The Fair Housing Act and Religious Freedom

Michael P. Seng

Abstract

The Texas Journal on Civil Liberties & Civil Rights originally published this article in its Fall 2005 edition. Please cite this article as 11 Tex. J. on C.L. & C.R. 1 (Fall 2005). This article contains page numbers from that edition so the Texas Journal on Civil Liberties & Civil Rights may be properly cited, i.e., [*1]. Professor Seng added an addendum to the article this past summer, which follows the article.

Copyright © 2005 Texas Journal on Civil Liberties & Civil Rights
The Fair Housing Act and Religious Freedom

By

Michael P. Seng

[*1] Whenever a state or federal law touches upon the subject of religion there is the possibility of conflict with the First Amendment. The First Amendment to the United States Constitution prohibits the government from establishing religion and from interfering with the free exercise of religion.1 Both the Fair Housing Act and the 1996 Welfare Reform Act raise delicate issues relating to the establishment and free exercise of religion in the private and public housing markets.

The Fair Housing Act,2 passed by Congress after the assassination of Martin Luther King, Jr. in 1968, and amended by the Fair Housing Amendments Act of 1988, prohibits housing discrimination on the basis of religion.3 The Act makes it illegal for a housing provider, public or private, to discriminate in the sale or rental of housing or in the provision of housing services on the basis of religion.4 The Act contains a very limited exemption for religious organizations.5

The Welfare Reform Act of 1996 contains a charitable choice provision that authorizes federal and state governments to provide religious organizations with direct monetary grants for social services on the same basis as any other private organization.6 The Charitable Choice provision of the 1996 Welfare Reform Act, which was introduced in Congress by Senator John Ashcroft and signed into [*2] law by President William Clinton, began what under the George W. Bush Administration became known as the “Faith-Based Initiatives” program.7 This program allows religious organizations to participate in government subsidy programs on an equal basis with secular organizations. The Act does not specifically define a religious organization; instead, it provides that a religious organization retains “its independence from Federal, State, or local governments, including such organization’s control over the definition, development, practice, and expression of its religious beliefs.”8 It further

---

1 U.S. Const. amend. I.
2 42 U.S.C. 3601 et seq. (2000) (It also prohibits discrimination on the basis or race, color, national origin, sex, handicap, and familial status. State and local laws and ordinances sometimes expand these protected classifications.)
3 42 U.S.C. 3604.
4 Id.
5 42 U.S.C. 3607(a).
6 42 U.S.C. 604a(c).
8 42 U.S.C. 604a(d)(1).
provides that, “neither the Federal Government nor a State shall require a religious organization to - (A) alter its form of internal governance; or (B) remove religious art, icons, scripture, or other symbols... ”

Under the Act, a religious organization may not refuse to serve persons on the basis of their religion or their refusal to participate in religious practice. The Federal Fair Housing Act’s broad prohibition on religious discrimination in the sale or rental of a dwelling, or in the provision of housing services applies to housing that is faith-based. For example, the Act’s prohibition on the publication of any notices, statements, or advertisements with respect to the sale or rental of a dwelling that indicates a preference, limitation, or discrimination based on religion undoubtedly affects the way many faith-based projects can be promoted to the public.

On the other hand, the Fair Housing Act exempts dwellings owned or operated by religious organizations from some of the prohibitions in the Act.

---

9 42 U.S.C. 604a(d)(2).
10 42 U.S.C. 604a(g).
11 See generally 42 U.S.C. 3604-3606 (2000). A dwelling is defined as “any building, structure, or portion thereof which is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land which is offered for sale or lease for the construction or location thereon of any such building, structure, or portion thereof.” United States v. Hughes Memorial Home, 396 F.Supp. 544, 548-49 (W.D. Va. 1975). The definition includes congregate as well as individual dwellings. The Act clearly applies to senior housing, assisted housing, and nursing homes, as dwellings for many seniors or persons with disabilities. Hovsons, Inc. v. Township of Brick, 89 F.3d 1096, 1102 (3d Cir. 1996).

