual insurance premium between 0.5% and 1.0% of the outstanding loan principal.⁵⁹ The early impact in the market was modest; for some lenders, FHA insurance did not outweigh the advantages of balloon payments, higher loan amounts, and interest rates.⁶⁰ By 1938, FHA-insured loans represented less than 20% of all new mortgage originations.⁶¹

B. National Housing Act and the Secondary Market

To provide liquidity necessary for spreading homeownership, the economy needed a market for mortgages. The National Housing Act of 1934 created the national mortgage associations for this purpose, establishing the secondary market for mortgages to be bought and securitized.⁶² The RFC formed two subsidiaries to purchase FHA-insured mortgages: (1) the RFC Mortgage Company, established in 1935, and (2) Fannie Mae, established in 1938.⁶³ Soon, Fannie Mae became the principal government purchaser of FHA-insured loans. In its first year, Fannie Mae purchased approximately \$82 million of mortgages; this number rose to \$207 million in 1941, which was approximately 1% of the total outstanding mortgages on single-to four-family homes.⁶⁴

A 1948 amendment to the National Housing Act of 1934 gave Fannie Mae a federal charter to break off from the RFC and the authority to purchase FHA- and

regionally, and to insulate housing markets from monetary and fiscal policy. Freddie Mac was established as a subsidiary to the Federal Home Loan Bank System to create a pass-through program for conventional mortgages. Additionally, the federal government also purchases mortgages made by private lenders through the Government National Mortgage Association ("Ginnie Mae"), 12 U.S.C. §§ 1716–23(h).” “Ginnie Mae buys and packages FHA/VA-insured mortgages and sells them directly to investors, creating a “pass-through” by guaranteeing principal and interest to the ultimate investor and servicing fees to the originator.” *Id.* (quoting Lily M. Hoffman & Barbara S. Heisler, *Home Finance: Buying and Keeping a House in a Changing Financial Environment*, in *HANDBOOK OF HOUSING, AND THE BUILT ENVIRONMENT IN THE UNITED STATES* 149, 152–53 (Elizabeth Huttman & William Van Vliet eds., 1988) (citations omitted)). “The Homeownership Assistance Program provides mortgage insurance for the purchase of one to four family homes, authorizes down payments as low as \$200 and subsidizes the interest paid by qualified low-income homebuyers on their mortgage loans, reducing interest rates to as low as 1% per year.” *Id.* (citing 12 U.S.C. § 1715(z) (1998)).

⁵⁶ Wheelock, *The Federal Response*, *supra* note 8, at 144.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *See id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 145.

⁶⁴ *Id.*

Veterans Administration- (“VA”) insured loans.⁶⁵ In 1968, Congress chartered Fannie Mae as a government-sponsored private corporation⁶⁶ with an initial capitalization of \$10 million.⁶⁷ To facilitate its mortgage purchasing activities, Congress authorized Fannie Mae to sell bonds to investors.⁶⁸ These bonds were thought to carry the implicit guarantee of the federal government because FHA-insured mortgages comprised almost all of Fannie Mae’s portfolio.⁶⁹

Freddie Mac was established in 1970 as part of the Federal Home Loan Bank System.⁷⁰ Together, Fannie Mae and Freddie Mac created a robust secondary market for mortgages and set standards for efficient operation. Mortgage instruments became standardized, prepayment premiums were eliminated, and down payment amounts were fixed.⁷¹

C. Interventions After the 2008 Crisis: From Predictability to Volatility

Through GSEs, the rate of homeownership rose to just under 70% of all households, and housing prices rose steadily over the decades.⁷² However, the prolonged period of prosperity from the late 1970s to the 1990s spurred the desire for more borrowing, more profits, and more risks. To satiate these wants, lenders introduced housing market participants to common practice standards and devices that made borrowing easier, but were more unpredictable and ultimately more burdensome.⁷³ The more notorious of these practices were the adjustable rate mortgage (“ARM”) and the interest-only payment mortgage, which made homeownership possible for a short time but only promised doom.⁷⁴ That doom came in the ARM case when the increasing interest rates caused concomitant rises in mortgage payments, sometimes in multiples of the original amounts. In the case of the interest-only mortgage, that doom came when the principal came due and the loan’s principal had not been reduced since loan origination.⁷⁵ This scenario was even more scandalous

⁶⁵ *Id.* at 140.

⁶⁶ See N. ERIC WEISS & KATIE JONES, CONG. RESEARCH SERV., R42995, AN OVERVIEW OF THE HOUSING FINANCE SYSTEM IN THE UNITED STATES 9 (2017); see also Green, *Disquiet on the Home Front*, *supra* note 13, at 17.

⁶⁷ Wheelock, *The Federal Response*, *supra* note 8, at 145.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ WEISS & JONES, *supra* note 66, at 9.

⁷¹ Robin Paul Malloy, *The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions*, 39 SW. L.J. 991, 994 (1986).

⁷² Green, *Disquiet on the Home Front*, *supra* note 13, at 13; Samuelson, *Rethinking the Great Recession*, *supra* note 28, at 16.

⁷³ FIN. CRISIS INQUIRY COMM’N, *supra* note 20, at 16.

⁷⁴ *Id.*

⁷⁵ Green, *Disquiet on the Home Front*, *supra* note 13, at 10; see Justin Pritchard, *Learn the Pros and Cons of Adjustable Rate Mortgages*, BALANCE (Nov. 7, 2017), <https://www.thebalance.com/adjustable-rate-mortgages-315667> (discussing ARMs); Elizabeth Weintraub, *Pros and Cons to an Interest Only Mortgage*, BALANCE (Nov. 26, 2016),

after the realization that many of the defaulting borrowers could not afford their loans in the first place; they received mortgages from low- or no-documentation loans where creditworthiness was not assessed.⁷⁶ The practice was curious—borrowers with no established income or ability to repay received large loans based on inflated appraisals with high interest rates.⁷⁷ At the height of the housing crisis, loan defaults occurred at an alarming rate, and banks scheduled millions of foreclosures.⁷⁸ Fannie Mae and Freddie Mac held millions of mortgages in their portfolios, a very high percentage of which were thought to be risky or of poor quality.⁷⁹

Unlike Nero,⁸⁰ the government could not sit idle while many of its venerable financial institutions teetered on the verge of demise. Instead, the government's response was massive.⁸¹ Some commentators assert the response lacked a comprehensive systemic vision, instead unfolding as a series of deals as individual catastrophes emerged—the decision to facilitate the acquisition of Bear Stearns by JP Morgan, the purchase of Merrill Lynch by Bank of America, the nationalization of AIG, and, paradoxically, the decision to let Lehman Brothers fail.⁸² The response included macro-level monetary and regulatory policies: the Federal Reserve opened its discount window to banks that it did not oversee, specifically to the seventeen institutions that the New York Federal Reserve listed “as ‘primary dealers’ in government securities that reported their statistics to the Federal Reserve”;⁸³ the Federal Reserve and Treasury received enhanced powers for bank regulation; the target rate for federal funds and the discount rate decreased by almost half;⁸⁴ and the Department of Housing and Urban Development (“HUD”) addressed the housing-specific aspects of the crisis under HERA.⁸⁵

<https://www.thebalance.com/what-is-an-interest-only-mortgage-1798407> (discussing interest-only payments mortgages).

⁷⁶ See Green, *Disquiet on the Home Front*, *supra* note 13, at 10.

⁷⁷ *Id.*

⁷⁸ *Id.* at 37.

⁷⁹ Arnold Kling, *The Financial Crisis: Moral Failure or Cognitive Failure?*, 33 HARV. J.L. & PUB. POL'Y 507, 509 (2010) (discussing the decisions by the GSEs to ignore risks as they pursued greater profits).

⁸⁰ See generally Bruce Bartlett, *How Excessive Government Killed Ancient Rome*, 14 CATO J. 287, 294–95 (1994).

⁸¹ Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 465 (2009).

⁸² *Id.* at 480, 494.

⁸³ *Id.* at 484.

⁸⁴ *Id.* The federal funds rate went “from 2.25% to 1.5% and the discount rate [dropped] from 2.5% to 1.75%.” *Id.*

⁸⁵ Housing and Economic Recovery Act, 122 Stat. at 2654.

1. Rescue of the GSEs for Stability of the Markets

In theory, HERA provided \$300 billion in aid to qualified subprime homebuyers and poised the GSEs as principal actors in engineering a housing recovery.⁸⁶ By its terms, HERA set out five large goals.⁸⁷ The first goal was to assist the GSEs to survive undercapitalization by closely monitoring their activities, placing restrictions on their asset growth, and requiring prior approval of any new acquisition and activities.⁸⁸ The second goal was to provide relief to lenders and borrowers through the HOPE for Homeowners Act (the "Act"), a voluntary plan to avoid foreclosure by refinancing loans (where in exchange for reducing loan debt to no greater than 90% of appraised value, lenders in turn waived all prepayment penalties, default fees, delinquent fees, and subordination liens).⁸⁹ Pursuant to the Act, the federal government would insure the new loans and was entitled to most of the equity upon a sale of the property during the early years of the program.⁹⁰ The third goal aimed to stabilize the housing market through new tax credits for homebuyers,⁹¹ support for redevelopment of abandoned properties,⁹² and support for real estate investment.⁹³ The fourth goal was to remedy the social consequences of foreclosures by expanding housing stock, with the GSEs leading by using flexible underwriting, making grants to local development agencies, slowing the foreclosure process for individuals serving in the military (and increasing the maximum loan guarantees to up to 125% of median area price), and promoting external increases in property value by developing and maintaining abandoned properties.⁹⁴ The fifth goal was to prevent a future housing crisis.⁹⁵ HERA attempted to prevent a new crisis through the creation of FHFA to oversee the GSEs,⁹⁶ expanding government-backed financing options for homebuyers, allowing for 3.5% down-payment,⁹⁷ adopting the Secure and Fair Enforcement of Mortgage Lending Act

⁸⁶ 12 U.S.C. § 1721 (2008).

⁸⁷ *Id.* § 4561.

⁸⁸ *Id.* § 4715(a)(2)(1).

⁸⁹ *Id.* § 1715z-23(b)(1)-(2).

⁹⁰ *Id.* §§ 1715z-23(b)(1)-(2), (d), (e)(1)(3).

⁹¹ 26 U.S.C. § 3002-05 (2008); Housing and Economic Recovery Act, 122 Stat. at 2879-86 (granting tax credits under this authority up to \$7,500).

⁹² The Act set aside \$4 billion for low- and moderate-income housing.

⁹³ 26 U.S.C. § 3012(b) (2008); Housing and Economic Recovery Act, 122 Stat. at 2892.

⁹⁴ 12 U.S.C. § 4565(d)(2)(a) (2008); Housing and Economic Recovery Act, 122 Stat. at 2705.

⁹⁵ Housing and Economic Recovery Act, 122 Stat. at 2840.

⁹⁶ 12 U.S.C. § 1703 (2008).

⁹⁷ *Id.* § 1454(a)(2). The expanded financing options changed loan limits, which started at \$417,000 for single-family homes and increased for certain high-cost regions. *Id.* The allowance of 3.5% down-payments also did not include the financing of down-payments. *Id.*

(“SAFE”) for regulating mortgage brokers,⁹⁸ and amending the Truth in Lending Act (“TILA”) to require additional disclosures to borrowers.⁹⁹

Congress enacted HERA just in time, as the GSEs were failing.¹⁰⁰ Together, Fannie Mae and Freddie Mac owned or guaranteed more than \$4 trillion in home mortgages, nearly half of which were outstanding.¹⁰¹ On September 5, 2008, government auditors discovered that the accounting records of Fannie Mae and Freddie Mac significantly overstated their capital; instead of a sound fiscal base, the programs were technically insolvent without any obvious remedy.¹⁰² FHFA exercised the powers conferred by HERA and placed the GSEs under conservatorship.¹⁰³ This move meant that the federal government became the owner or guarantor of approximately 42% of American mortgages, a number that was growing in size and scope.¹⁰⁴ The Treasury Secretary at the time, Henry Paulson, decided to shrink the portfolios of retained mortgage and mortgage-backed securities to approximately \$850 billion by December 31, 2009; through a 10% decline per year, he hoped to reach an ultimate goal of an asset portfolio of \$250 billion for each GSE.¹⁰⁵ At the same time, the mortgage markets did not announce wholesale withdrawal of Fannie Mae and Freddie Mac.¹⁰⁶ Instead, the government made a public announcement concerning its commitment to grow these institutions over the next fifteen months to provide assistance to the housing markets.¹⁰⁷ As is the subject of this Article, the measures adopted only served to frustrate the promise to grow the GSEs.

⁹⁸ Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (“S.A.F.E. Act”), Pub. L. No. 110-289, 122 Stat. 2810 (codified at 12 U.S.C. § 5101 *et seq.* and implemented through regulations 12 C.F.R. §§ 1007–08).

⁹⁹ 15 U.S.C. § 1601 (2008). For a thorough description of HERA, see Bruce Arthur, *Recent Development: Housing and Economic Recovery Act of 2008*, 46 HARV. J. ON LEGIS. 585 (2009).

¹⁰⁰ See OFFICE OF FED. HOUS. ENTER. OVERSIGHT, A PRIMER ON THE SECONDARY MORTGAGE MARKET I (2008).

¹⁰¹ *Id.* at 2.

¹⁰² Gretchen Morgenson & Charles Duhigg, *Mortgage Giant Overstated Size of Its Capital Base*, N.Y. TIMES, Sept. 6, 2008, at A1.

¹⁰³ *Id.*

¹⁰⁴ The figure is as of September 30, 2008. U.S. SEC. & EXCH. COMM’N, 0-50231, SEPT. 2008 Q. REP. 9 (2008), <http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2008/q32008.pdf>.

¹⁰⁵ OFFICE OF PUB. AFFAIRS, U.S. DEP’T OF THE TREASURY, FACT SHEET: TREASURY SENIOR PREFERRED STOCK PURCHASE AGREEMENT 30 (2008), https://www.treasury.gov/press-center/press-releases/Documents/pspa_factsheet_090708%20hp1128.pdf.

¹⁰⁶ See Press Release, U.S. Dep’t of the Treasury, Statement by Secretary Henry M. Paulson Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), <http://www.ustreas.gov/press/releases/hpl129.htm>.

¹⁰⁷ *Id.*

2. Propping Up the Banks

When the crisis began to impact the financial markets, Congress enacted the Troubled Asset Relief Program (“TARP”)¹⁰⁸ under the Emergency Economic Stabilization Act of 2008 (“EESA”).¹⁰⁹ The aim of TARP was to support Wall Street and to avoid a cascading effect from failures from across other parts of the economy.¹¹⁰ However, these efforts came too late; the stock markets were already roiling, unemployment was already soaring, and GDP was already halted.¹¹¹ Nevertheless, many viewed the efforts as a “bailout” of the banks whose own greed precipitated the financial crisis.¹¹² While many banks received TARP funds, two in particular, Citigroup and Bank of America, were seen as “systemically significant”—meaning “too big to fail”—and received significant capital infusions.¹¹³ At the heart “of EESA was the authorization of up to \$700 billion to fund TARP.”¹¹⁴ At first, the government only committed \$475 billion, with \$245 billion allocated to investments in bank capital.¹¹⁵ Of the latter number, TARP expended \$204.9 billion to buy preferred stock in banks under the Capital Purchase Program (“CPP”).¹¹⁶ Under Treasury Department rules, no financial institution could receive more than \$25 billion under the CPP.¹¹⁷ Yet, the bulk of the initial CPP funds—about \$125 billion—went to nine of the largest financial institutions.¹¹⁸

¹⁰⁸ Emergency Economic Stabilization Act of 2008 § 101, Pub. L. No. 110-343, 122 Stat. 3765, 3767 (codified at 12 U.S.C. § 5211); see Green, *Disquiet on the Home Front*, *supra* note 13, at 12 n.22.

¹⁰⁹ 12 U.S.C. § 5201 (2008); Emergency Economic Stabilization Act of 2008, 122 Stat. at 3765.

¹¹⁰ Emergency Economic Stabilization Act of 2008, 122 Stat. at 3767.

¹¹¹ See *supra* text accompanying note 14.

¹¹² Lissa Lamkin Broome, *The Dodd-Frank Act: TARP Bailout Backlash and Too Big to Fail*, 15 N.C. BANKING INST. 69, 69 (2011).

¹¹³ *Id.*

¹¹⁴ *Id.* at 70.

¹¹⁵ OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLE ASSET RELIEF PROGRAM, SIG-QR-10-04, OCT. 2010 Q. REP. CONG. 43 (2010) [hereinafter SIGTARP Q. REP.]; Broome, *supra* note 112, at 70–71.

¹¹⁶ SIGTARP Q. REP., *supra* note 115, at 45.

¹¹⁷ *Capital Purchase Program: Program Purpose & Overview*, U.S. DEP'T TREASURY, <https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/bank-investment-programs/cap/Pages/overview.aspx> (last updated Oct. 16, 2015).

¹¹⁸ Those nine financial institutions were: Citigroup (\$25 billion), JPMorgan Chase & Co. (\$25 billion), Wells Fargo & Company (\$25 billion), Bank of America Corporation (\$15 billion plus \$10 billion from Merrill Lynch), The Goldman Sachs Group, Inc. (\$10 billion), Morgan Stanley (\$10 billion), The Bank of New York Mellon Corporation (\$3 billion), and State Street Corporation (\$2 billion). U.S. DEP'T OF TREASURY, TROUBLED ASSET RELIEF PROGRAM (TARP) MONTHLY 105(A) REP.—DEC. 2010 app. 2 (2011).