Providing safe and affordable housing for seniors is a matter of growing public policy concern, and while there are presently only a few cases that involve discrimination in senior housing, more claims will inevitably arise. The New York Times has reported that most seniors prefer to live in homes where they can be with persons of similar backgrounds and interests and that housing providers are building communities to meet these needs. Hilary Apelman, All Your Neighbors Are Just Like You, N.Y. Times, April 13, 2004, at E1. This is understandable, but it also presents greater opportunities for providers of senior housing to discriminate in violation of the Federal Fair Housing Act.

The Fair Housing Act clearly prohibits discrimination in senior housing on the basis of race, color, religion, sex, handicap, familial status or national origin in senior housing. 42 U.S.C. 3604. The exemption in the Fair Housing Act for “housing for older persons,” only allows these projects to exclude children under 18 years of age, which otherwise would be forbidden under the familial status provisions of the Act. 42 U.S.C. 3607(b)(1). Senior housing is not exempt from any of the other anti-discrimination provisions of the Act.

Many senior projects are faith-based, and therefore, questions can arise about the role of religion in these facilities. Many seniors find great solace in religion, and religion often takes a prominent role in their lives. Consequently, the right of elderly persons to the free exercise of religion is important, especially when they are disabled or otherwise in need of assistance, so that they can fulfill their religious obligations.

However, the First Amendment forbids the government from promoting religion. Whenever the government provides assistance to faith-based senior housing projects there is a concern that the government should not go too far and breach the wall of separation between church and state.
Thus, the Act attempts to walk the delicate boundary between not favoring religion and not disadvantaging religion.

Early in his presidency, George W. Bush attempted to expand the application of the Charitable Choice provisions of the Act. Although he was unsuccessful with Congress, President Bush published a series of executive orders that expanded Faith-Based Initiatives. Traditionally government funding had been available to groups, such as Catholic Charities, that operated as independent Section 501(c)(3) organizations. The Charitable Choice provisions of the Act and the Bush executive orders generally make government funds more available to faith-based religious organizations, and consequently they raise important concerns under the Establishment Clause of the First Amendment.

The 1996 Act did not apply directly to federal housing programs, and an attempt to extend the Charitable Choice provisions to housing assistance was defeated in 2001. However, in 2004 the Federal Department of Housing and Urban Development (HUD) adopted regulations to implement the President’s Faith-Based Initiatives in all HUD programs. The regulations make possible equal participation of religious organizations in HUD programs and activities by prohibiting discrimination against an organization on the basis of the organization’s religious character or affiliation. The regulations prohibit the organization from engaging in “inherently religious activities” when participating in any activities funded by HUD. “Inherently religious activities” include worship, religious instruction, or proselytism. This prohibition is tempered by the qualification that these “inherently religious activities” may be offered separately, “in time or location,” from the programs, activities, or services supported by HUD funds, and participation in these activities must be voluntary for the beneficiaries of the program.

HUD regulations, like all administrative actions, must comply with federal legislative and constitutional mandates; thus, the HUD regulations regarding

---

14 See, Community Solutions Act, H.R. 7, 107th Cong. 201(c)(4) (2001).
16 David M. Ackerman, Public Aid to Faith-Based Organizations (Charitable Choice) in the 107th Congress: Background and Selected Legal Issues, Congressional Research Service Report for Congress, order code RL31043, at 7 (Aug. 19, 2003).
18 H.R. 7.
20 Id.
21 24 C.F.R. 5.109(c).
22 Id.
23 Id.
Faith-Based Initiatives specifically provide that an organization’s participation in HUD programs and activities must comply with applicable federal fair housing and nondiscrimination requirements.\textsuperscript{24} Furthermore, in administering HUD programs, the Secretary (as well as all other executive departments and agencies) has a Congressional mandate under the Fair Housing Act “affirmatively to further” fair housing.\textsuperscript{25}

As drafted, neither the Fair Housing Act nor the Faith-Based Initiatives Program appears to violate the First Amendment. However, both statutes require careful application so as not to disrupt the careful balance required by the First Amendment.