3. Help for Homeowners

While some banks were too big to fail, this was not the case for the hapless homeowner whose folly or naivety, not unlike that which animated the big banks, led them to mortgages they could not afford. Rather than providing cash assistance to bring their mortgages current, the Administration adopted the Home Affordable Refinance Program (“HARP”), which allowed for the refinancing of existing Fannie Mae and Freddie Mac loans up to 125% of the current value of the home.¹¹⁹ Additionally, the Home Affordable Modification Program (“HAMP”) aimed “to reduce delinquent and at-risk borrowers’ monthly mortgage payments” through loss-mitigation alternatives, such as loan modifications, that extended the term of the loan or reduced the loan’s interest rate to make monthly payments manageable.¹²⁰

a. New Federal Underwriting Standards

Other federal agencies, which were able to step back and assess the systemic ills of the lending industry, attacked the crisis from the front end—loan origination.¹²¹ Among other things, the Federal Reserve Board adopted amendments to Regulation Z of TILA.¹²² Recognizing that “the low- or no-documentation loans contributed to the burgeoning default rates and subsequent housing crisis by providing high-priced mortgages to high-risk borrowers,” the Regulation Z amendments included enhanced disclosures to borrowers on higher-priced mortgage loans and restrictions on certain proven onerous features, such as balloon payments and prepayment penalties.¹²³ The amendments prohibit deceptive advertising, influence by lenders and brokers on appraisers, and unfair servicing practices by servicers as related to fees and billing.¹²⁴

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), adopted in July 2010, includes comprehensive measures on investment banking and substantial measures regulating mortgage lending.¹²⁵ Dodd-Frank created the Consumer Financial Protection Bureau (“CFPB”) to ensure fairness in consumer transactions.¹²⁶ Lenders are now required to ensure that the borrower has the ability to repay and delineates “qualified mortgage[s]”—“which are mortgages with safe

¹¹⁹ See *HARP Refinancing Program—Check Your HARP Eligibility*, LENDERS NETWORK, <https://thelendersnetwork.com/harp-program-refinance-loan> (last visited Feb. 8, 2018).

¹²⁰ Abigail Lawlis Kuzma, *Foreclosure in the Heartland: What Did We Learn?*, 49 VAL. U. L. REV. 39 (2014) (describing the mechanics as well as the profound failures of the programs, including that from administrative negligence and carelessness).

¹²¹ Daniel Wagner, *Subprime Lending Execs Back in Business Five Years After Crash*, CTR. PUB. INTEGRITY (Sept. 11, 2013), <https://www.publicintegrity.org/2013/09/11/13327/subprime-lending-execs-back-business-five-years-after-crash>.

¹²² See Truth in Lending; Final Rule, 73 Fed. Reg. 44,521, 44,522 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226).

¹²³ *Id.*; Kuzma, *supra* note 120, at 53.

¹²⁴ Truth in Lending, *supra* note 122, at 44,563, 44,586–90.

¹²⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 5301 *et seq.*).

¹²⁶ *Id.* at 1964–2035.

underwriting practices, lower fees, and an absence of risky features”¹²⁷—as a “safe harbor.”¹²⁸ The safe harbor is “a conclusive presumption that [the mortgage] satisfied ability-to-pay requirements and a rebuttable presumption for higher-priced mortgage loans”¹²⁹ In making loans, lenders must “verify the borrower’s income and ensure the borrower has the ability to repay the loan over its full term” rather than only at the initial rate in the case of an adjustable rate mortgage.¹³⁰ “[L]enders must provide a good faith estimate of the amount the monthly payment will be *after* it adjusts or resets”¹³¹ and must provide “six months’ notice before the mortgage interest rate resets from a fixed to a variable rate”¹³² “Dodd-Frank also prohibits steering incentives and yield spread premiums, which are ‘payments made by a lender to a mortgage broker upon origination for placing the borrower in a loan with riskier terms . . . or a higher interest rate than the minimum rate required by the lender.’”¹³³

Dodd-Frank prohibits “prepayment penalties for adjustable rate and higher cost mortgages that are not ‘qualified mortgage[s]’” and prohibits a lender from offering “a fixed rate qualified loan with a prepayment penalty without also offering the

¹²⁷ Kuzma, *supra* note 120, at 53 (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2145–48). “On January 30, 2013 and June 12, 2013, the CFPB issued final regulations amending Regulation Z and implementing the ability-to-repay and qualified mortgage standards effective January 10, 2014.” *Id.* at 53 n.93 (citing Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 35,430–35,506 (June 12, 2013) (codified at 12 C.F.R. pt. 1026); Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408–20 (Jan. 30, 2013) (codified at 12 C.F.R. pt. 1026)).

¹²⁸ *Id.* at 54.

¹²⁹ *Id.* at 55; *see id.* at 54 n.94 (citing Qualified Mortgage Definition for HUD Insured and Guaranteed Single Family Mortgages, 78 Fed. Reg. 59,890 (Sept. 30, 2013) (codified at 24 C.F.R. pts. 201, 203, 1005, 1007)). “In October 2014, federal agencies loosened regulations to increase the flow of housing credit. ‘The government is in a tight spot. Some six years after the financial crisis, thousands of apparently creditworthy borrowers are being shut out of the housing market because they cannot get mortgages.’” *Id.* (quoting Peter Eavis, *U.S. Loosens Reins, but Mortgage Lenders Want More Slack*, N.Y. TIMES (Oct. 22, 2014), <http://dealbook.nytimes.com/2014/10/22/u-s-loosens-reins-but-mortgage-lenders-want-more-slack/>).

¹³⁰ 15 U.S.C. § 1639c(a) (2018); Kuzma, *supra* note 120, at 54.

¹³¹ Kuzma, *supra* note 120, at 55 (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2154).

¹³² *Id.* (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2154, 2178–81).

¹³³ *Id.* at 54, 54 n.95 (quoting Linda Singer et al., *Breaking Down Financial Reform: A Summary of the Major Consumer Protection Portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 14 J. CONSUMER & COM. L. 2, 6 (2010)); *see* Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2139–41 (codified at 15 U.S.C. § 1639b (2010)). “Yield spread premiums have long been considered predatory because they ‘provide[] a financial incentive for brokers to place borrowers into more expensive, and oftentimes typically more risky, mortgages’—the broker makes more money when he or she can convince the homeowner to purchase this less-desirable mortgage product.” Kuzma, *supra* note 120, at 54, 54 n.96 (quoting Singer et al., *supra*, at 6).

borrower a loan without a prepayment penalty.”¹³⁴ Finally, Dodd-Frank places limits on the financing of worthless credit or other insurance into the mortgage’s principal.¹³⁵

b. State Initiatives

A myriad of state laws now protect borrowers at the initial contracting stage, when the world changes, and when borrowers face foreclosure.¹³⁶ Disclosures of loan costs, limits on terms of high-cost loans,¹³⁷ required counseling, and advice before taking the loan all protect borrowers at loan origination.¹³⁸ Mediation and settlement conferences before a foreclosure now avert foreclosure after default or enable time to cure default.¹³⁹ In the first six months of 2008, the Massachusetts, Minnesota, and New York state legislatures considered legislation to impose moratoria on foreclosure, and state representatives introduced legislation for a national moratorium in Congress.¹⁴⁰

¹³⁴ Kuzma, *supra* note 120, at 55 (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2149–53).

¹³⁵ Singer et al., *supra* note 133, at 7. “Before Dodd-Frank, it was common practice in the subprime market to charge exorbitant premiums for unnecessary insurance, such as credit insurance, and finance these premiums into the mortgage principal.” Kuzma, *supra* note 120, at 55 n.105 (citing Singer et al., *supra* note 133, at 7); *but see* Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2151 (requiring residential mortgage loans to include credit unemployment insurance where “the unemployment insurance premiums are reasonable, the creditor receives no direct or indirect compensation in connection with the unemployment insurance premiums, and the unemployment insurance premiums are paid pursuant to another insurance contract and not paid to an affiliate of the creditor.”). “Under Dodd-Frank, no residential mortgage loan secured by the homeowner’s principal dwelling may include financing of ‘any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance.’” Kuzma, *supra* note 120, at 55 n.105 (quoting Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. at 2149–50).

¹³⁶ Shelby D. Green & JoAnn T. Sandifer, *MERS Remains Afloat in a Sea of Foreclosures*, PROB. & PROP. July/August 2013, at 18.

¹³⁷ *See, e.g.*, N.Y. BANKING LAW § 6-1 (McKinney 2018); *LaSalle Bank, N.A. v. Shearon*, 850 N.Y.S.2d 871 (N.Y. Sup. Ct. 2008) (canceling debt upon violations of banking law on high cost loan), *aff’d on reh’g*, 881 N.Y.S.2d 599 (N.Y. Sup. Ct. 2009).

¹³⁸ Kuzma, *supra* note 120, at 63.

¹³⁹ *See generally* NEV. REV. STAT. § 107.086(3) (2011); ALON COHEN, CTR. FOR AM. PROGRESS, WALK THE TALK: BEST PRACTICES ON THE ROAD TO AUTOMATIC FORECLOSURE MEDIATION 2 (2010); GEOFFRY WALSH, NAT’L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? 30 (2009); Frank S. Alexander et al., *Legislative Responses to the Foreclosure Crisis in Nonjudicial Foreclosure States*, 31 REV. BANKING & FIN. L. 341 (2011); Aleatra P. Williams, *Foreclosing Foreclosure: Escaping the Yawning Abyss of the Deep Mortgage and Housing Crisis*, 7 NW. J.L. & SOC. POL’Y 454 (2012).

¹⁴⁰ PEW CHARITABLE TRUSTS, DEFAULTING ON THE DREAM: STATES RESPOND TO AMERICA’S FORECLOSURE CRISIS (2008). “In the summer of 2009, California imposed a ninety-day moratorium on foreclosure proceedings.” Alexander et al., *supra* note 139, at 365. “Many leaders in the last year have imposed voluntary moratoria on foreclosures.” Green, *Disquiet on the Home Front*, *supra* note 13, at 33 n.122. By one estimate, approximately half of all United States urban home mortgages were delinquent during the Great Depression as of January 1, 1934. *Id.* “State and local governments responded by changing state laws governing foreclosure.

III. FROM SHORING UP TO SELF-PRESERVATION

The FHFA placed Fannie Mae and Freddie Mac under conservatorship¹⁴¹ after concluding that the GSEs could not fulfill their mission without government intervention.¹⁴² Announcing the decision, the director of FHFA stated:

After this exhaustive review, I have determined that the companies cannot continue to operate safely and soundly and fulfill their critical public mission, without significant action to address our concerns, which are:

- the safety and soundness issues . . . including current capitalization;
- current market conditions;
- the financial performance and condition of each company;
- the inability of the companies to fund themselves according to normal practices and prices; and
- the critical importance each company has in supporting the residential mortgage market in this country.

Therefore, in order to restore the balance between safety and soundness and mission, FHFA has placed Fannie Mae and Freddie Mac into conservatorship. That is a statutory process designed to stabilize a troubled institution with the objective of returning the entities to normal business operations. FHFA will act as the conservator to operate the Enterprises until they are stabilized.¹⁴³

At the time the conservatorship went into effect, the Treasury Department provided \$189.5 billion in support with an initial placement of \$1 billion to both Fannie Mae and Freddie Mac as well as an additional cumulative \$187.5 billion investment.¹⁴⁴

The conferred powers and protections under HERA are broad, including exemptions for any property of FHFA from state, county, or local taxation¹⁴⁵ and exemption from “levy, attachment, garnishment, foreclosure, or sale” without FHFA’s consent.¹⁴⁶ The FHFA curtailed the GSEs’ borrowing capacity and “launched initiatives to recover losses that resulted from the housing crisis” to avoid further

These measures included enhancements of borrowers’ redemption rights and limiting deficiency judgments.” *Id.* (internal citations omitted); see Wheelock, *Changing the Rules*, *supra* note 23, at 574.

¹⁴¹ Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by HERA, FHFA has authorization to “take such action as may be: (i) necessary to put the regulated entity in a sound and solvent condition; and (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.” 12 U.S.C. § 4617(b)(2)(D)(i)–(ii) (2018).

¹⁴² Fed. Hous. Fin. Agency, Statement of Director James B. Lockhart at News Conference Announcing Conservatorship of Fannie Mae and Freddie Mac (Sept. 7, 2008).

¹⁴³ *Id.*

¹⁴⁴ *FHFA as Conservator of Fannie Mae and Freddie Mac*, FEDERAL HOUSING FINANCE AGENCY [hereinafter *FHFA as Conservator*].

¹⁴⁵ 12 U.S.C. § 4617(j)(2) (2018).

¹⁴⁶ *Id.* § 4617(j)(3).

liability.”¹⁴⁷ The FHFA reduced the amount of outstanding repurchases and reduced the number of loans created under poor underwriting standards.¹⁴⁸

Four years later, after the market began to settle, FHFA released the 2012 Strategic Plan for Enterprise Conservatorships.¹⁴⁹ The plan “envisioned a new securitization infrastructure to replace Fannie Mae’s and Freddie Mac’s . . . outdated infrastructures and attract private capital to share credit risk” that the GSEs previously took on alone.¹⁵⁰ Section 4617 of HERA gave the FHFA not only the power to act as conservator or receiver, but also the power to reorganize, rehabilitate, or wind up the GSEs affairs.¹⁵¹ This “winding up” power is central to the FHFA’s activities and is of most concern.

A. *The Tools of Self-Preservation*

Purportedly, FHFA adopted these measures to help Wall Street and consumers survive the crisis. The measures acknowledged that there was enough blame to go around, but did not place the blame anywhere in particular. Rather, they applied funds and efforts best calculated to quell the roiling seas.¹⁵² To be sure, a conservatorship

¹⁴⁷ *FHFA as Conservator*, *supra* note 144; *History of Fannie Mae & Freddie Mac Conservatorships*, FED. HOUS. FIN. AGENCY (2012) [hereinafter *History of Fannie Mae*], <https://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx> (last visited Mar. 12, 2018).

¹⁴⁸ *FHFA as Conservator*, *supra* note 144.

¹⁴⁹ FED. HOUS. FIN. AGENCY, STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS 2 (2012) [hereinafter FED. HOUS. FIN. AGENCY, STRATEGIC PLAN].

¹⁵⁰ *FHFA as Conservator*, *supra* note 144. “FHFA proposed a common platform that would support Fannie Mae’s and Freddie Mac’s existing business and upgrade their aging and inflexible infrastructures . . . [to] save taxpayers the costs of maintaining and upgrading two parallel structures in the future.” *Id.* The Strategic Plan led to a white paper in October 2012 that proposed:

a framework for a common securitization platform and an improved contractual and disclosure framework and requested public input. The white paper sought to identify the core components (proposed as data validation, issuance, disclosure, bond administration, and master servicing) of mortgage securitization that would be needed in the housing finance system in the future. The securitization platform could be used by multiple issuers to process payments and perform other functions.

Along with the white paper, FHFA joined Fannie Mae and Freddie Mac . . . in outreach to a full range of stakeholders, including a variety of industry participants—small and large companies, trade groups, advocacy organizations, vendors, originators, servicers, investors, and mortgage insurers . . . [—to solicit feedback] on the securitization platform prototype, to align key contract features and practices, and address additional protections investors require.

Id.; FED. HOUS. FIN. AGENCY, WPR-2012-001, WHITE PAPER: FHFA-OIG’S CURRENT ASSESSMENT OF FHFA’S CONSERVATORSHIP OF FANNIE MAE & FREDDIE MAC (2012), <https://www.fhfaog.gov/Content/Files/WPR-2012-001.pdf>.

¹⁵¹ 12 U.S.C. § 4617(a)(2) (2018).

¹⁵² Christian E. Weller, *10 Reasons Why Public Policies Rescued the U.S. Economy*, CTR. FOR AM. PROGRESS (May 29, 2012),

meant to stave off claims holds the potential to stabilize a turbulent event. However, it is the usual case that conservatorships are temporary measures adopted in the event of crisis,¹⁵³ although in certain instances, such as in the case of a finite resource, they can be permanent devices used to prevent complete dissipation or irretrievable diminutions in value or quantity.¹⁵⁴ Nothing under HERA imposed any limits on the operation of FHFA as conservator of the GSEs or any requirements that their historic purposes be continued.¹⁵⁵ Instead of working to stabilize the GSEs by fortifying their roles in the housing market, FHFA used them for restoring and recovering assets, even though such uses effectively diminished their impact and undermined the secondary market.¹⁵⁶ Having invested nearly \$200 billion—although far less than the government spent under TARP—the mission of the GSEs changed from its founding principle of furthering housing to a principle of self-preservation, a defeating and demoralizing position.¹⁵⁷ This new face of the GSEs is most apparent in a number of policies adopted for handling nonperforming loans and foreclosed properties.

The self-protective stance continued long after the GSEs recovered financially. Four years after the crisis, the GSEs began making profits and repaying the Treasury many times over what Treasury had advanced to prop them up after the crisis.¹⁵⁸ In a

<https://www.americanprogress.org/issues/economy/news/2012/05/29/11593/10-reasons-why-public-policies-rescued-the-u-s-economy>.

¹⁵³ *Conservatorship*, LEGAL DICTIONARY, <https://legaldictionary.net/conservatorship> (last visited Feb. 19, 2018).

¹⁵⁴ *History of Fannie Mae*, *supra* note 147.