I. The Fair Housing Act

A. Religion as a Protected Class

Religion is a protected class under the Fair Housing Act, and housing providers are prohibited from discriminating on the basis of religion with regard to any housing units covered by the Act.\textsuperscript{26}

Remarkably, the United States Supreme Court has stated that it does not believe there has been a recent history of pervasive religious discrimination proven by the States.\textsuperscript{27} Regardless of the [*5] validity of this assertion, there is no challenge under the Fair Housing Act.

\textsuperscript{24} Supra note 21 at 41,713.

\textsuperscript{25} 42 U.S.C. 3608(e) (2000). The Eight Circuit Court of Appeals has held that the duty “affirmatively to further” fair housing means that the HUD Secretary, when administering programs, has “an obligation to assess negatively those aspects of a proposed course of action that would further limit the supply of genuinely open housing and to assess positively those aspects of a proposed course of action that would increase that supply.” Darst-Webbe Tenant Assoc. v. St. Louis Housing Authority, 339 F.3d 702, 713 (8th Cir. 2003). See also Dean v. Martinez, 336 F.Supp.2d 477 (D. Md. 2004).

\textsuperscript{26} 42 U.S.C. 3604.

\textsuperscript{27} See City of Boerne v. Flores, 521 U.S. 507, 530-32 (1997) (held that the Religious Freedom Restoration Act was unconstitutional as applied to the states under section 5 of the Fourteenth Amendment, finding that Congress did not have sufficient evidence of recent instances of state discrimination on the basis of religious practice). It is doubtful that this reasoning would prevail in an attack against the Fair Housing Act, which is grounded on both section 5 and the Commerce Clause and applies to private action as well as public action.

No challenges based on Boerne have been made to the prohibition of religious discrimination under the Fair Housing Act. However, in Groome Resources Ltd. v. Parish of Jefferson, 234 F.3d 192, 205-16 (5th Cir. 2000), the Court of Appeals held that Congress had the power to eliminate handicap discrimination under the Fair Housing Act, and in Seniors Civil Liberties Ass’n v. Kemp, 965 F.2d 1030, 1034 (11th Cir. 1992), the Court of Appeals held that Congress had the power to eliminate familial status discrimination. Both cases found that housing discrimination, on the basis of familial status and handicap, has a substantial effect on commerce. Groome Resources Ltd., 234 F.3d at 207-08; Seniors Civil Liberties Ass’n, 965 F.2d at 1034. The same reasoning could be applied to religious discrimination as well.

The legislative history of the 1968 Fair Housing Act is not helpful in construing the provisions prohibiting religious discrimination. See Jean Eberhart Dubofsky, Fair Housing: A Legislative
question that there is a long history of religious discrimination in the private housing market. The most notable example was the prevalence of restrictive covenants in certain residential areas against Jewish people. Though prevalent, religious discrimination has not generated a large number of cases under the Fair Housing Act. However, such cases may arise in the future. The terrorist attacks of September 11, 2001, and the resulting “War on Terrorism” have focused attention on Arab-Americans and Muslims and could realistically result in increased housing discrimination against these persons because of their religion.

Because religious affiliation is a protected class, requiring a religious test to occupy a housing unit would violate the Fair Housing Act. Unless the dwelling is exempt from the Act, a religious organization cannot treat members of its faith preferentially, just as a white housing provider cannot favor a white applicant, or a Chinese American cannot favor another Chinese American. The Act may also be violated if there is discrimination in the terms or conditions of occupancy or in the provision of services or facilities. Inquiring about someone’s religion under circumstances where it appears that religion may be relevant to the occupancy of the unit or the nature of the services available may similarly violate the Act.

In LeBlanc-Sternberg v. Fletcher, a municipal zoning ordinance forbade private homes from being used to conduct religious services. Orthodox Jews claimed that the law discriminated against them and that the law was enacted, at

---


28 See, TO SECURE THESE RIGHTS - THE REPORT OF THE PRESIDENT’S COMMITTEE ON CIVIL RIGHTS, 68-69 (1947). Judicial enforcement of these covenants that discriminate in violation of the 14th Amendment was prohibited by the United States Supreme Court in Shelley v. Kraemer, 334 U.S. 1 (1948).