¹⁵⁵ There has long been a push by some legislators to abolish the GSEs entirely. *See, e.g.*, Nick Timiraos & Michael R. Crittenden, *Fannie Mae, Freddie Mac Should Be Eliminated*, *Frank Says*, WALL ST. J. (Jan. 22, 2010), <https://www.wsj.com/articles/SB10001424052748704509704575019162391608940> (detailing Rep. Barney Frank's (D.-Mass.) calls to abolish GSEs).

¹⁵⁶ *FHFA as Conservator*, *supra* note 144.

¹⁵⁷ *Id.*

¹⁵⁸ When the GSEs were placed in conservatorship in 2008, they were each given access to multi-billion-dollar lines of credit from the U.S. Treasury, to be repaid pursuant to a Senior Preferred Stock Agreement ("SPSA"). Jann Swanson, *Unsealed Court Docs Paint Fannie/Freddie as Congressional Cash Cow*, MORTGAGE NEWS DAILY (July 25, 2017), http://www.mortgagenewsdaily.com/07252017_gse_conservatorship.asp. Under the SPSA, the U.S. Treasury received dollar-for-dollar shares of preferred stock along with a fixed quarterly dividend. *Id.* Over the course of four years under conservatorship, Fannie Mae had drawn \$116.1 billion, and Freddie Mac had drawn \$71.3 billion. *Id.* Yet, the GSEs absurdly continued to make quarterly draws, even after they had largely recovered, it seems, to make the quarterly dividend payment. *Id.* This deal was not satisfactory to the Treasury. "In late 2012, FHFA acting director Edward J. DeMarco and Treasury Secretary Tim Geithner announced they were amending the SPSA, replacing the dividend with a 'net worth sweep' that would take all of the companies' net profits each quarter less a steadily decreasing buffer of capital." *Id.* This would eventually leave the GSEs with no capital reserves. *Id.* DeMarco and Geithner gave two rationales for the change: first, under the existing agreement, borrowing and repayment was ridiculously circular—Fannie Mae and Freddie Mac constantly borrowed from the Treasury to pay stakeholders—"and second, the change would help preserve the remaining Treasury balance available to the GSEs in the event they needed them." *Id.* As it stands, Fannie Mae having paid Treasury \$159.9 billion in dividends and Freddie Mac having paid \$105.9 billion,

deposition from pending litigation against the GSEs, Fannie Mae's CFO revealed that "she had told Treasury officials on August 9, 2012 that [Fannie Mae] was 'now in a sustainable profitability, that [Fannie Mae] would be able to deliver sustainable profits over time.'"¹⁵⁹ Documents unsealed as part of the litigation contained ten years of "internal financial projections from Fannie [Mae], indicating that the company would not require further assistance from taxpayers."¹⁶⁰ Other documents revealed that Freddie Mac was "'expected to be net income positive by the end of 2012 and Fannie [Mae] by the end of 2013.'"¹⁶¹ The GSEs got to this point of fiscal sobriety through policies that trampled the rights and interests of homeowners.

B. Sale of Non-Performing Loans

In February 2012, FHFA announced a program exploring new approaches to the disposition of foreclosed properties ("real estate owned" or "REO") in Fannie Mae's and Freddie Mac's inventory.¹⁶²

The REO Initiative allows qualified investors to purchase pools of foreclosed properties with the requirement to rent the purchased properties for a specified number of years. This rental period could provide relief for local housing markets that continue to be depressed by the volume of foreclosed properties, and provide additional rental options to certain markets. Pre-qualification ensures investors will have the financial capacity and operational expertise to manage properties in a way that is conducive to the stabilization of communities hard hit by the housing downturn.¹⁶³

By 2016, FHFA had sold thousands of nonperforming loans with a total unpaid principal balance of \$14 billion.¹⁶⁴ Most of these sales were made to large investors, like the Blackstone Group, American Homes 4 Rent, and American Residential

their Treasury debt remains the same. *Id.* But, there have been no new draws since the fourth quarter of 2012. *Id.*

¹⁵⁹ *Id.* (quoting Susan McFarland, former Fannie Mae CFO). "McFarland said that Fannie could soon reap about \$50 billion in income because of the reversal of an accounting entry, known as a deferred tax asset, required under accounting rules when the company began earning profits again." *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.* (quoting a Memo to Treasury Secretary Tim Geithner from Mary John Miller, assistant secretary for financial markets).

¹⁶² *Real Estate Owned (REO)*, FED. HOUS. FIN. AGENCY, [https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Real-Estate-Owned-\(REO\).aspx](https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Real-Estate-Owned-(REO).aspx) (last visited Feb. 20, 2018).

¹⁶³ *Id.* The program was adopted by the FHFA in conjunction with Treasury and HUD. *FHFA Announces Interested Investors May Pre-Qualify for REO Initiative*, FED. HOUS. FIN. AGENCY (Feb. 1, 2012), <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Interested-Investors-May-PreQualify-for-REO-Initiative.aspx>.

¹⁶⁴ FED. HOUS. FIN. AGENCY, 2016 REPORT TO CONGRESS (2017), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA_2016_Report-to-Congress.pdf.

Properties.¹⁶⁵ Needless to say, the investors were not motivated to further the national policy toward homeownership by returning homes to their former owners.¹⁶⁶

C. Limits on Transfers of Fannie Mae- and Freddie Mac-Mortgaged Properties

There were additional onerous self-preservation measures and policies implemented that have since been abandoned.¹⁶⁷ These policies are the “Arm’s Length” and “Make-Whole” policies.

1. Arm’s Length Requirements for Short Sales

Under the Arm’s Length Policy,¹⁶⁸ the GSEs issued guidance documents, described as anti-fraud provisions, to mortgage servicers:

A servicer must not approve a borrower for a short sale if there is evidence of fraud or misrepresentation in the transaction. The borrower, purchaser, and all parties involved in the transaction must sign and date a *Short Sale Affidavit* (Form 191) at the time of the closing confirming that the transaction is an arm’s-length transaction with all proceeds (net of allowable transaction costs as described above) applied to the mortgage loan payoff in full satisfaction of the entire first-lien mortgage debt. An arm’s-length transaction is a transaction between parties who are unrelated and unaffiliated by family, marriage, or commercial enterprise. The servicer may allow the borrower, purchaser, and all parties involved to sign individually on separate copies of the short sale affidavit. In addition, the servicer must retain the original signed short sale affidavit(s) in the mortgage loan servicing file.¹⁶⁹

By its terms, this policy makes a short sale, which is the sale of a property in default whose proceeds are used to satisfy the debt, more difficult by prohibiting a related party—meaning a family member—from buying the distressed property.¹⁷⁰ Perversely, an unrelated third-party could purchase the property in a short sale and sell or rent it as she pleased, meaning she could allow the foreclosed owner to rent or buy back the property.¹⁷¹ However, a family member could not.¹⁷² The policy was also

¹⁶⁵ Matthew Goldstein, *Investors Who Bought Foreclosed Homes in Bulk Look to Sell*, N.Y. TIMES, June 28, 2014, at B1.

¹⁶⁶ See *infra* text accompanying note 173.

¹⁶⁷ Press Release, Attorney Gen. of Mass., AG Coakley Sues Fannie Mae and Freddie Mac over Their Refusal to Engage in Foreclosure Buyback Programs (June 2, 2014) [hereinafter Press Release, Attorney Gen. of Mass.].

¹⁶⁸ FANNIE MAE, *SERVICING GUIDE ANNOUNCEMENT SVC-2012-19*, 1 (2012) [hereinafter FANNIE MAE, *SERVICING GUIDE ANNOUNCEMENT*] (discussing the policy changes made to implement the FHFA’s July 3, 2012 Directive).

¹⁶⁹ *Id.* at 13; see FREDDIE MAC, BULLETIN NO. 2012-16, 2 (Aug. 21, 2012).

¹⁷⁰ FANNIE MAE, *SERVICING GUIDE ANNOUNCEMENT*, *supra* note 168.

¹⁷¹ *Id.*

¹⁷² *Id.*

applied to prevent purchase by a non-profit entity for the purpose of resale to the former owner.¹⁷³

2. Make-Whole Provisions After Foreclosure

The GSEs' Make-Whole policy "required homeowners who had been through foreclosure and wanted to buy their homes back to pay the entire amount owed on the mortgage."¹⁷⁴ But a homeowner who is unable to save the property through the exercise of the equitable right of redemption, which exists in all states, is unlikely to be able to pay the entire balance owed after foreclosure. I discuss how pernicious this policy is below.¹⁷⁵

D. Partial Pull Back by GSEs

On November 25, 2014, the FHFA "directed Fannie Mae and Freddie Mac . . . to alter one of their policies relating to the sale of (REO) properties in their current inventory."¹⁷⁶ This alteration permitted the GSEs to sell their existing "properties to any qualified purchaser at the property's fair-market value, as determined by the [GSEs]."¹⁷⁷ The FHFA then extended this requirement "to anyone buying the home for the benefit of the previous homeowner."¹⁷⁸ Under the new policy change, former homeowners—or a third-party on the homeowner's behalf—can repurchase the home under the fair-market value policy that applies to all other purchasers of REO properties.¹⁷⁹ However, the policy change was expressly limited to Fannie Mae and Freddie Mac REO inventory of single-family homes as of November 25, 2014,¹⁸⁰ thereby leaving thousands of homeowners who had lost their homes to foreclosure without a right to recover them.¹⁸¹

IV. THE CHALLENGES

The financial losses from the crisis coupled with the GSEs' post-crisis responses were breathtaking. Some of the challenges to the GSEs' policies in state courts, which asserted violations of state laws aimed to preserve homeownership, often faced counterarguments asserting federal preemption.¹⁸² In this section of the Article, I suggest that trying to require the GSEs to abide by state law was not the only strategy

¹⁷³ Discussed *infra* in *Massachusetts v. Fed. Hous. Fin. Agency*, 54 F. Supp. 3d 94 (D. Mass. 2014), and *Suero v. Fed. Home Loan Mortg. Corp.*, 123 F. Supp. 3d 162 (D. Mass. 2015).

¹⁷⁴ *FHFA Directs Fannie Mae and Freddie Mac to Change Requirement Relating to Sales of Existing REO*, FED. HOUS. FIN. AGENCY (Nov. 25, 2014) [hereinafter *FHFA Directs Fannie Mae*], <https://www.fhfa.gov/Media/PublicAffairs/pages/fhfa-directs-fannie-mae-and-freddie-mac-to-change-requirements-relating-to-sales-of-existing-reo.aspx>.

¹⁷⁵ See *infra* text accompanying notes 300–10.

¹⁷⁶ *FHFA Directs Fannie Mae*, *supra* note 174.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² See *Massachusetts v. Fed. Hous. Fin. Agency*, 54 F. Supp. 3d 94 (D. Mass. 2014).

available. Instead, a better course might be to force compliance with co-equal federal laws—those aimed at equal treatment in the receipt of federal benefits and in access and retention of housing. In the latter scenario, the only apparent theoretical barrier might be statutory preclusion, but this is established by a wholly different set of considerations.

A. Preemption Under the Supremacy Clause

The failed legal challenges to the GSEs' policies were predicated upon state and local laws, which are subordinate to federal law in our national scheme of government, and were met with the successful assertion of the preemption doctrine:¹⁸³ in Chicago, an ordinance required the registration and maintenance of vacant buildings by all mortgagees, including Fannie Mae and Freddie Mac,¹⁸⁴ and in Massachusetts, an act limited foreclosures and required mitigation measures.¹⁸⁵ However, in Washington, the court upheld a challenge to the GSEs' policy of taking possession of homes in default by entering and changing locks prior to foreclosure.¹⁸⁶

The Supremacy Clause provides that the laws and treaties of the United States “shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”¹⁸⁷ The long-settled interpretation of this clause is that state laws in conflict with federal law are “without effect.”¹⁸⁸ Even in the absence of an express preemption, federal law may impliedly preempt state law “where it is impossible for a private party to comply with both state and federal requirements”¹⁸⁹ When state law requires an action that federal law forbids, the state law is without effect.¹⁹⁰

Preemption traditionally falls into three categories: express preemption, field preemption, and conflict preemption.¹⁹¹ “Express preemption occurs when Congress enacts a statute that expressly commands that state law on the particular subject is

¹⁸³ *Id.*

¹⁸⁴ CHI., ILL., MUN. CODE § 13-12-125(a)(1) (2018).

¹⁸⁵ Act Preventing Unlawful and Unnecessary Foreclosures, MASS. GEN. LAWS ch. 244, §§ 14, 35B–35C (2018).

¹⁸⁶ *Jordan v. Nationstar Mortg., LLC*, 240 F. Supp. 3d 1114, 1117 (E.D. Wash. 2017).

¹⁸⁷ U.S. CONST. art. VI, cl. 2.

¹⁸⁸ *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981); *McCulloch v. Maryland*, 17 U.S. 316, 427 (1819); see *Gade v. Nat'l Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 108 (1992) (“[U]nder the Supremacy Clause, from which our pre-emption doctrine is derived, ‘any state law, however clearly within a State’s acknowledged power, which interferes with or is contrary to federal law, must yield.’” (quoting *Felder v. Casey*, 487 U.S. 131, 138 (1988) (quoting *Free v. Bland*, 369 U.S. 663, 666 (1962))).

¹⁸⁹ *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990); see *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142–43 (1963) (“A holding of federal exclusion of state law is inescapable and requires no inquiry into congressional design where compliance with both federal and state regulations is a physical impossibility for one engaged in interstate commerce”).

¹⁹⁰ *Mut. Pharm. Co. v. Bartlett*, 570 U.S. 472, 475 (2013).

¹⁹¹ *Oneok, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591, 1594–95 (2015).

displaced.”¹⁹² Field preemption occurs if Congress “intended ‘to foreclose any state regulation in the area,’ irrespective of whether state law is consistent or inconsistent with ‘federal standards.’ In such situations, Congress has forbidden the State to take action in the field that the federal statute pre-empts.”¹⁹³ Finally, “conflict pre-emption exists where ‘compliance with both state and federal law is impossible,’ or where ‘the state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’”¹⁹⁴ Moreover, preemption can occur through federal regulations in addition to statutes.¹⁹⁵

Yet, “[u]nder our system of dual sovereignty, courts deciding whether a particular state law is preempted under the Supremacy Clause must strive to maintain the ‘delicate balance’ between the States and the Federal Government, . . . especially when Congress is regulating in an area ‘traditionally occupied by the States.’”¹⁹⁶ “[C]ourts applying the Supremacy Clause are to begin with a presumption against preemption.”¹⁹⁷ Courts also apply “‘a plain statement rule,’ holding that a federal statute preempts a state law only when it is the ‘clear and manifest’ purpose of Congress to do so. Only where the state and federal laws cannot be reconciled do courts hold that Congress’s enactments must prevail.”¹⁹⁸ To determine whether there is a conflict, the Court discerns what duties are required by state law.¹⁹⁹ Then, it considers what liabilities are imposed for failing to fulfill those duties.²⁰⁰ If complying with those state law duties in a way that does not run afoul of a federal pronouncement is not possible, then the federal law preempts the state law.²⁰¹

B. Local Regulation of GSEs in Their Ownership of Mortgages

An effort to cause the enterprises to engage in specific practices for the benefit of borrowers, but not to avoid losses, as is the current tenor of GSE policy, will run up against the preemption doctrine. The first case to attempt to reconcile such issues is *Federal Housing Financing Agency v. City of Chicago*.²⁰² In that case, the City of Chicago adopted an ordinance that required the registration and maintenance of vacant

¹⁹² *Gadda v. Ashcroft*, 377 F.3d 934, 944 (9th Cir. 2004) (citing *Ting v. AT&T*, 319 F.3d 1126, 1135 (9th Cir. 2003)).

¹⁹³ *Oneok, Inc.*, 135 S. Ct. at 1595 (emphasis omitted) (quoting *Arizona v. United States*, 567 U.S. 387, 401 (2012)).

¹⁹⁴ *Id.* (quoting *California v. ARC Am. Corp.*, 490 U.S. 93, 100, 101 (1989)).

¹⁹⁵ *See, e.g., Norfolk S. Ry. Co. v. Shanklin*, 529 U.S. 344, 351–59 (2000) (finding the Federal Railroad Safety Act preempted certain state tort claims through regulations implemented under the Act).

¹⁹⁶ *Gonzalez v. Arizona*, 677 F.3d 383, 392 (9th Cir. 2012) (first quoting *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991); then quoting *United States v. Locke*, 529 U.S. 89, 108 (2000)).

¹⁹⁷ *Id.*

¹⁹⁸ *Id.* (quoting *Gregory*, 501 U.S. at 461).

¹⁹⁹ *Mut. Pharm. Co. v. Bartlett*, 570 U.S. 472, 480 (2013).

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *Fed. Hous. Fin. Agency v. City of Chicago*, 962 F. Supp. 2d 1044 (N.D. Ill. 2013).

buildings by all mortgagees, including those held by the GSEs.²⁰³ FHFA challenged the application of the ordinance to it, relying on HERA.²⁰⁴ The district court agreed that HERA had no express preemption because the language asserting supremacy referred specifically to other agencies of the federal government or any state, but did not contain a limitation on actions by local governments.²⁰⁵ The court pointed out that although express preemption requires Congress to declare its intentions to preempt through a direct statement,²⁰⁶ “HERA’s lack of reference to local governments in its preemption clause” only meant that “the statutory language alone [was] insufficient to demonstrate a clear and manifest purpose to preempt the [o]rdinance.”²⁰⁷

The court went on to consider whether the local regulation was precluded by field preemption. It noted that “Congress enacted an extensive federal statutory scheme which specifically requires the Director of FHFA to ‘establish risk-based capital requirements for [Fannie and Freddie] to ensure that [they] operate in a safe and sound manner, maintaining sufficient capital and reserves to support the risks that arise in the operations and management of [Fannie and Freddie].’”²⁰⁸ “[T]he [o]rdinance encroach[ed] on an area of regulation that Congress reserved exclusively for FHFA,” giving FHFA the authority to manage its collateral.²⁰⁹ This authority included control specifically over “how this collateral—which FHFA [did] not actually own—should be preserved.”²¹⁰ The court found that “[o]nce placed in conservatorship, Congress intended for FHFA to be the sole entity responsible for operating Fannie and Freddie’s nationwide business of purchasing and securitizing mortgages.”²¹¹ The City of Chicago claimed that HERA simultaneously intended to preempt state governments while also leaving local governments to regulate FHFA.²¹² The court rejected this claim because it was untenable and would create chaos, as “FHFA would be subject to a variety of potentially conflicting ordinances, raising the expenses of the FHFA in not only complying with those ordinances, but in simply monitoring the various requirements.”²¹³ There was also conflict preemption to an extent:

²⁰³ *Id.* at 1047–48.

²⁰⁴ *Id.* at 1048.

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 1056.

²⁰⁷ *Id.* at 1057.

²⁰⁸ *Id.* at 1059 (citing 12 U.S.C. § 4611(a) (2013)).

²⁰⁹ *Id.* at 1059.

²¹⁰ *Id.* Specifically, “when FHFA issues guidelines and instructions to servicers regarding the nature and frequency of inspections of vacant and abandoned properties, it is taking those steps it believes necessary to preserve and conserve Fannie and Freddie’s assets and property.” *Id.*

²¹¹ *Id.* at 1059–60 (citing 12 U.S.C. § 4617(a)(7) (2013)).

²¹² *Id.* at 1058.

²¹³ *Id.* at 1060. The court cautioned that “[t]his is not to say that FHFA can let properties where it is the mortgagee become decrepit.” *Id.* Instead, Fannie Mae and Freddie Mac’s “own guidelines . . . require it to maintain the properties in a manner to preserve their value.” *Id.*

the [o]rdinance obstructs Congress's intent to have one conservator take control of Fannie Mae and Freddie Mac, and take action as may be "appropriate to carry on [their business] and preserve and conserve [their] assets and property" without being "subject to the direction or supervision of any other agency of the United States or any [s]tate . . ." ²¹⁴

In the end, the court found "the overall goal of HERA was to preserve the assets of Fannie Mae and Freddie Mac," ²¹⁵ and the local ordinance that tended to restrict that ability must be preempted. ²¹⁶

C. *Anti-Injunction Under HERA*

In 2012, the Massachusetts legislature passed "An Act Preventing Unlawful and Unnecessary Foreclosures" (the "Foreclosure Law"). ²¹⁷ The Foreclosure Law aimed both to offer relief to homeowners burdened by the riskiest subprime mortgages and to curb abusive foreclosure practices as they pertained to new mortgage loans. ²¹⁸ For existing homeowners, the law required a mortgagee-creditor to extend a loan modification offer to a borrower in circumstances where it would lead to more affordable payments and cost less than the expenses of foreclosure. ²¹⁹ The Foreclosure Law also regulated the foreclosure process. ²²⁰

²¹⁴ *Id.* at 1061 (quoting 12 U.S.C. § 4617(b)(2)(D)(ii) (2013)).

The Court [also found] that the registration fee required by the Ordinance [was] an impermissible tax on the federal government, because the revenue from the registration fee "[did] not go to pay for some service that [the City] renders to [FHFA], or . . . to some service that is required by the existence of [FHFA]."

Id. at 1063 (some alteration in original) (footnote omitted) (quoting *Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc.*, 651 F.3d 722, 733 (7th Cir. 2011)).

The City's monitoring of vacant properties is not a service the City "renders to" FHFA, but is an action the City undertakes to benefit City residents in general. Further, FHFA's "existence" does not cause properties to be vacant, and vacant properties are not a necessary aspect of FHFA's participation in the mortgage market.

Id.

²¹⁵ *Id.* at 1060.

²¹⁶ *Id.* at 1061.

²¹⁷ MASS. GEN. LAWS ch. 244, §§ 14, 35B–35C (2018); *Compliance with Chapter 194 of the Acts of 2012, an Act Preventing Unlawful and Unnecessary Foreclosures*, MASS.GOV (Oct. 3, 2012), <https://www.mass.gov/advisory/compliance-with-chapter-194-of-the-acts-of-2012-an-act-preventing-unlawful-and-unnecessary>.

²¹⁸ MASS. GEN. LAWS ch. 244, § 14 (2018).

²¹⁹ *Id.* § 35B.

²²⁰ Among other things, the law imposes stringent notice requirements, prohibits the initiation of a foreclosure by a party without the actual authority to do so, forbids a creditor from shifting the costs of correcting title defects to third-parties or imposing non-foreclosure related fees on borrowers, and punishes a creditor for making false statements in a court of law about its compliance with these requirements or about the borrower's payment history. *Id.* §§ 14, 35C.

When a violation of the Foreclosure Law occurs, injunction ordinarily is the method of enforcement.²²¹ But, when the FHFA is the foreclosing entity, this remedy is unavailable because of the anti-injunctions provision in HERA: “no court may take any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator” of the GSEs.²²²

Two cases before the district court in Massachusetts ruled that enforcement of the Foreclosure Law must give way to the anti-injunction provisions of HERA. In the first, *Massachusetts v. Federal Housing Financing Agency*,²²³ the court ruled that the anti-injunction provision deprived the court of jurisdiction to rule on a challenge to Freddie Mac’s Arm’s Length and Make-Whole restrictions.²²⁴ The challenge asserted that the restrictions under the state law conflicted with what the Arm’s Length and Make-Whole provisions allowed.²²⁵ The restrictions provided:

no creditor shall require as a condition of sale or transfer to any [non-profit] entity any affidavit, statement, agreement or addendum limiting ownership or occupancy of the residential property by the borrower and, if obtained, such affidavit, statement, agreement or addendum shall not provide a basis to avoid a sale or transfer²²⁶

The district court concluded that, in directing the GSEs to implement and enforce the Arm’s Length and Make-Whole restrictions, the FHFA acted within the scope of its powers and duties as conservator under HERA.²²⁷ The FHFA reasoned that the GSEs would suffer losses without the Arm’s Length and Make-Whole restrictions if

²²¹ WILLIAM V. HOVEY ET AL., 28 MASSACHUSETTS PRACTICE SERIES 3 (4th ed. 2004 & Supp. 2009–2010).

²²² 12 U.S.C. § 4617(f) (2018).

²²³ *Massachusetts v. Fed. Hous. Fin. Agency*, 54 F. Supp. 3d 94, 101–02 (D. Mass. 2014).

²²⁴ *Id.* Is asking whether unwritten directives are “federal laws” protected by Preemption Doctrine a fair question? The only way to answer this question is to back into it, starting with some settled propositions. In *Christensen v. Harris County*, the Supreme Court confronted “an interpretation contained in an opinion letter, not one arrived at after, for example, a formal adjudication or notice-and-comment rulemaking.” *Christensen v. Harris Cty.*, 529 U.S. 576, 587 (2000). The Court stated that “[i]nterpretations such as those in opinion letters—like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant *Chevron*-style deference.” *Id.* From this proposition, can one conclude that such policies are not the law of the land entitled to deference under the Supremacy Clause? The State of Massachusetts declined to take this approach, but FHFA asserted its mere existence as a federal agency meant that any policy they adopted preempted any state law that interfered.

²²⁵ *Id.* at 95–96.

²²⁶ MASS. GEN. LAWS ch. 244, § 35C(h) (2018). In 2009, the Boston Community Capital (“BCC”) established the Stabilizing Urban Neighborhoods Initiative (the “SUN Initiative”) to remediate inner-city neighborhoods plagued by “underwater” mortgages and abandoned homes through the purchase of troubled mortgages or post-foreclosure homes at their current fair market value then reselling or renting the properties to the former homeowners at their reassessed (lower) value. BCC claimed to have saved homeownership for 475 families. *Massachusetts*, 54 F. Supp. 3d at 96.

²²⁷ *Massachusetts*, 54 F. Supp. 3d at 101.

distressed homeowners opted to submit to an “otherwise avoidable foreclosure on a mortgage in anticipation of later repurchasing the home at a lower price from the non-profit intermediary entity.”²²⁸ The court characterized the decision to reject the terms of the state buy-back law as a matter of “business judgment intended to ‘preserve and conserve [the GSEs’] assets and property’”; therefore, the court was precluded from looking into the matter.²²⁹ The court also concluded that even if HERA did not preclude the suit, the preemption doctrine would bar it because the situation presented an “irreconcilable conflict” between the federal and state laws.²³⁰

The second case, *Suero v. Federal Home Loan Mortgage Corporation*, had virtually identical facts and was brought by an individual former homeowner.²³¹ Because *Massachusetts* was pending, the court in *Suero* held the case under advisement until the resolution of the other case.²³² When the appellate court dismissed the appeal of the ruling in *Massachusetts*, the court in *Suero* found the anti-injunction provisions of HERA precluded the action to enjoin Freddie Mac to sell a foreclosed property to a non-profit entity pursuant to the state Foreclosure Law.²³³ The court also found that HERA preempted the state law.²³⁴ Apparently acknowledging the insuperable bars to an action, the homeowner could only offer challenges based on seemingly unimportant distinctions²³⁵ and the court rejected all of them.²³⁶ In particular, the court rejected the claim that Freddie Mac’s refusal was a policy promulgated by Freddie Mac and therefore was not an act by FHFA as a conservator because FHFA had adopted Freddie Mac’s policy and program.²³⁷ FHFA was also acting as a conservator because it promoted Freddie Mac’s policy and retained capital with their business activities.²³⁸ FHFA endorsed the policy as a means of protecting the GSEs against fraud and preventing distressed homeowners from strategically defaulting with plans to repurchase their homes at a lower price from the non-profit intermediary entity.²³⁹ Measures and policies toward this end constituted acting as a conservator for purposes of the anti-injunction provision.²⁴⁰ The court determined that FHFA acts as conservator when “it evaluates the risk of certain business transactions

²²⁸ *Id.*

²²⁹ *Id.* (quoting 12 U.S.C. § 4617(b)(2)(D)(ii) (2014) (noting that this law expressly removed conservatorship decisions from judicial oversight)).

²³⁰ *Id.* at 101 n.8.

²³¹ *Suero v. Fed. Home Loan Mortg. Corp.*, 123 F. Supp. 3d 162 (D. Mass. 2015).

²³² *Id.* at 165.

²³³ *Id.*

²³⁴ *Id.* at 165 n.2.

²³⁵ *Id.* at 173–74.

²³⁶ *Id.*

²³⁷ *Id.* at 174.

²³⁸ *Id.*

²³⁹ *Id.* at 172.

²⁴⁰ *Id.* at 172–73.

and takes prudential action to avoid those that it deems undesirable.”²⁴¹ This was also the case with the Arm’s Length and Make-Whole policies.²⁴² The court stated that while “‘FHFA’s powers as conservator are not limitless,” FHLMC and Fannie Mae had “demonstrated how FHFA’s adoption of the [Arm’s Length] and Make-Whole policies furthers its statutory mission as a protective conservator. That is enough to preclude judicial intervention.”²⁴³

D. Unlimited Powers to Contravene State Law Rejected

In *Jordan v. Nationstar Mortgage, LLC*,²⁴⁴ the FHFA intervened in a suit that challenged a policy by the GSEs’ loan servicers.²⁴⁵ The policy permitted the loan servicers to take possession of foreclosed homes by entering and changing locks prior to foreclosure.²⁴⁶ This practice violated state law.²⁴⁷ In a close textual and policy analysis of HERA, the district court rejected FHFA’s assertion of preemption.²⁴⁸ The court took the language adopting HERA to heart, believing that “Congress enacted HERA not only to prevent . . . [further] ‘irresponsible behavior’ [of the GSEs,] but also to aid homeowners by ‘mak[ing] the American dream of homeownership for all a reality instead of a nightmare.’”²⁴⁹ The court found nothing in the legislation that suggested Congress saw the “need to protect the [GSEs’] pre-foreclosure assets, displace state foreclosure law, or to sanctify pre-foreclosure lender possession.”²⁵⁰ Instead, the court determined that the opposite was true; the purpose of the legislation was to rescue homeowners from the brink of foreclosure.²⁵¹ No express preemption of the particular law or type of law was at issue. Instead, the text of the legislation as a whole revealed that whenever Congress intended to preempt, it did so expressly,²⁵² and the state law here did not purport to intrude on any of the areas expressly off limits to states.²⁵³ The court pointed out that although FHFA’s powers are broad, the authority conferred is not “infinite, conservator authority,” but “extends only so far as

²⁴¹ *Id.* at 172 (quoting *Massachusetts v. Fed. Hous. Fin. Agency*, 54 F. Supp. 3d at 99, 100 (D. Mass. 2014)).

²⁴² *Id.* at 172 n.3.

²⁴³ *Id.* at 174 (quoting *City of Sonoma v. Fed. Hous. Fin. Agency*, 710 F.3d 987, 993 (9th Cir. 2013)).

²⁴⁴ *Jordan v. Nationstar Mortg., LLC*, 240 F. Supp. 3d 1114 (E.D. Wash. 2017).

²⁴⁵ *Id.* at 1117.

²⁴⁶ *Jordan v. Nationstar Mortg., LLC*, No. 2:14-CV-0175-TOR, 2017 U.S. Dist. LEXIS 65426, 2017 WL 1550238, at *1 (E.D. Wash. Apr. 28, 2017) (denying request for certification of interlocutory appeal).

²⁴⁷ WASH. REV. CODE § 7.28.230 (2018).

²⁴⁸ *Jordan*, 240 F. Supp. 3d at 1126–27.

²⁴⁹ *Id.* at 1119 (quoting 154 CONG. REC. E1142-02 (June 4, 2008)).

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.* at 1121–22.

²⁵³ *Id.* at 1123.

HERA's text, purpose, and regulatory scheme allow."²⁵⁴ Preemption cannot be inferred merely because the scheme is comprehensive.²⁵⁵ Indeed, the GSEs already recognized the force of state and local laws and had instructed their servicers to comply with them.²⁵⁶ In this vein, the court rejected conflict preemption because compliance with state foreclosure laws would not thwart FHFA's charge to conserve assets, but would only safeguard a homeowner's property from entry prior to foreclosure and sale.²⁵⁷ In the end, the court stated that HERA does not confer a right to FHFA that the state law takes away, nor does HERA authorize FHFA to repudiate statutory property interest protections.²⁵⁸

While the result of *Jordan* may be encouraging, the other two cases remain as obstacles to the GSEs' practices as they are lodged in the courts on similar grounds.²⁵⁹ Let us turn to other theories for challenge.

V. PROMISING AVENUES FOR CHALLENGING GSEs: SOVEREIGN IMMUNITY AND STATUTORY PRECLUSION NOTWITHSTANDING

Under the above-mentioned principles, a federal agency is endowed with a degree of freedom to maneuver without interference and intrusion by state and local governments.²⁶⁰ Constitutional provisions govern agencies and serve as a check on due process and equal protection infractions.²⁶¹ Sovereign immunity will not bar a suit based on alleged unconstitutional or otherwise unlawful conduct by federal officials.²⁶²

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ *Id.* at 1124.

²⁵⁷ *Id.* at 1127.

²⁵⁸ *Id.* at 1128.

²⁵⁹ Compare the complaint on maintenance obligations filed in *Quintero v. Wells Fargo Bank, N.A.*, a class action suit filed in federal court in San Francisco. *Quintero v. Wells Fargo Bank, N.A.*, No. C-13-04937 JSC, 2014 WL 202755, 2014 U.S. Dist. LEXIS 6807, at *10-11 (N.D. Cal. Jan. 17, 2014) (rejecting conflict presumption by the Homeowners Loan Act of California that required notice and contact with a borrower before initiating default remedies because the state statute did not pertain to terms of credit, interest, or payments as covered by the Federal Act).

²⁶⁰ *Principles for State-Federal Relations*, NAT'L GOVERNORS ASS'N, <https://www.nga.org/cms/policy-positions/executive-committee/principles-for-state-federal-relations> (last visited Jan. 28, 2018).

²⁶¹ U.S. CONST. art. IV, cl. 2.

²⁶² *Dugan v. Rank*, 372 U.S. 609, 620 (1963); see *Powelton Civic Home Owners Ass'n v. Dep't of Hous. & Urban Dev.*, 284 F. Supp. 809, 834 (E.D. Pa. 1968); cf. *Bolling v. Sharpe*, 347 U.S. 497, 500 (1954); *Shannon v. U.S. Dep't of Hous. & Urban Dev.*, 436 F.2d 809, 815-16 (3d Cir. 1970); *Hicks v. Weaver*, 302 F. Supp. 619, 623 (E.D. La. 1969).