29 Part of this may be because discrimination against Jews and Muslims and other religious groups is often characterized as “racial” or “national origin” discrimination under the civil rights laws. See Shaare Tefila Congregation v. Cobb, 481 U.S. 615 (1987) (discrimination against Jews is a form of racial discrimination under the Civil Rights Act of 1866); Saint Francis College v. Al-Khazraji, 481 U.S. 604 (1987) (discrimination against Arabs is a form of racial discrimination under the Civil Rights Act of 1866). However, religious discrimination as such will not violate the Civil Rights Act of 1866. In Bachman v. St. Monica’s Congregation, 902 F.2d 1259, 1261-62 (7th Cir. 1990), the Court of Appeals held that discrimination against non-Catholics was not, in and of itself, discrimination on the basis of race even though a Jewish couple was denied the housing.

30 See generally 42 U.S.C. 3604.

31 Id. at § 3604 (b).

32 But see Knutzen v. Eben Ezer Lutheran Hous. Center, 617 F. Supp. 977, 984 (D. Colo. 1985), aff’d, 815 F.2d 1343 (10th Cir. 1987), which held that inquiries about religious affiliation were simply to allow the housing provider to notify the tenant’s clergyman in case of an emergency and not for purposes of discriminating in the admissions process. However, a landlord is obviously on slippery ground when asking such questions.

33 67 F.3d 412 (2d Cir. 1995).
least in part, to keep them out of the village. On appeal, the Court held that the evidence and the law supported a jury verdict against the village. This case supports the argument that a rule that discriminates on the basis of religion because it purposefully singles out religion for special treatment is illegal. LeBlanc-Sternberg also supports an argument that facially neutral rules that have a disparate impact upon those who want to practice their religion would be illegal under the Fair Housing Act unless the housing provider could justify it with some religiously neutral reason, regardless of whether a reasonable accommodation for religious practices is required.

[*7] A rule that required housing residents to attend religious services appears to directly affect the terms and conditions of occupancy in violation of section 3604(b). While there are no reported cases on point, sometimes such rules of dubious legality have been imposed by providers of homeless shelters. The new HUD regulations concerning faith-based organizations forbid recipients of federal moneys from requiring residents to participate in these programs.

If a housing provider serves meals, must the provider accommodate the special dietary needs imposed by a particular resident’s religious practices? It can be argued that this is a service that is provided to residents as part of the housing and that the effect of the non-accommodation is to send a message that persons of...

34 Id. at 416.
35 Id. The Leblanc decision raises a number of questions. For instance, the Court of Appeals mentions that religious discrimination can be established either by showing a discriminatory intent or a discriminatory impact. See generally, Fletcher, 67 F.3d at 426. Under the facts of the case, there was probably more than enough evidence for the jury to find a discriminatory intent. A finding that an ordinance is illegal on an intent theory is obviously much easier to sustain on an appeal than a finding that it is illegal under an impact theory. See Simms v. First Gibraltar Bank, 83 F.3d 1546, 1555 (5th Cir. 1996) (impact must be established by a policy or practice and not by a mere incidence of discrimination). Also, the Village had previously allowed home worship and then passed an ordinance against it. How much that sequence of events may have influenced the jury is not disclosed.
36 Id. See also Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah, 508 U.S. 520, 534-40 (1993) (holding that an ordinance that prohibited animal sacrifices was not neutral because it prohibited only slaughtering for the purpose of religious practices).
37 See discussion of reasonable accommodations infra Part I D.
38 Although the Supreme Court has not decided the issue, lower courts have held that policies or practices that have a disparate impact against a protected class may violate the Fair Housing Act. See, e.g., United States v. City of Black Jack, 508 F.2d 1179, 1185 (8th Cir. 1974), cert. denied, 422 U.S. 1042 (1975); Metropolitan Housing Development Corp. v. Village of Arlington Heights, 558 F.2d 1283, 1288 (7th Cir. 1977), cert. denied, 434 U.S. 1025 (1978); Huntington Branch, NAACP v. Town of Huntington, 844 F.2d 926, 934 (2d Cir. 1988), aff’d per curiam, 488 U.S. 15 (1988). While continuing to adhere to the disparate impact standard, the Court of Appeals for the Seventh Circuit has questioned whether the standard is appropriate in a racial steering case, Village of Bellwood v. Dwivedi, 895 F.2d 1521, 1529 (7th Cir. 1990), and, without deciding the question, in insurance redlining cases. NAACP v. American Family Mutual Insurance Co., 978 F.2d 287, 291 (7th Cir. 1992), cert. denied, 508 U.S. 907 (1993).
39 See, e.g., Woods v. Foster, 884 F. Supp. 1169, 1173 (N.D. Ill. 1995) (homeless shelter for battered women who are looking for permanent housing is a dwelling).
40 See, 24 C.F.R. 5.109(c).
different religions are not welcome. The housing provider would argue that it treats everyone the same and has no independent responsibility to accommodate the needs of each resident by serving meals. Nonetheless, by volunteering to serve meals, the housing provider offers a service that is covered under the Fair Housing Act.