A. Due Process and Equal Protection

1. A History of Discriminatory Practices

Constitutional claims have been successful against federal housing agencies.²⁶³ This assessment does not account for the early insidious history of the Federal Housing Administration. Despite what began as a lofty, honorable mission—to facilitate homeownership—in its early years, the Federal Housing Administration engaged in intentional racial discrimination.²⁶⁴ At first, while the GSEs worked alongside the federal tax programs to make housing affordable by providing mortgage insurance,²⁶⁵ capping interest rates, prescribing uniform lending criteria, lowering down-payments, and expanding mortgage terms,²⁶⁶ the Federal Housing Administration and Veterans Administration mortgage insurance program guidelines contained other eligibility requirements that operated as barriers to homeownership for certain persons.²⁶⁷ Among these requirements were minimum lot sizes, low-density settings, stringent construction standards, and limitations of qualifying homes to individual units.²⁶⁸ All of such properties were more likely found in suburban areas that were largely populated by whites and as such, these standards operated to exclude racial minorities from the benefits of Federal Housing Administration programs;²⁶⁹ a large percentage of minority home buyers did not live in areas that satisfied the above-mentioned criteria,²⁷⁰ but instead resided in the densely-populated inner cities.²⁷¹ In addition, when determining the amount and availability of mortgage insurance, the Federal Housing Administration partially based its appraisals on neighborhood quality, giving lower appraisals to homes in neighborhoods that had predominantly African-American residents.²⁷² The valuation standards did not consider the need for

²⁶³ Interview by Terry Gross with Richard Rothstein, Author, Univ. of Cal., Berkeley Sch. of Law (May 3, 2017), <https://www.npr.org/2017/05/03/526655831/a-forgotten-history-of-how-the-u-s-government-segregated-america>.

²⁶⁴ Terry Gross, *A 'Forgotten History' of How the U.S. Government Segregated America*, NPR (May 3, 2017), <https://www.npr.org/2017/05/03/526655831/a-forgotten-history-of-how-the-u-s-government-segregated-america>.

²⁶⁵ See 12 U.S.C. §§ 1701–50(g) (1994).

²⁶⁶ See Green, *The Search*, *supra* note 55, at 86 n.103 (“The availability of below market interest rates for mortgages under the Homeownership Assistance Program enabled more minorities to purchase homes. However, in many respects, the program proved a failure for minorities. In particular, default and foreclosure rates reached higher than 18% in 1979. It appears that realtors, acting to exploit racial attitudes, were able to acquire properties from whites at artificially low prices and sold them to blacks at inflated values. Laxity in enforcement of standards resulted in loan balances higher than the value of the homes.”).

²⁶⁷ *Id.* at 86.

²⁶⁸ *Id.*

²⁶⁹ *Id.* at 86 n.104 (citing Michael H. Schill & Susan M. Wachter, *The Spatial Bias of Federal Housing Law and Policy: Concentrated Poverty in Urban America*, 143 U. PA. L. REV. 1285, 1309 (1995)).

²⁷⁰ *Id.* at 91–92.

²⁷¹ *Id.*

²⁷² *Id.* at 86; see Schill & Wachter, *supra* note 269, at 1309–10.

customized work, a greater number of skilled workers, higher levels of supervision, and control for inner city properties.²⁷³ The Federal Housing Administration also overtly maintained policies that were aimed at perpetuating segregated neighborhoods.²⁷⁴ For example, it recommended that municipalities enact racially restrictive zoning ordinances and restrictive covenants that prohibited African-Americans from owning homes in certain areas.²⁷⁵

Although FHA ultimately abandoned these practices, other overt forms of discrimination by government agencies continued.²⁷⁶ Early on, the discriminatory practices were challenged under the Fifth Amendment, which guarantees citizens equal protection of the law and due process of law.²⁷⁷ Courts interpret these provisions to prohibit discrimination by the government on the basis of race, religion, national origin, and other such characteristics.²⁷⁸ The notion that a federal agency could be held liable for due process and equal protection violations was not fairly tested in the housing context until *Gautreaux v. Romney*.²⁷⁹ In that case, the Seventh Circuit ruled that HUD's acquiescence to the Chicago Housing Authority's ("CHA") admittedly discriminatory housing program violated the Due Process Clause of the Fifth Amendment and Section 601 of the Civil Rights Act of 1964.²⁸⁰ HUD violated these laws by approving and funding segregated CHA housing sites.²⁸¹ Neither the district court nor the Seventh Circuit was persuaded by HUD's argument that its approval should be excused as an attempted accommodation of an admittedly urgent need for housing.²⁸² The facts undeniably showed that while the sites for the projects that had

²⁷³ Green, *The Search*, *supra* note 55, at 86 n.108; see JOSEPH L. STEVENS, IMPACT OF FEDERAL LEGISLATION AND PROGRAMS ON PRIVATE LAND IN URBAN AND METROPOLITAN DEVELOPMENT 10–11 (1973) (noting mortgage capital for home improvement was largely unavailable and discussing FHA restrictions).

²⁷⁴ Green, *The Search*, *supra* note 55, at 86 n.106 (“The FHA underwriting manual warned against making loans in areas with ‘inharmonious racial groups’ and instructed lenders that if a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes.”) (internal quotation marks omitted) (quoting Schill & Wachter, *supra* note 269, at 1310)); see Florence Wagman Roisman, *Intentional Racial Discrimination and Segregation by the Federal Government as a Principal Cause of Concentrated Poverty: A Response to Schill & Wachter*, 143 U. PA. L. REV. 1351, 1355–56 (1995) (examining the interplay of housing policies and the poor).

²⁷⁵ See Schill & Wachter, *supra* note 269, at 1310.

²⁷⁶ Natasha M. Trifun, *Residential Segregation After the Fair Housing Act*, 36 HUM. RTS. 14, 14 (2009).

²⁷⁷ *Gautreaux v. Romney*, 448 F.2d 731, 737–38 (7th Cir. 1971).

²⁷⁸ *Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2525–26 (2015).

²⁷⁹ *Gautreaux*, 448 F.2d 731 (7th Cir. 1971).

²⁸⁰ 42 U.S.C. §2000d (2012) (“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.”).

²⁸¹ *Gautreaux*, 448 F.2d at 737.

²⁸² *Id.*

been constructed were “chosen primarily to further the praiseworthy and urgent goals of low-cost housing and urban renewal,” there was a deliberate policy to separate the races.²⁸³ HUD could not justify this policy by its good intentions with which it pursued other laudable goals.²⁸⁴ Instead, HUD’s alleged good faith was “no more of a defense to segregation in public housing than it [was] to segregation in public schools.”²⁸⁵ The Supreme Court eloquently expressed this near-universal sentiment on this point in *Burton v. Wilmington Parking Authority*:²⁸⁶ “[i]t is of no consolation to an individual denied the equal protection of the laws that it was done in good faith.”²⁸⁷ Nor do otherwise honorable efforts toward desegregation preclude liability for an otherwise segregated result.²⁸⁸

The fact that the actor was a federal agency or officer made no difference, as the Constitution does not impose a lesser duty on the federal government.²⁸⁹ HUD played an integral role in the construction of the public housing system in Chicago, as it provided the bulk of funding for home construction.²⁹⁰ Between 1950 and 1966, HUD funded nearly \$350 million worth of housing construction costs and exercised a large amount of discretion over both site selection and the tenant assignment procedures in the housing system.²⁹¹ “[T]he [HUD] Secretary exercised the above-described powers in a manner which perpetuated a racially discriminatory housing system in Chicago, and . . . the Secretary and other HUD officials were aware of that fact.”²⁹² The

²⁸³ *Id.* at 738.

²⁸⁴ *Gautreaux v. Chi. Hous. Auth.*, 296 F. Supp. 907, 914 (N.D. Ill. 1969).

²⁸⁵ *Gautreaux*, 448 F.2d at 738 (citing *Gautreaux*, 296 F. Supp. at 907); *Kennedy Park Homes Ass’n v. City of Lackawanna*, 436 F.2d 108 (2d Cir. 1970).

²⁸⁶ *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 725 (1961).

²⁸⁷ *Id.*

²⁸⁸ *Id.* Thus, for example, in *Cooper v. Aaron*, the local school board admittedly was “going forward with its preparation for desegregating the Little Rock[, Arkansas] school system,” but was still held liable when it abandoned those plans in the face of stiff community and state governmental resistance. *Cooper v. Aaron*, 358 U.S. 1, 8 (1958); see *Watson v. City of Memphis*, 373 U.S. 526, 535 (1963); *Green v. Kennedy*, 309 F. Supp. 1127, 1136 (D.D.C. 1970).

²⁸⁹ *Gautreaux*, 448 F.2d at 738 (citing *Bolling v. Sharpe*, 347 U.S. 497, 500, (1954)); see *Green*, 309 F. Supp. at 1136.

²⁹⁰ *Gautreaux*, 448 F.2d at 732.

²⁹¹ *Id.* at 739. “HUD’s ‘Annual Contributions Contract’ contained detailed provisions concerning program operations” and included “eight pages of regulations on the subject of site selection alone.” *Id.*

²⁹² *Id.*

The fact that HUD knew of such circumstances is borne out by the District Court’s specific finding in this suit that HUD tried to block “the activity complained of, succeeded in some respects, but continued funding knowing of the possible action the City Council would take.” This finding [was] supported by, among other record items, the HUD letter to the West Side Federation . . . and by the affidavit of HUD official Bergeron recalling his unsuccessful attempts in the early 1950s “to enlist [Mayor Kennelly’s] assistance in having project sites located in white neighborhoods.”

Secretary's past actions constituted racially discriminatory conduct in their own right, and the fact that the Secretary's exercise of his powers may have more often reflected CHA's own racially discriminatory choices than it did any ill will on HUD's part did not alter this finding.

Even while fully sympathetic to the arguments advanced by the Secretary on appeal, the court concluded that the great weight of case law favored the plaintiffs' position; HUD violated the Due Process Clause of the Fifth Amendment as well as Section 601 of the Civil Rights Act of 1964.²⁹³

Two other decisions buttressed the court's ruling. First, in *Hicks v. Weaver*,²⁹⁴ the court reasoned:

HUD was not only aware of the situation in Bogalusa[, Louisiana] but it effectively directed and controlled each and every step in the program. . . . HUD thus sanctioned the violation of plaintiffs' rights and was an active participant since it could have halted the discrimination at any step in the program. Consequently, its own discriminatory conduct in this respect is violative of 42 U.S.C. [§] 2000d.²⁹⁵

Likewise, in *Shannon v. United States Department of Housing and Urban Development*,²⁹⁶ the Third Circuit stopped HUD from changing the structure of a proposed housing project in Philadelphia from an owner-occupied complex to a 100% rent supplement assistance program that was the "functional equivalent of a low rent public housing project."²⁹⁷ The *Shannon* court acknowledged that Congress vested HUD with broad discretion to supervise its various programs, but held "that discretion must be exercised within the framework of the national policy against discrimination in federally assisted housing . . . and in favor of fair housing."²⁹⁸

2. GSEs Are State Actors Whose Policies Offend Due Process

The GSEs' Make-Whole and Arm's Length policies offend due process because they deny homeowners rights of redemption that exist under state law.²⁹⁹ The right to redeem property before foreclosure (through the equitable right of redemption) and after foreclosure (through statutory redemption) are inalienable property rights that burden a mortgage.³⁰⁰ All states afford a defaulting mortgagor the equitable right of

Id. (first quoting *Gautreaux*, 296 F. Supp. at 907; then quoting HUD official Bergeron's affidavit).

²⁹³ *Id.* at 737.

²⁹⁴ *Hicks v. Weaver*, 302 F. Supp. 619 (E.D. La. 1969).

²⁹⁵ *Id.* at 623.

²⁹⁶ *Shannon v. U.S. Dep't of Hous. & Urban Dev.*, 436 F.2d 809, 809 (3d Cir. 1970).

²⁹⁷ *Id.* at 819.

²⁹⁸ *Id.*

²⁹⁹ See JOHN RAO & GEOFF WALSH, NAT'L CONSUMER LAW CTR., FORECLOSING A DREAM: STATE LAWS DEPRIVE HOMEOWNERS OF BASIC PROTECTIONS 32-35 (2009), <http://www.nclc.org/images/pdf/pr-reports/report-foreclosing-dream.pdf>.

³⁰⁰ See generally THOMPSON ON REAL PROPERTY § 101.07 (David A. Thomas ed., 2d ed. 1998); U.S. FORECLOSURE NETWORK, NATIONAL MORTGAGE SERVICER'S REFERENCE

redemption, and more than half of states provide a statutory right to redeem foreclosed property after the foreclosure sale for a specified period.³⁰¹ In most jurisdictions, the homeowner has the right to possess the property during the redemption period and may redeem at the amount paid for the property at the foreclosure sale.³⁰² The GSEs' policies deny, or at a minimum frustrate, these rights in a way that denies the mortgagor due process and equal protection.

The only possible obstacle to due process and equal protection challenges to the GSEs' policies is the requirement of state action. Fannie Mae unquestionably was a government agency at the time Congress created it; but, in 1968, Fannie Mae's organizational character changed when Congress chartered it as a government-sponsored private corporation.³⁰³ Even as a private corporation, Fannie Mae's federal charter gave it special privileges not enjoyed by corporations chartered under state law.³⁰⁴ In particular, Fannie Mae was exempted from taxation and, because it was created to purchase and deal in FHA-insured mortgages, it carried an implicit government guarantee.³⁰⁵ Nevertheless, its formal status as a private corporation has been asserted to bar claims under the Due Process and Equal Protection clauses because both constitutional provisions require state action to be applicable.³⁰⁶

For an entity to be considered a state-actor, it must (1) be created in order to further governmental objectives and (2) be under the permanent control and authority of the government.³⁰⁷ These two requirements can be satisfied by looking at the FHFA's powers under HERA. The imposition of the conservatorship over the GSEs was expressly made to stabilize the GSEs in an effort to protect housing markets as well as taxpayers.³⁰⁸ These are clearly governmental objectives. The conservatorship has been in place for nearly a decade, and nothing under HERA sets a time limit for the conservatorship or otherwise limits the powers of the FHFA over the activities of the GSEs.³⁰⁹ Because the GSEs must be regarded as state actors, they should be held liable for conduct that offends due process and equal protection—conduct that deprives

DIRECTORY ch. 10 (34th ed. 2018); Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399 (2004).

³⁰¹ The period of time that states permit for this right to redeem ranges from ten days to two years. See Nelson & Whitman, *supra* note 300, at 1404.

³⁰² *Id.*

³⁰³ See WEISS & JONES, *supra* note 66, at 30; see also Green v. Kennedy, 309 F. Supp. 1127, 1139 (D.D.C. 1970).

³⁰⁴ WEISS & JONES, *supra* note 66, at 10.

³⁰⁵ See W. Scott Frame & Lawrence J. White, *Charter Value, Risk-Taking Incentives, and Emerging Competition for Fannie Mae and Freddie Mac*, 39 J. MONEY, CREDIT & BANKING 83, 87 (2007).

³⁰⁶ Nelson & Whitman, *supra* note 300, at 1451.

³⁰⁷ See *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 400 (1995).

³⁰⁸ WEISS & JONES, *supra* note 66, at 10.

³⁰⁹ See generally Brian Taylor Goldman, *The Indefinite Conservatorship of Fannie Mae and Freddie Mac Is State-Action*, 17 J. BUS. & SEC. L. 11, 22 (2017).

individuals of property rights and protections under state law. This is the same result reached in *Gautreaux*.³¹⁰

Moreover, FHFA is clearly a federal agency, as it was created under HERA and derives its expansive powers from that legislation.³¹¹ As the district court in *Jordan*³¹² found, the FHFA succeeded to ““all rights, titles, powers, and privileges”” of the GSEs, ““plac[ing] FHFA in the shoes of Fannie Mae and Freddie Mac, and giv[ing] the FHFA *their* rights and duties, not the other way around.””³¹³ Indeed, all of the GSEs’ self-preservation policies were implemented pursuant to directives from FHFA.³¹⁴ Hence, the presence of state action is confirmed, and the burdens on property rights under state law (those attending mortgaged property) and interests in the equal distribution of government benefits (e.g., loan forgiveness) complete the case for constitutional challenges.

B. *The Fair Housing Act*

Agencies acting under their own governing statutes are not free to ignore the strictures of co-terminus statutes, such as the Fair Housing Act (“FHA”).³¹⁵ Where other federal statutes are concerned, preemption would not be the issue.³¹⁶ In this instance, however, the question is whether a cause of action under one federal statute is precluded by the provisions of another federal statute.³¹⁷ In making this statutory preclusion determination, the Supreme Court has stated that the end is to reconcile or harmonize the statutes, not “to enforce both statutes in full unless there is a genuinely irreconcilable conflict”³¹⁸ If neither statute, in express terms, forbids or limits the other, then other tools must be used for reconciliation.³¹⁹ An express preemption of state law is not necessarily a preemption of a related federal law.³²⁰

In deciding whether there is statutory preclusion, courts first look at the statutory structures—for example, whether the two complement each other in terms of scope and purpose as well as remedies.³²¹ If each statute has its own mechanism to address its objectives, the court considers whether precluding one statute would impair the

³¹⁰ *Gautreaux v. Romney*, 448 F.2d 731, 738 (7th Cir. 1971).

³¹¹ *Jordan v. Nationstar Mortg., LLC*, 240 F. Supp. 3d 1114 (E.D. Wa. 2017).

³¹² *Id.* at 1122.

³¹³ *Id.* at 1125 (first quoting 12 U.S.C. § 4617(b)(2)(A)(i) (2017); then quoting *Adams v. Aurora Loan Servs., Inc.*, 813 F.3d 1259, 1261 (9th Cir. 2016)).

³¹⁴ *Swanson*, *supra* note 158.

³¹⁵ *POM Wonderful LLC v. Coca-Cola Co.*, 134 S. Ct. 2228, 2237 (2014).

³¹⁶ *Id.*

³¹⁷ *Id.* at 2236 (ruling a challenge under the Lanham Act for false and deceptive labeling was not precluded by the FDA regulating the same conduct).

³¹⁸ *Id.* at 2237.

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ *Id.* at 2238.

ability of the other to achieve its purposes.³²² Next, courts analyze whether enforcing one statute would defeat the other's larger Congressional policy (such as the interests in centralization, forums, or resources).³²³ That the text of the two statutes vary in certain respects, such as one statute addressing its causes with more specificity than the other, does not matter.³²⁴

Under this analysis and the FHA's stature, it seems highly unlikely that Congress intended HERA to preclude its application to the matters covered by the FHA. First, HERA does not have an express preclusion of other federal laws, only state laws.³²⁵ Second, HERA and the FHA complement each other to the extent that HERA can be read as aiming to shore up the historic role of the GSEs in serving the cause of housing.³²⁶ Third, and most significantly, Congress did not intend for federal agencies to engage in conduct that would defeat the overarching Congressional policy underlying the work of the GSEs, i.e., housing access as safeguarded by the FHA.³²⁷

Congress enacted the FHA in 1968 to combat and prevent segregation and discrimination in housing.³²⁸ The purpose of the FHA was "to provide, within constitutional limitations, for fair housing throughout the United States."³²⁹ As with the Civil Rights Act of 1866, Congress passed the FHA pursuant to its power under the Thirteenth Amendment to eliminate the badges and incidents of slavery.³³⁰ In construing the former statute, the Supreme Court declared that "when racial discrimination herds men into ghettos and makes their ability to buy property turn on the color of their skin, then it too is a relic of slavery."³³¹

Fair housing issues arise in a host of contexts beyond the basic purchase and rental of housing, such as in lending,³³² brokerage and insurance services;³³³ decisions by municipalities on land use, including barriers to the construction of affordable, multi-

³²² *Id.* at 2239 (discussing that there is lesser "policing of misleading food and beverage labels than in competitive markets for other products.").

³²³ *Id.*

³²⁴ *Id.* at 2240.

³²⁵ See Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (codified at scattered sections of 12, 15, 26, 37, 38, 42 U.S.C.).

³²⁶ William M. Isaac, *A No-Brainer for Trump Team: Recapitalize the GSEs*, AM. BANKER: BANKTHINK (Mar. 28, 2017), <https://www.americanbanker.com/opinion/a-no-brainer-for-trump-team-recapitalize-the-gses>.

³²⁷ *POM Wonderful LLC*, 134 S. Ct. at 2232.

³²⁸ Douglas S. Massey, *The Legacy of the 1968 Fair Housing Act*, 30 SOC. F. 571, 574 (2015).

³²⁹ 42 U.S.C. § 3601 (2018).

³³⁰ Massey, *supra* note 328, at 574.

³³¹ *Jones v. Alfred H. Mayer Co.*, 392 U.S. 409, 442-43 (1968).

³³² See *Inclusive Cmty. Project, Inc. v. Tex. Dep't of Hous. & Cmty. Affairs*, 747 F.3d 275 (5th Cir. 2014), *aff'd*, 135 S. Ct. 2507 (2015).

³³³ See, e.g., *Garvin v. Tran*, No. C 07-1571 RS, 2009 U.S. Dist. LEXIS 92704, at *4 (N.D. Cal. Oct. 5, 2009).

unit housing;³³⁴ urban renewal and using eminent domain to redevelop an area;³³⁵ and the award of low-income housing tax credits.³³⁶

The FHA's language prohibiting discrimination in housing is broad and inclusive; the purpose of its reach is to replace segregated neighborhoods with truly integrated and balanced living patterns.³³⁷ In commemorating the fortieth anniversary of the FHA and the twentieth anniversary of the FHA Amendments, the House of Representatives reiterated that "the intent of Congress in passing the Fair Housing Act was broad and inclusive, to advance equal opportunity in housing and achieve racial integration for the benefit of all people in the United States"³³⁸ However, until very recently, the Supreme Court had not yet settled the question of whether a violation of the FHA required a showing of intent. For equal protection violations, the Supreme Court had already answered the question. In *Village of Arlington Heights v. Metropolitan Housing Development Corporation*, the Court ruled that constitutional due process and equal protection violations require a showing of intent.³³⁹ In *Gautreaux*, the court found evidence of intentional discrimination in violation of the Constitution and a federal civil rights statute (but not under the FHA as most of the violations occurred before the enactment) by the deliberate adoption of policies setting up segregated communities.³⁴⁰

1. Disparate Impact Theory

The discriminatory effect of a governmental rule or policy arises in two contexts: adverse impact on members of a protected class and harm to the community generally by the perpetuation of patterns of segregation.³⁴¹ Perpetuation of segregation claims are typically filed against municipal defendants alleged to have used their zoning or other land-use powers, either through individual decisions or broad policy, to prevent construction of integrated housing developments in predominantly white areas.³⁴²

³³⁴ *United States v. Yonkers Bd. of Educ.*, 837 F.2d 1181, 1184 (2d Cir. 1987); *MHANY Mgmt. v. Cty. of Nassau*, No. 05-cv-2301, 2017 WL 4174787, 2017 U.S. Dist. LEXIS 153214, at *4 (E.D.N.Y. Sept. 19, 2017).

³³⁵ *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 377 (3d Cir. 2011).

³³⁶ *Inclusive Cmty. Project, Inc.*, 747 F.3d at 275.

³³⁷ *Mayor of Baltimore v. Wells Fargo Bank, N.A.*, No. JFM-08-62, 2011 WL 1557759, 2011 U.S. Dist. LEXIS 44013, at *3-4 (D. Md. Apr. 22, 2011) (finding the city had standing to challenge predatory lending claims against the lender offering onerous and risky terms that resulted in high numbers of defaults and foreclosures in African-American neighborhoods); see also *Bank of Am. Corp. v. City of Miami*, 137 S. Ct. 1296 (2017), discussed *infra* at notes 415-19 and accompanying text.

³³⁸ H.R. Res. 1095, 110th Cong. (2008) (enacted).

³³⁹ *Vill. of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 265 (1977).

³⁴⁰ *Gautreaux v. Romney*, 448 F.2d 731, 740 (7th Cir. 1971).

³⁴¹ *Huntington Branch, NAACP v. Huntington*, 844 F.2d 926, 934, 937-38 (2d Cir. 1988).

³⁴² *But see, e.g., Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1293 (7th Cir. 1977) (observing that perpetuation of segregation claims against private defendants have also been recognized).

A plaintiff may establish a violation of the FHA in one of two ways: showing discriminatory intent or disparate impact.³⁴³ Proving the first theory is a difficult task because those determined to violate the law with impunity rarely announce their intentions or reveal their animus.³⁴⁴ Consequently, the disparate impact theory has been the most successful way to challenge ostensibly harmless practices that operate to exclude or affect certain groups disproportionately.³⁴⁵ Thus, disparate impact theory is implicated in cases where facially neutral policies and laws do not evince discriminatory import upon passage, but develop into powerful discriminatory mechanisms when applied.³⁴⁶ Every circuit court that has considered the question upheld this theory as viable.³⁴⁷

2. The Recent Disparate Impact Trilogy

Only recently, in *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*,³⁴⁸ did the Supreme Court validate a cause of action under the FHA for discrimination by disparate impact.³⁴⁹ This was the third case on the same issue that the Court was poised to consider.³⁵⁰ A Supreme Court ruling on the cognizability of disparate impact theory was nixed in two prior cases when the parties settled at the last minute.³⁵¹ The Eighth and Third Circuit Courts of Appeal upheld the disparate impact theory in *Gallagher v. Magner*³⁵² and *Mt. Holly Gardens Citizens in Action v. Township of Mount Holly*.³⁵³

³⁴³ *Huntington Branch, NAACP*, 844 F.2d at 933.

³⁴⁴ There are, to be sure, a number of cases where the bias is more than evident. See *City of Cuyahoga Falls v. Buckeye Cmty. Hope Found.*, 538 U.S. 188, 195–96 (2003) (upholding a referendum to block an ordinance providing for affordable housing despite evidence that referendum was motivated by racial animus).

³⁴⁵ Robert G. Schwemm & Calvin Bradford, *Proving Disparate Impact in Fair Housing After Inclusive Communities*, 19 LEGIS. & PUB. POL.'Y 685, 685 (2016).

³⁴⁶ *Id.* at 693.

³⁴⁷ *McCulloch v. Town of Milan*, 559 F. App'x 96, 99 (2d Cir. 2014); *City of Fort Lauderdale v. Scott*, 551 F. App'x 972, 978 (11th Cir. 2014); *Pac. Shores Props., LLC v. City of Newport Beach*, 730 F.3d 1142, 1148 (9th Cir. 2013); *L & F Homes & Dev., LLC v. City of Gulfport*, 538 F. App'x 395, 398 (5th Cir. 2013); *Sheptock v. Fenty*, 707 F.3d 326 (D.C. Cir. 2013); *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 377 (3d Cir. 2011); *Gallagher v. Magner*, 619 F.3d 823 (8th Cir. 2010), *cert. granted*, 565 U.S. 1013 (2011), *reh'g denied*, 636 F.3d 380 (8th Cir. 2013); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1293 (7th Cir. 1977).

³⁴⁸ *Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2510 (2015).

³⁴⁹ *Id.*

³⁵⁰ *Id.*

³⁵¹ Allegedly, the Obama Administration orchestrated the settlements to avert a ruling against the disparate impact theory.

³⁵² *Gallagher*, 619 F.3d at 845.

³⁵³ *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 377 (3d Cir. 2011).

In *Gallagher*, the owners of substandard housing challenged the aggressive enforcement of the housing code.³⁵⁴ The owners argued that the enforcement caused a discriminatory impact because it raised their costs, which in turn reduced the number of affordable housing units available to protected classes.³⁵⁵ The court found that the evidence reasonably demonstrated that the city's aggressive enforcement of the housing code resulted in a disproportionate impact on racial minorities, particularly African-Americans.³⁵⁶ Additionally, the evidence showed that the city's housing code enforcement temporarily, if not permanently, burdened landlords.³⁵⁷ This burden on landlords indirectly burdened their tenants.³⁵⁸ The court also found that, given the existing shortage of affordable housing in the city, it was reasonable to infer that the overall amount of affordable housing decreased as a result.³⁵⁹ They concluded that after "taking into account the demographic evidence in the record, it [was] reasonable to infer racial minorities, particularly African-Americans, were disproportionately affected by these events."³⁶⁰

In *Mt. Holly Gardens Citizens in Action*, the city embarked on an urban renewal program that called for the condemnation of many homes, most of which were owned by African-Americans and Latinos.³⁶¹ The homes to be constructed in the revitalized area were unaffordable to a disproportionate number of the minority residents displaced by the program.³⁶² The court ruled:

[A] disparate impact inquiry requires us to ask whether minorities are disproportionately *affected* by the redevelopment plan. . . . [A] *prima facie* case of disparate impact [can be established] by showing that minorities are disproportionately burdened by the redevelopment plan or that the redevelopment plan '[falls] more harshly' on minorities.³⁶³

In *Texas Department of Housing and Community Affairs*,³⁶⁴ the Court ruled that a disparate impact theory was cognizable under the FHA.³⁶⁵ The Texas Department of Housing and Community Affairs (the "Department") was the state agency in charge

³⁵⁴ *Gallagher*, 619 F.3d at 835.

³⁵⁵ *Id.* at 831.

³⁵⁶ *Id.* at 835.

³⁵⁷ *Id.* at 838.

³⁵⁸ *Id.* at 835.

³⁵⁹ *Id.*

³⁶⁰ *Id.*

³⁶¹ *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 378 (3d Cir. 2011).

³⁶² *Id.* at 384.

³⁶³ *Id.* at 383 (quoting *Doe v. City of Butler*, 892 F.2d 315, 323 (3d Cir. 1989)).

³⁶⁴ *Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2507 (2015).

³⁶⁵ *Id.* at 2512.

of administering the federal Low Income Housing Tax Credit Program.³⁶⁶ The program required states to allocate tax credits according to a “qualified allocation plan . . . which set[] forth selection criteria to be used to determine housing priorities of the housing credit agency which [were] appropriate to local conditions”³⁶⁷ The federal law required states’ qualified allocation plan to give preference to projects in low-income areas.³⁶⁸ State law required the Department to “score and rank the applications using a point system,” which in turn required the Department to prioritize the criteria “in descending order.”³⁶⁹ The Department retained some discretion to develop “below-the-line” criteria to supplement those statutorily mandated factors, but these could not outweigh any “above-the-line” factors.³⁷⁰ The trial court found that the Department “approved tax credits for 49.7% of proposed non-elderly units in 0% to 9.9% Caucasian areas, but only approved 37.4% of proposed non-elderly units in 90% to 100% Caucasian areas.”³⁷¹

The Court’s ruling rested on a comparison to other antidiscrimination laws. The Court first traced the history of segregated housing patterns in the country.³⁷² Notwithstanding the striking down of *de jure* residential segregation by race, the vestiges of racial segregation remained.³⁷³ The social unrest during the 1960s and the conclusions of the Koerner Commission set up by President Johnson led to the passage of the FHA.³⁷⁴

Next, the Court looked to the language of two analogous antidiscrimination statutes: Title VII, which governs employment discrimination, and the Age Discrimination in Employment Act.³⁷⁵ The Court concluded that Congress proscribed not only overt discrimination, but also practices that are fair in form but discriminatory in operation.³⁷⁶ “Congress directed the thrust of [operative provisions of § 703(a)(2)] to the consequences of employment practices, not simply the motivation.”³⁷⁷ Thus, “[i]n light of the statute’s goal of achieving ‘equality of employment opportunities and remov[ing] barriers that have operated in the past’ to favor some races over others, the

³⁶⁶ *Id.* at 2513–14.

³⁶⁷ 26 U.S.C. § 42(m)(1)(B)(i) (2018).

³⁶⁸ *Id.*

³⁶⁹ TEX. GOV’T CODE ANN. § 2606.6710(b)–(b)(1) (West 2018); *Tex. Dep’t of Hous. & Cmty. Affairs*, 135 S. Ct. at 2513–14.

³⁷⁰ *Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 747 F.3d 275, 277–78 (5th Cir. 2014).

³⁷¹ *Tex. Dep’t of Hous. & Cmty. Affairs*, 135 S. Ct. at 2514 (internal quotation marks omitted) (quoting *Inclusive Cmty. Project, Inc. v. Tex. Dep’t of Hous. & Cmty. Affairs*, 749 F. Supp. 2d 486, 499 (N.D. Tex. 2010)).

³⁷² *Id.* at 2515.

³⁷³ *Id.*

³⁷⁴ *Id.* at 2516.

³⁷⁵ *Id.*

³⁷⁶ *Id.* at 2517.

³⁷⁷ *Id.* (quoting *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971)).

Court held that § 703(a)(2) of Title VII must be interpreted to allow disparate-impact claims.³⁷⁸

Similarly, the language of the ADEA prohibited such “actions that ‘deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual’s[] race or age.’”³⁷⁹ The Court also noted that “the text of these provisions ‘focuses on the effects of the action . . . rather than the motivation’”³⁸⁰ The Court concluded that, together, the rulings under Title VII and the ADEA instruct “that antidiscrimination laws must be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of actors, and where that interpretation is consistent with statutory purpose.”³⁸¹ The same language appears in the FHA, which makes it unlawful “[t]o refuse to sell or rent . . . or refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny . . .” fair housing.³⁸² The use of the words “‘otherwise make unavailable’ refers to the consequences of an action rather than the actor’s intent”;³⁸³ thus, “the operative text looks to results” rather than intent.³⁸⁴

Allowing disparate impact claims is consistent with FHA’s purpose to eradicate discriminatory practices within a sector of the nation’s economy.³⁸⁵ As such, the theory has been applied to strike down zoning laws and other housing restrictions that function to unfairly exclude minorities from certain neighborhoods without any sufficient justification.³⁸⁶ Disparate impact plays a role in uncovering discriminatory intent, permitting plaintiffs to counteract unconscious prejudices and disguising animus that escape easy classification as disparate treatment. Yet, liability based solely on “statistical disparity” is not likely to be ruled a violation.³⁸⁷ Instead, a causal connection between the policy and the impact is required as part of the prima facie case.³⁸⁸ The disparate impact theory only mandates “‘removal of artificial, arbitrary, and unnecessary barriers,’ not the displacement of valid governmental policies.”³⁸⁹ The best application is one that gives housing authorities and private developers the leeway to state and explain the valid interest served by their policies. This application is analogous to the business necessity exception under Title VII and is a defense

³⁷⁸ *Id.* (quoting *Griggs*, 401 U.S. at 429–30).

³⁷⁹ *Id.* at 2518 (emphasis omitted) (quoting *Smith v. City of Jackson*, 544 U.S. 228, 235 (2005)).

³⁸⁰ *Id.* (emphasis omitted) (quoting *Smith*, 544 U.S. at 236).

³⁸¹ *Id.*

³⁸² 42 U.S.C. § 3604(a) (2018).

³⁸³ *Tex. Dep’t of Hous. & Cmty. Affairs*, 135 S. Ct. at 2518.

³⁸⁴ *Id.* at 2519.

³⁸⁵ *Id.* at 2521.

³⁸⁶ *See supra* text accompanying note 266.

³⁸⁷ *Tex. Dep’t of Hous. & Cmty. Affairs*, 135 S. Ct. at 2523.

³⁸⁸ *Id.* at 2523–24.