Questions can arise about the right of residents to display religious symbols. Obviously a rule that specifically prohibited the display of religious pictures or icons would discriminate on the basis of religion and violate the Fair Housing Act. However, a rule of general applicability that was passed in response to specific complaints about the display of religious symbols or under circumstances where the only symbols displayed were religious, should also be found to discriminate on the basis of religion. For example, if a condominium association pass a rule prohibiting the display of signs or symbols of any kind and a resident desires to display a mezuzah, which is required by Jewish custom, the rule [*8] should be illegal under the reasoning of LeBlanc-Sternberg if there is no independent religiously neutral reason that would justify the rule.

Additionally, religion is a protected classification for a person that is “institutionalized” in state housing, such as a senior who resides in a nursing home or care center, under the Religious Land Use and Institutionalized Persons Act of 2000 (RLUIPA). RLUIPA adopts the definition of “institution” used in the Civil Rights of Institutionalized Persons Act. The Civil Rights of Institutionalized Persons Act defines the term “institution” to mean:

“any facility or institution - (A) which is owned, operated, or managed by, or provides services on behalf of any State or political subdivision of a State; and (B) which is - (i) for persons who are mentally ill, disabled, or retarded, or chronically ill or handicapped

41 In HUD v. Hous. Auth. of the City of Reno, 2A Fair Hous.-Fair Lending (Aspen) 26,286 (H.U.D. A.L.J. June 19, 2002), a HUD Administrative Law Judge held that a housing authority was not required to accommodate a disabled tenant by considering his purchase of restaurant meals as a medical expense in calculating his rental contribution. The tenant argued that it was dangerous for him to cook and therefore he had to eat all his meals outside the unit. Id. at 26,287-88. This case involved a request to pay for meals outside the housing complex and does not involve a housing provider that offers meals as part of the housing “package.” Id. at 26,288-89. The judge found that a reasonable accommodation was not necessary to afford him an equal opportunity to use and enjoy his apartment. Id. at 26,291-93.
42 42 U.S.C. 3604(b).
43 See Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah, 508 U.S. 520, 534-40 (1993) (the Court invalidated a city ordinance that specifically targeted a religious practice under the First Amendment. The Fair Housing Act would similarly invalidate a private housing rule that was neither “neutral” nor “of general applicability”).
... or (v) providing skilled nursing, intermediate or long-term care, or custodial or residential care.”

Whether residents of a state-run nursing home or care facility are considered “institutionalized” under the RLUIPA, so that they can seek the higher level of protection, will largely depend upon whether the facts satisfy the definition.

B. Advertising and Section 3604(c)

Section 3604(c) makes it unlawful:
to make, print, or publish, or cause to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on race, color, religion, sex, [*9] handicap, familial status, or national origin or an intention to make such preference, limitation or discrimination.”

HUD has adopted a nuanced approach to the application of this section.

Many faith-based housing complexes are religiously owned or sponsored and convey that sponsorship in their names: The Lutheran Home for the Aged, the Masonic Home, or Saint Anne’s Hospice. Many people might assume that the names of these homes, even though the homes may be open to all, nominally indicate a preference for persons of that faith or creed. HUD’s new Faith-Based Initiatives directive specifically provides that religiously affiliated organizations that receive federal funding may retain religious terms in their organization’s name and in their mission statements and other governing documents.

However, under the Fair Housing Act, advertising should not contain an explicit preference, limitation, or discrimination because of religion. For example, a real estate company’s excessive use of Christian images and slogans in

47 42 U.S.C.1997(1). “Privately owned and operated facilities are not deemed ‘institutions’ if –
“(A) the licensing of such facility by the State constitutes the sole nexus between such facility and such State; (B) the receipt by such facility, on behalf of persons residing in such facility, of payments under title XVI, XVIII, or under a State plan approved under title XIX, of the Social Security Act [42 U.S.C.A. 1381 et seq., 1395 et seq., or 1396 et seq.], constitutes the sole nexus between such facility and such State; or (C) the licensing of such facility by the State, and the receipt by such facility, on behalf of persons residing in such facility, of payments under title XVI, XVIII, or under a state plan approved under title XIX, of the Social Security Act [42 U.S.C.A. 1381 et seq., 1395 et seq., or 1396 et seq.], constitutes the sole nexus between such facility and such State.” 42 U.S.C. 1997(2).
48 42 U.S.C. 3604(c).
49 5 C.F.R. 5.109(d).
50 Supra note 42.
its real estate advertising may convey a message of exclusion.\textsuperscript{51} HUD has advised that advertising containing a religious reference or symbol will not automatically violate 3604(c), if it is accompanied by a disclaimer that the home is open to all without discrimination.\textsuperscript{52} Also, advertisements that state that the complex contains a chapel or that kosher meals are available do not on their face discriminate or violate the Act.\textsuperscript{53} Regardless of whether these distinctions made by HUD make sense in light of the overall policies of the Fair Housing Act, there can be no doubt that they reflect current practices in the market place; and it is unlikely that a court would find that HUD was acting unreasonably in refusing to find that such practices violate the Fair Housing Act.

The display of religious symbols by faith-based organizations may present special problems under the Fair Housing Act. The new HUD faith-based initiatives directive specifically states that religious organizations need not remove religious art, icons, scriptures or other religious symbols from spaces where services are provided using HUD funding.\textsuperscript{54} Having a crucifix or a Star of David in the lobby or a picture of the Last Supper in the dining room would not seem in and of itself to send an exclusionary message. However, whether such symbols violate the Fair Housing Act will depend upon the total context of the display and the effect that the display would have on the average person.\textsuperscript{55} If the symbols are pervasive and would make a reasonable person of a different religion feel unwanted or uncomfortable, they may act as a deterrent to persons who are not of the same faith and could, in these circumstances, violate the Fair Housing Act.

\textbf{C. The Exemptions}

The Fair Housing Act attempts to accommodate religious bodies by giving them a limited exemption. Section 3607(a) states:

“Nothing in this title shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same

\textsuperscript{51} See, Lotz Realty Co. v. U.S. Dept. of Justice, 717 F.2d 929, 930 (4th Cir. 1983).
\textsuperscript{52} See, Achtenberg, FHEO Guidance Regarding Advertisements under Section 804(c) of the Fair Housing Act, 1 Fair Hous.-Fair Lending (Aspen) 5365, 5366 (Fair Hous. and Equal Opportunity Jan. 9, 1995).
\textsuperscript{53} Id.
\textsuperscript{54} 5 C.F.R. 5.109(d).
\textsuperscript{55} See Ragin v. The New York Times Co., 923 F.2d 995, 1000 (2d Cir. 1991) (human model advertisements that would convey a preference to the ordinary observer violate the Fair Housing Act).
religion, or from giving preference to such persons, unless membership in such religion is restricted on account of race, color, or national origin.”

There are very few reported cases where this exemption has been raised. As with any exception to a general regulatory scheme, Congress intended that the exemption be read narrowly in light of the overreaching purpose of the Act to prohibit discrimination against protected classes. The language of the exemption is also narrow. It applies to the “sale, rental, or occupancy of dwellings” or giving “preference” to persons of the same religion. By its terms, it does not cover other practices prohibited by the Fair Housing Act.