³⁸⁹ *Id.* at 2522 (quoting *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971)).

against disparate impact liability.³⁹⁰ Further, disparate impact liability does not mandate any particular set of priorities or their ordering.³⁹¹

3. Permutations of Disparate Impact Theory

The federal circuit courts have held that “[t]o establish a prima facie case under [the disparate impact] theory, the plaintiff must show: ‘(1) the occurrence of certain outwardly neutral practices, and (2) a significantly adverse or disproportionate impact on persons of a particular type produced by the defendant’s facially neutral acts or practices.’”³⁹² Merely showing impact is not enough; a plaintiff must demonstrate a “causal connection between [a] facially neutral policy . . . and the resultant [impacts on a] proportion of minority’ group members in the population at issue.”³⁹³

The circuit courts have developed a number of permutations of this theory.³⁹⁴ In most circuits, a plaintiff generally must present statistical evidence showing a disproportionate or segregative effect.³⁹⁵ Once the plaintiff makes a prima facie showing, the court performs a burden-shifting analysis,³⁹⁶ meaning the plaintiff could shift the burden to the defendant to show that the challenged practice is justified by a “substantial, legitimate, nondiscriminatory objective.”³⁹⁷ If that showing is made, most burden-shifting circuits assign a further burden to the defendant to show that no less discriminatory alternatives could achieve the objective.³⁹⁸ The Sixth and Eighth

³⁹⁰ See, e.g., *Mountain Side Mobile Estates P’ship v. Sec’y of Hous. & Urban Dev.*, 56 F.3d 1243, 1254 (10th Cir. 1995).

³⁹¹ *Tex. Dep’t of Hous. & Cmty. Dev.*, 135 S. Ct. at 2523.

³⁹² *Tsombanidis v. W. Haven Fire Dep’t*, 352 F.3d 565, 574–75 (2d Cir. 2003) (emphasis omitted) (quoting *Reg’l Econ. Cmty. Action Program, Inc. v. City of Middletown*, 294 F.3d 35, 52–53 (2d Cir. 2002) (quoting *Gamble v. City of Escondido*, 104 F.3d 300, 306 (9th Cir. 1997))). Although a claimant does not need to provide proof of discriminatory intent, he must demonstrate “the challenged practice of the defendant ‘actually or predictably results in racial discrimination; in other words[,] that it has a discriminatory effect.’” *Huntington Branch, NAACP v. Huntington*, 844 F.2d 926, 934 (2d Cir. 1988) (quoting *United States v. City of Black Jack*, 508 F.2d 1179, 1184–85 (8th Cir. 1974)); *id.* at 935 (noting further that sometimes “[facially neutral] rules bear no relation to discrimination upon passage, but develop into powerful discriminatory mechanisms when applied.”). “The discriminatory effect of a rule arises in two contexts: adverse impact on a particular minority group and harm to the community generally by the perpetuation of segregation.” *Id.* at 937 (citing *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977)).

³⁹³ *Hack v. President & Fellows of Yale Coll.*, 237 F.3d 81, 90–91 (2d Cir. 2000) (quoting *Brown v. Coach Stores, Inc.*, 163 F.3d 706, 712 (2d Cir. 1998)).

³⁹⁴ See 24 C.F.R. § 100.500(a) (2013); *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 382 (3d Cir. 2011).

³⁹⁵ *Mount Holly*, 658 F.3d at 385; *Huntington Branch, NAACP*, 844 F.2d at 936; *Thompson v. U.S. Dep’t of Hous. & Urban Dev.*, 348 F. Supp. 2d 398, 417 (D. Md. 2005).

³⁹⁶ Michael G. Allen et al., *Assessing HUD’s Disparate Impact Rule: A Practitioner’s Perspective*, 49 HARV. C.R.-C.L. L. REV. 155, 161 n.36 (2014) [hereinafter Allen et al., *Assessing HUD’s Disparate Impact Rule*].

³⁹⁷ *Id.* at 161; see, e.g., *Mount Holly*, 658 F.3d at 385–86; *Huntington Branch, NAACP*, 844 F.2d at 936.

³⁹⁸ *Graoch Assocs. No. 33 Ltd. P’ship v. Louisville/Jefferson Cty. Metro Human Relations Comm’n*, 508 F.3d 366, 374 (6th Cir. 2007).

Circuits, however, place the ultimate burden on the plaintiff to show that less discriminatory alternatives existed.³⁹⁹ Several circuits have gone on to impose a final analysis that weighs the defendant's justifications against the plaintiff's showing of a discriminatory effect.⁴⁰⁰

In place of the burden shifting approach, a minority of circuits utilize a multifactor balancing test that considers:

(1) the magnitude of discriminatory effect, (2) whether there is any evidence of discriminatory intent, (3) the defendant's interest in taking the complained-of action, and (4) whether the plaintiffs sought to compel the defendant affirmatively to provide housing for members of a protected class or merely restrain the defendant from interfering with individual property owners who wish to provide such housing.⁴⁰¹

Attorneys at the Equal Justice Society synthesized these approaches, stating:

Courts must conduct a "searching inquiry" of whether unlawful discrimination has influenced the decisions that lead to disparate treatment. By focusing a legal inquiry on a municipality's intent at the moment a redevelopment decision is made, "the law fails to recognize that discrimination 'can intrude much earlier, as cognitive process-based errors in perception and judgment subtly distort the ostensibly objective data set upon which a decision is ultimately based.'"⁴⁰²

In fact, "measuring disproportionate impact . . . attributable—at least in part—to implicit bias is [even] more valuable than measuring explicit bias."⁴⁰³ This is where disparate impact has its most value because it checks harmful government and private conduct where illicit motivations are subliminal.⁴⁰⁴ As the Court explained, the point of disparate impact theory is not to assign liability just because a state of affairs seems

³⁹⁹ Allen et al., *Assessing HUD's Disparate Impact Rule*, *supra* note 396, at 161.

⁴⁰⁰ *Id.*

⁴⁰¹ Cent. Ala. Fair Hous. Ctr. v. Magee, 835 F. Supp. 2d 1165, 1195 (M.D. Ala. 2011), *vacated on other grounds by* No. 11-16114-CC, 2013 WL 2372302, 2013 U.S. App. LEXIS 11316 (11th Cir. May 17, 2013). "This is the approach used in the Seventh Circuit and, for claims against governmental defendants, the Fourth Circuit." Allen et al., *Assessing HUD's Disparate Impact Rule*, *supra* note 396, at 162 n.41 (first citing *Arthur v. City of Toledo*, 782 F.2d 565, 575 (6th Cir. 1986); then citing *Smith v. Town of Clarkton*, 682 F.2d 1055, 1065 (4th Cir. 1982); then citing *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977)).

⁴⁰² Wilson Sonsini Goodrich et al., *Lessons from Mt. Holly: Leading Scholars Demonstrate Need for Disparate Impact Standard to Combat Implicit Bias*, 11 HASTINGS RACE & POVERTY L.J. 241, 261–62 (2014) (quoting Melissa Hart, *Subjective Decisionmaking and Unconscious Discrimination*, 56 ALA. L. REV. 741, 746 (2005) (quoting Linda H. Krieger, *The Content of Our Categories: A Cognitive Bias Approach to Discrimination and Equal Employment Opportunity*, 47 STAN. L. REV. 1161, 1211 (1995))).

⁴⁰³ *Id.* at 262.

⁴⁰⁴ *See id.*

unfair or there is different treatment.⁴⁰⁵ Instead, disparate impact portends liability because that unfairness or different treatment is the result of volitional acts by a defendant, regardless of whether he intended to do harm when there were other, non-harmful choices available. This theory puts the onus on the putative defendant to be cognizant of the consequences of his act, but it does not punish absent culpability.⁴⁰⁶ The culpability resides in the elevation of all other interests, particularly the proverbial "property values," and in the case of FHFA, conserving assets, thereby denying those on the outside of this paradigm the ability to fulfill one of society's most basic needs.⁴⁰⁷

4. Disparate Impacts from the Crisis

Although we cannot charge the GSEs for causing the housing crisis, we can attribute to them some responsibility for its intensity, the irresponsible practices, and, to some extent, the cupidity that animated non-government actors. Heedless lending on subprime terms by loan originators and securitizing those loans for resale on the secondary markets by the GSEs set the industry up for collapse.⁴⁰⁸ At the time of the collapse, the GSEs held millions of mortgages and over \$5.14 trillion in outstanding mortgage-backed securities.⁴⁰⁹ However, the effects from the industry collapse were not spread evenly among the population. Subprime lending was more prevalent in the fast-growing areas of the country, such as the desert west and Florida, which were experiencing rapid new construction.⁴¹⁰ Also, African-American and Latino borrowers had a much higher likelihood than white borrowers with the same risk profile (e.g., credit score, income level) to be approved for and steered toward a subprime mortgage rather than a more affordable and predictable fixed rate mortgage.⁴¹¹ Further, when the borrowers defaulted, these same minority borrowers faced foreclosure at nearly twice the rate than for white borrowers at the same income level.⁴¹² The high levels of foreclosures

⁴⁰⁵ *Id.* at 263.

⁴⁰⁶ *Id.*

⁴⁰⁷ *Id.* at 249.

⁴⁰⁸ See discussion *supra* Section II.B.1.

⁴⁰⁹ Davidoff & Zaring, *supra* note 81, at 488.

⁴¹⁰ Matthew J. Rossman, *Counting Causalities in Communities Hit Hardest by the Foreclosure Crisis*, 2 UTAH L. REV. 245, 257 (2016) (citing Chris Mayer & Karen Pence, *Subprime Mortgages: What, Where, and to Whom?* 11 (Fed. Reserve Bd., Working Paper No. 2008-29, 2008), <http://www.federalreserve.gov/pubs/feds/2008/200829/200829pap.pdf>).

⁴¹¹ *Id.* at 258 (citing DEBBIE GRUENSTEIN BOCIAN ET AL., CTR. FOR RESPONSIBLE LENDING, FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS 6 (2010), <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf>); *id.* at 258 n.87 (first citing MONIQUE W. MORRIS, NAACP, DISCRIMINATION AND MORTGAGE LENDING IN AMERICA (2009), http://action.naACP.org/page/-/resources/Lending_Discrimination.pdf); then citing Paul S. Calem et al., *The Neighborhood Distribution of Subprime Mortgage Lending*, 29 J. REAL EST. FIN. & ECON. 393, 407 (2004), Rossman, *supra* note 410, at 258 n.90; and Mayer & Pence, *supra* note 410, at 12–14).

⁴¹² Green, *Disquiet on the Home Front*, *supra* note 13, at 13 n.25; Rossman, *supra* note 410, at 258 (citing BOCIAN ET AL., *supra* note 411, at 2).

in minority communities forced reductions in home prices by a much larger percent than in white communities.⁴¹³

C. GSEs' Policies and Practices on the Handling and Disposition of REO Properties Violate the FHA

Although the disparate impacts on minorities from the housing crisis is well-established, holding the GSEs accountable absent a sufficiently close nexus between their imprudent conduct and the eventual fall of the market is another hurdle that must be overcome. In *Bank of America Corporation v. City of Miami*,⁴¹⁴ the Supreme Court concluded, “foreseeability alone is not sufficient to establish proximate cause under the FHA”⁴¹⁵ In that case, the city had standing to assert a FHA violation against lenders as to minority borrowers.⁴¹⁶ However, the city had to allege more than simply the foreseeability that predatory loan terms would result in disproportionate defaults.⁴¹⁷ Instead, the city had to show that disproportionate defaults caused foreclosures and vacancies, which lowered property values and harmed the city by reducing property tax revenues.⁴¹⁸

With respect to the GSEs’ policies on the disposition of REO properties, there is more than the mere foreseeability of harm, but harm in fact. The FHA makes it unlawful to “otherwise make unavailable or deny” housing to a protected class “by, among other things, action that limits the availability of affordable housing.”⁴¹⁹ As the Supreme Court explained in *Texas Department of Housing and Community Development*, making housing unavailable can occur by intentional, conscious acts as well as by subliminal, unthinking acts, such as by official acts in the form of granting permissions and doling out public benefits.⁴²⁰ Such official acts rarely evince the kind

⁴¹³ Rossman, *supra* note 410, at 259 n.92 (citing JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION’S HOUSING 31–32 (2014) (“asserting that price drops as a result of the Foreclosure Crisis were three times greater in minority neighborhoods than in white neighborhoods”); *id.* (citing Michael Fletcher, *A Shattered Foundation: African Americans Who Bought Homes in Prince George’s Have Watched Their Wealth Vanish*, WASH. POST (Jan. 24, 2015), <http://www.washingtonpost.com/sf/investigative/2015/01/24/the-american-dream-shatters-in-prince-georges-county/> (“comparing ‘housing values in two suburban Washington Zip codes’ and finding that in the predominantly black community housing prices have not recovered any of the nearly 50% in lost value, while in the predominantly white community housing prices have recouped two-thirds of lost value”)).

⁴¹⁴ *Bank of Am. Corp. v. City of Miami*, 137 S. Ct. 1296, 1300–01 (2017). The city alleged predatory lending practices on minority borrowers set high rates of foreclosures causing declines in property values that impacted racial composition of the city and reduced tax revenues to the city. *Id.*

⁴¹⁵ *Id.* at 1305.

⁴¹⁶ *Id.* at 1301.

⁴¹⁷ *Id.* at 1306.

⁴¹⁸ *Id.* at 1305.

⁴¹⁹ 42 U.S.C. § 3604(a) (2018); *Mt. Holly Gardens Citizens in Action, Inc. v. Twp. of Mount Holly*, 658 F.3d 375, 381 (3d Cir. 2011).

⁴²⁰ *Tex. Dep’t of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2533 (2015); *S. Burlington Cty. NAACP v. Twp. of Mount Laurel Twp.*, 336 A.2d 713, 729

of overt racial animus that would support a discriminatory treatment claim.⁴²¹ Yet, the performance of these acts may make housing unavailable.⁴²² For example, no apartment buildings can be constructed, but expensive, unaffordable detached homes can; homes belonging to African-American and Latino families are demolished, and the new homes built in their places are unaffordable. On the surface, each of these acts all move housing toward the asserted lofty and uncontroversial end of encouraging neighborhoods conducive to families or eradicating demoralizing blighted conditions, but the impacts are disparate and harmful. For GSEs, their policies on the handling and disposition of its REO properties—which include lower maintenance standards, sales of nonperforming loans to investors, and the Arm's Length and Make-Whole policies—reveal impacts that are disparate, but largely avoidable.⁴²³

1. Disparate Maintenance Standards

A City of Chicago ordinance that imposed maintenance responsibility upon mortgagees as to mortgages in default was rejected, but that ruling rested on the Supremacy Clause.⁴²⁴ A new challenge based on either disparate treatment or disparate impact under the FHA may have a stronger chance of success. In December 2016, the National Fair Housing Alliance filed a housing discrimination suit against Fannie Mae and alleged that it purposefully failed to maintain its REO properties in middle- and working-class African-American and Latino neighborhoods to the same level of quality it did for foreclosed properties it owned in white middle- and working-class neighborhoods.⁴²⁵ The complaint offered substantial photographic evidence of the unmowed lawns and invasive weeds, unrepaired doors and windows, and litter and trash that characterized the properties in the minority neighborhoods in contrast to the neatly maintained properties in the white neighborhoods.⁴²⁶ The lawsuit maintained that these maintenance lapses invite vandalism, create (or at least perpetuate) blight, reduce home values in the community, and cause physical (because of the presence of mold) and emotional health problems for residents.⁴²⁷ The lapses also lower the

(N.J. 1975); *Berenson v. Town of New Castle*, 341 N.E.2d 236, 239 (N.Y. 1975); Goodrich et al., *supra* note 402, at 261.

⁴²¹ *Tex. Dep't of Hous. & Cmty. Affairs*, 135 S. Ct. at 2512.

⁴²² *Id.* at 2510.

⁴²³ FANNIE MAE, *SELLING GUIDE: FANNIE MAE SINGLE FAMILY 46* (2014).

⁴²⁴ *Fed. Hous. Fin. Agency v. City of Chicago*, 962 F. Supp. 2d 1044, 1061–63 (N.D. Ill. 2013).

⁴²⁵ *Nat'l Fair Hous. All. Inc. v. Fed. Nat'l Mortg. Ass'n*, No. 3:2016cv06969 (N.D. Cal. filed Dec. 5, 2016); see Press Release, Nat'l Fair Hous. All., National Fair Housing Alliance Accuses Mortgage Giant Fannie Mae of Racial Discrimination in 38 U.S. Metro Areas (Dec. 5, 2016), <http://nationalfairhousing.org/2016/12/05/national-fair-housing-alliance-accuses-mortgage-giant-fannie-mac-of-racial-discrimination-in-38-u-s-metro-areas/>.

⁴²⁶ *Nat'l Fair Hous. All. Inc.*, No. 3:2016cv06969.

⁴²⁷ *Id.*

likelihood that the foreclosed homeowner will be able to recover the property because few lenders are willing to lend on a dilapidated property.⁴²⁸

A party could make a disparate impact claim by offering evidence that the properties were comparable (in terms of their pre-foreclosure values and levels of outstanding debt) and the care and maintenance of homes situated in minority neighborhoods were remarkably different from that in white neighborhoods.

2. Disparate Impact Under NPL Bulk Sale Policy

As suggested earlier, the NPL sale policy was implemented to conserve the GSEs' assets.⁴²⁹ While this aim cannot be faulted out of hand, we can criticize and challenge the implementation of the sale policy. The first iteration of the NPL program did not contain minimum good faith and fairness requirements for the investors in their dealings with occupiers (renters or buyers) of the homes.⁴³⁰ In fact, the sale of NPLs created what can be described as a cottage industry in a contract for deed, also called an installment land contract.⁴³¹ Nationwide, more than three million people are estimated to have bought a foreclosed GSE home through a contract for deed, a device attractive to those with poor credit.⁴³² Investors sometimes sell these homes through this device for four times their purchase price.⁴³³ Some scholars claim that the investors are targeting African-American and Latino homebuyers⁴³⁴ because they stereotypically are thought to be unsophisticated and inexperienced.⁴³⁵ Several

⁴²⁸ Claudia Coulton et al., *REO and Beyond: The Aftermath of the Foreclosure Crisis in Cuyahoga County, Ohio*, in *REO & VACANT PROPERTIES* 47, 49 (2010).

⁴²⁹ Amanda Maher, *Speed of Sales and Buyers Create Questions About Purpose of Fannie Mae's NPL Bulk-Sales*, VALUEWALK (Nov. 12, 2015), <http://www.valuwalk.com/2015/11/fannie-mae-npl-bulk-sales/>.

⁴³⁰ FANNIE MAE, FANNIE MAE NPL SALES 6 (2015).

⁴³¹ Ken Xuhao Zhang, *GSE NPL Sales Programs: Five Questions to Ask Before Investing in Non-Performing Loans*, RISKSPAN (June 13, 2017), <https://www.riskspan.com/news-insight-blog/gse-npl-sales-programs-investing-in-non-performing-loans>.

⁴³² Matthew Goldstein & Alexandra Stevenson, *Market for Fixer-Uppers Traps Low-Income Buyers*, N.Y. TIMES (Feb. 20, 2016) [hereinafter Goldstein & Stevenson, *Market for Fixer-Uppers*], <https://www.nytimes.com/2016/02/21/business/dealbook/market-for-fixer-uppers-traps-low-income-buyers.html>.

⁴³³ "Fannie Mae notes the bulk sale program for hard-to-sell homes accounted for a small fraction of the 900,000 homes it has sold since the financial crisis[.]" many of them run-down and sold at bargain prices. *Id.*

⁴³⁴ "The [National Consumer Law] [C]enter has begun to survey housing lawyers in states where these contracts are most commonly used, in part to help determine the effect of new institutional players in the market." Matthew Goldstein & Alexandra Stevenson, *'Contract for Deed' Lending Gets Federal Scrutiny*, N.Y. TIMES (May 10, 2016) [hereinafter Goldstein & Stevenson, *Contract for Deed*], <https://www.nytimes.com/2016/05/11/business/dealbook/contract-for-deed-lending-gets-federal-scrutiny.html>. "Harbour Portfolio bought more than 6,700 single-family homes following the financial crisis of 2008, most of them from Fannie Mae through bulk sales. In recent months, Harbour has sold more than 600 homes with existing contracts for deeds in place to other investment firms and individual investors." *Id.*

⁴³⁵ Goldstein & Stevenson, *Market for Fixer-Uppers*, *supra* note 432. The authors state:

lawsuits have been lodged challenging such practices on various grounds.⁴³⁶ These seller-financed deals, which include contracts for deed and rent-to-own leases, come with great risk. The usual consumer protections applicable to mortgage financing and lead paint disclosures,⁴³⁷ among other things, are absent, and landlords can easily evict residents after failure to make payments because the seller retains legal title to the home until final payment is made.⁴³⁸ Only in the last year or so has the FHFA begun to scrutinize the nature of the post-sale relationship between investors and occupants of formerly REO properties.⁴³⁹ The Consumer Financial Protection Bureau reportedly

One of several firms Mr. Groeger's office has fielded complaints about is Harbour Portfolio Advisors of Dallas.

One of the larger firms in this market, Harbour has bought more than 6,700 single-family homes in Ohio, Michigan, Illinois, Florida, Georgia, Pennsylvania and a handful of other states since 2010—most of them from Fannie Mae, according to the mortgage finance firm and the foreclosure research firm RealtyTrac.

Ten of the more than [fifty] homes Harbour bought in Akron have been torn down after being condemned and two others are slated for demolition, Mr. Groeger said.

In Detroit, 300 homes bought by Harbour have received notices for prolonged failure to pay property taxes, according to a Wayne County website. Harbour disputes the accuracy of the county's figures and says the number of homes it owns in Detroit is much lower.

....

In November, they were some of the hosts of a fund-raiser for the Perot Museum of Nature and Science.

Harbour, which raised more than \$60 million from wealthy investors, was the single largest buyer of foreclosed homes from Fannie Mae's bulk sale program from 2010 to 2014, which the mortgage giant used to unload more than 20,000 homes that were hard to sell. The homes were bought by Harbour for an average of \$8,000 each in cities like Akron, Detroit and Flint, Mich.

Id.; see JEREMIAH BATTLE, JR. ET AL., NAT'L CONSUMER LAW CTR., TOXIC TRANSACTIONS 3–4 (2016); see also JAMES H. CARR ET AL., NAT'L ASS'N REAL ESTATE BROKERS, STATE OF HOUSING IN BLACK AMERICA (2016).

⁴³⁶ “[A] lawsuit filed earlier this year by the Atlanta Legal Aid Society[] contend[ed] that Harbour had targeted African-American communities to sell contracts for deeds on homes at inflated prices.” Matthew Goldstein & Alexandra Stevenson, *How a Home Bargain Became a ‘Pain in the Butt,’ and Worse*, N.Y. TIMES (July 7, 2017), <https://www.nytimes.com/2017/07/07/business/dealbook/how-a-home-bargain-became-a-pain-in-the-butt-and-worse.html>.

⁴³⁷ Alexandra Stevenson & Matthew Goldstein, *Seller-Financed Deals Are Putting Poor People in Lead-Tainted Homes*, N.Y. TIMES (Dec. 26, 2016), <https://www.nytimes.com/2016/12/26/business/dealbook/seller-financed-home-sales-poor-people-lead-paint.html>.

⁴³⁸ *Id.*

⁴³⁹ *Fannie Targets ‘Abusive Seller Financing’ Sales*, REALTORMAG (May 25, 2017), <http://realtormag.realtor.org/daily-news/2017/05/25/fannie-targets-abusive-seller-financing->

has begun to investigate whether some companies are taking advantage of consumers.⁴⁴⁰ However, belated scrutiny will not obviate what may be a glaring FHA violation. Only selling homes to certain populations through the risky contract for deed device surely operates to make housing unavailable when default results in immediate eviction.

Contracts for deed are not inventions from the housing crisis.⁴⁴¹ In this arrangement, the contract remains executory for long periods, such as ten or twenty years.⁴⁴² The buyer typically gains immediate possession and incurs all the risks of loss from casualties while the seller holds legal title.⁴⁴³ At the same time, the buyer has the burden of maintenance and often has to pay property taxes.⁴⁴⁴ The greatest risk to buyers under contracts for deed is forfeiture upon default, which may occur late in the contract term.⁴⁴⁵ A forfeiture upon default causes the buyer to lose not only the property, but all the money that had been paid on the contract to date.⁴⁴⁶ Unaware of equitable protections that might exist under the law, many buyers simply walk away from contracts without contesting a seller's decision to invoke a forfeiture clause. Often, the contracts contain arbitration clauses to settle disputes between the seller and buyer; this precludes the right to litigate onerous clauses in a court.⁴⁴⁷

Additional risks confront purchasers of foreclosed property through contracts for deed. The homes are often put on the market "as is," meaning buyers incur substantial other costs to repair and bring the properties up to code.⁴⁴⁸ Municipal officials across the country have complained that out-of-state investors who sell properties with a contract for deed often perform minimal maintenance on properties and fall behind on paying property taxes or water bills.⁴⁴⁹ Because contracts for deed often are not

sales. "Fannie Mae officials also said this week that they will be reviewing how investors who purchase more than [twenty-five] foreclosed homes a year are using the properties. They plan to ask those investors to provide data about the homes." *Id.*

⁴⁴⁰ Alexandra Stevenson & Matthew Goldstein, *Federal Watchdog Agency Steps Up Inquiry into Home Contracts*, N.Y. TIMES (Nov. 14, 2016) [hereinafter Stevenson & Goldstein, *Federal Watchdog*], <https://www.nytimes.com/2016/11/15/business/dealbook/federal-watchdog-agency-steps-up-inquiry-into-home-contracts.html>.

⁴⁴¹ See generally Grant S. Nelson & Dale A. Whitman, *The Installment Land Contract—A National Viewpoint*, 1977 BYU L. REV. 541 (1977).

⁴⁴² *Id.* at 543.

⁴⁴³ *Id.* at 541.

⁴⁴⁴ *Id.*

⁴⁴⁵ *Id.* at 542.

⁴⁴⁶ *Id.* at 543.

⁴⁴⁷ See, e.g., *Mitchell v. Dahlberg*, 547 N.W.2d 74, 76 (Mich. Ct. App. 1996).

⁴⁴⁸ Crystal Myslajek, *Risks and Realities of the Contract for Deed*, FED. RES. BANK OF MINNEAPOLIS (Jan. 1, 2009), <https://www.minneapolisfed.org/publications/community-dividend/risks-and-realities-of-the-contract-for-deed>.

⁴⁴⁹ "The Consumer Financial Protection Bureau is trying to determine how many other firms are selling homes nationally with a contract for deed already in place or are renting out homes with an option to buy" Goldstein & Stevenson, *Contract for Deed*, *supra* note 434; see Stevenson & Goldstein, *Federal Watchdog*, *supra* note 440.

recorded in the land records,⁴⁵⁰ complete statistics on their prevalence is difficult to obtain. More importantly, the lack of recording places the buyer at risk of losing all of her investments through a sale by the seller to a subsequent purchaser without notice of the contract.

The counterargument is that contracts for deed enable home ownership for those otherwise unable to obtain a bank loan or to come up with a down-payment.⁴⁵¹ In recent years, courts and legislatures have responded to the apparent unfairness of the forfeiture provisions and have offered some relief.⁴⁵² Some vendees and their advocates appealed to courts and legislatures to expose the truth underlying the contract for deed and to illuminate how onerous, given all the equities, forfeiture was.⁴⁵³ Some courts were receptive of these arguments. In those cases, the courts employed a legal fiction that conceived the vendee/vendor relationship like a mortgagor/mortgagee relationship: the seller retained the legal title for purposes of security, and the vendee was the owner for all intents and purposes.⁴⁵⁴ Thus established, as a mortgagee, the vendor was bound by those rules that bind all mortgagees.⁴⁵⁵ The vendor was required to foreclose vendee's interest in cases of default.⁴⁵⁶ If the public sale produced a surplus, it belonged to the vendee.⁴⁵⁷ At the same time, other courts used their equitable powers to intervene to relieve a hapless vendee from foreclosure and give her restitution of amounts paid exceeding the land value.⁴⁵⁸ Some states allow for reinstatement of defaulting buyers after payment of

⁴⁵⁰ Myslajek, *supra* note 448.

⁴⁵¹ *Id.*

⁴⁵² *Id.*

⁴⁵³ There are to be sure some successful uses of contracts for deeds. In Minnesota, a "nonprofit program called Bridge to Success sells homes using contracts for deeds." Goldstein & Stevenson, *Market for Fixer-Uppers*, *supra* note 432. "The initiative, by Dayton's Bluff Neighborhood Housing Services and the Greater Minneapolis Housing Corporation, requires financial coaching and one-on-one counseling for buyers." *Id.* The program has bought more than 400 homes that were in foreclosure. *Id.* It uses financing from financial institutions and wealthy investors. *Id.* The contours of the program make the homes affordable, with an average purchase price of \$145,000, requiring a monthly payment of \$1,100, including interest at 7.5%. *Id.* Although the typical contract term is ten years, "the expectation is that buyers will . . . either [restructure] the deal with a bank mortgage, or . . . [sell] the home." *Id.* Another program run by Battery Point Financial, largely funded by leading private equity firm Kohlberg Kravis Roberts & Company, "rehabilitates all the homes it sells" and offers twenty-year contracts that comply with new federal guidelines pertaining to high cost mortgages. *Id.* "To date, Battery Point has bought more than 300 homes in [sixteen] states and intends to resell the properties for around \$72,000." *Id.*

⁴⁵⁴ See, e.g., Skendzel v. Marshall, 301 N.E.2d 641, 646 (Ind. 1973).

⁴⁵⁵ *Id.*

⁴⁵⁶ See, e.g., *id.* at 650–51; Bean v. Walker, 464 N.Y.S.2d 895, 898 (N.Y. App. Div. 1983); Eric T. Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. 609, 656 n.23 (1988).

⁴⁵⁷ *Bean*, 464 N.Y.S.2d at 898–99.

⁴⁵⁸ Peterson v. Hartell, 707 P.2d 232, 234 (Cal. 1985); Rosewood Corp. v. Fisher, 263 N.E.2d 833, 838–39 (Ill. 1970).

amounts in default.⁴⁵⁹ These state law inventions aimed to mitigate the harm from the operation of the contract for deed do not erase the GSEs' culpability when it engages in bulk sales of REO properties to investors without constraints on abusive practices.

3. Disparate Impact from Arm's Length and Make-Whole Policies

As a disproportionate number of foreclosures occur in minority neighborhoods, the same statistic emerged in the course of the applications of the Arm's Length and Make-Whole policies.⁴⁶⁰ Other practices that led to the housing crisis, including inflated property appraisals,⁴⁶¹ caused homes to become quickly underwater; the fees (e.g., discount points, brokerage fees) and high interest rates increased the cost of home ownership.⁴⁶² These practices made refinancing difficult, if not impossible.⁴⁶³ Requiring the payment of the principal balance, as opposed to the foreclosure purchase price as many states allowed, made homeowners ready victims of unfair practices for a second time and otherwise made housing unavailable.

VI. CONCLUSION

The housing crisis of 2008 was indeed momentous. The event prompted deep thinking about why it occurred and forced consideration of what went wrong, lapses in judgment or in oversight, and myopia. The GSEs and private sector investors retreated. The government intervened to bail them out of their impossible position. Thereafter, the GSEs lost sight of their historical mission to further housing and adopted a program toward asset protection. To be sure, for them to continue playing a role in housing, they needed to survive. But, the measures taken were heavy-handed and exacting for homeowners. During the Great Depression, the federal government tried to tame finance's most dangerous traits through heavy regulation aimed at safety.⁴⁶⁴ Alas, housing market participants did not heed lessons learned from that experience. Given the new mantra of self-preservation, the only recourse may be action in the legal trenches. A challenge to the GSEs' self-preservation policies under the FHA may have long odds, but such a challenge is not altogether impossible. In many respects, these policies are similar to HUD's programs that

⁴⁵⁹ *Peterson*, 707 P.2d at 235; *Rosewood Corp.*, 263 N.E.2d at 835, 838–39 (denying application of Forcible Entry and Detainer statute to purchasers under land sale contract).

⁴⁶⁰ “In 2007, almost half of African Americans who moved out of their homes did so through foreclosure rather than sale. Between 1998 and 2006, African American borrowers lost an estimated \$92 billion of wealth and equity from subprime loans, while Latino borrowers lost an estimated \$98 billion. This amounts to the greatest loss of wealth for people of color in modern U.S. history, reversing recent progress in homeownership.” Sarah Treuhart et al., *Reclaiming Foreclosed Properties for Community Benefit*, KINTERA (July 2009), http://www.kintera.org/site/c.lkIXLbMNJrE/b.5521929/k.9A4/Reclaiming_Foreclosed_Properties_for_Community_Benefit/apps/nl/newsletter2.asp.

⁴⁶¹ FIN. CRISIS INQUIRY COMM'N, *supra* note 20, at 12; Audrey G. McFarlane, *The Properties of Instability: Markets, Predation, Racialized Geography, and Property Law*, 2011 WIS. L. REV. 855, 857–58 (2011) (discussing the practice of false appraisals and its effects on minority homebuyers).

⁴⁶² Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 723, 728–29 (2013).

⁴⁶³ JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., *supra* note 413, at 30–32.

⁴⁶⁴ Lohr, *supra* note 4, at B1.

were found to violate equal protection and civil rights in *Gautreaux*. In some cases, the government agency made decisions, even if well-meaning in aim,⁴⁶⁵ that disastrously impacted a protected class of people. In *Gautreaux*, the impact was relegating certain populations based on race to undesirable areas of the city.⁴⁶⁶ The GSEs' policies employed different maintenance standards on REO properties and housing became unavailable because of the hurdles for buying back foreclosed homes.⁴⁶⁷ In both cases, the government agencies had knowledge of the harm, disparate treatment, and impacts on protected persons.⁴⁶⁸ These claims would not be precluded by federal preemption because they involve violations of law. Most concerning in all of this is the GSEs' new stance, which is unforgiving, cowering from any risk, and leaves those most in need without support.

⁴⁶⁵ See *Tex. Dep't. of Hous. & Cmty. Affairs. v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2514 (2015) (noting that the agency's purpose to encourage the construction of affordable housing in needy areas, though well-meaning, had negative impacts elsewhere, perpetuating segregated housing patterns).

⁴⁶⁶ *Gautreaux v. Chi. Hous. Auth.*, 448 F.2d 731, 732–33 (7th Cir. 1971).

⁴⁶⁷ See Stephen M. Dane et al., *Discriminatory Maintenance of REO Properties as a Violation of the Federal Fair Housing Act*, 17 CUNY L. REV. 383, 394 (2014).

⁴⁶⁸ *Gautreaux*, 448 F.2d at 739–40.