Section 3607(a) does not apply to properties owned and operated by religious organizations, associations or societies for commercial purposes. This limitation on the exemption makes it inapplicable to many religiously owned or operated properties because most housing owned or operated by religious organizations will be operated for a commercial purpose. The Act does not define what a commercial purpose is. Clearly a church can restrict who occupies a rectory or manse or allow only nuns or monks to reside in a convent or monastery. However, once a religious organization decides to sell or rent homes to lay persons, it must not restrict the sales or leases only to members of the religion of the organization.

The religious exemption will not apply if there is discrimination on the basis of race, color, or national origin. This limitation is in accordance with the government’s compelling interest in eliminating discrimination. In United States v. Hughes Memorial Home, a private home for children was held not to be exempt under the Act because it discriminated on the basis of race, and not religion. The exemption does not explicitly refer to discrimination on the basis of sex, handicap, or familial status. Therefore, a question could be raised whether religious organizations can discriminate on a basis other than race, color, or national origin. However, section 3607(a) only exempts religious organizations’ preferential treatment of members of their religion. It does not exempt religious organizations that discriminate on a basis other than religion. Because the Fair Housing Act prohibits discrimination based on sex, handicap, or familial status generally, because exemptions are to be narrowly construed, and because

---

56 42 U.S.C. 3607(a).
57 United States v. Columbus Country Club, 915 F.2d 877, 882 (3d Cir. 1990). The legislative history is not helpful in interpreting the religious exemption to the Fair Housing Act.
58 42 U.S.C. 3607(a).
59 Id.
62 Id.
63 42 U.S.C. 3604.
64 Supra note 61 at 882.
Congress has not articulated a sound policy reason that would allow religious organizations to discriminate on the basis of sex, handicap or familial status, this type of discrimination by religious organizations should be illegal under the Act.

The leading case addressing the question of what constitutes a “religious organization” under section 3607(a) is United States v. Columbus Country Club. The Knights of Columbus, a Roman Catholic organization, formed the Columbus Country Club as a not-for-profit organization in 1920, but no longer had any legal relationship with it. The Club maintained summer homes on a 23-acre tract on the Delaware River. Members of the Club were required to be Roman Catholics and to be recommended by their parish priest. Although the Club had no formal affiliation with the Roman Catholic Church, weekly celebration of the mass was conducted on the Club property and some members of the Club gathered at the Chapel every evening to say the rosary. A statue of the Virgin Mary was located near the entrance to the Club.

The District Court found and the parties agreed that the Club itself was not a “religious organization,” but the Club maintained that it was “operated, supervised or controlled by or in conjunction with” a religious organization. The Court of Appeals held that the Church’s grant of the privilege of having weekly mass on the Club grounds and its tacit approval of the recital of the rosary was not sufficient to show that it was operated in conjunction with a religious organization. The appellate court defined “operated in conjunction with” to require:

[A] mutual relationship between the non-profit society and a religious organization. The existence of this relationship cannot depend solely on the activities of the non-profit organization nor be viewed only from its perspective. Indeed, evidence of the club’s unilateral activities would go to whether it is itself a religious organization not to whether it is operated “in conjunction with” a religious organization. Furthermore, the Church’s ability to withdraw permission to hold mass and the fact that on one occasion it may have indirectly influenced the club’s Board of Governors by threatening to do so are not enough. Without further evidence of interaction or involvement by the Church, we cannot conclude that as a matter of law, the Church controlled the

---

66 Id. at 878-79.
67 Id. at 879.
68 Id.
69 Id.
70 Id.
71 Id. at 882.
72 Id.
73 Id. at 883.
defendant or that the defendant was operated “in conjunction with” the Church. Consequently, on this record and in light of our unwillingness to read the statutory exemption broadly, we hold that the defendant failed to carry its burden of proving its entitlement of the religious organization exemption.\textsuperscript{74}

The Court of Appeals used a parochial school as an example of what might be considered an affiliated organization\textsuperscript{75}, citing [*13] comments of Senator Walter Mondale, the Fair Housing Act’s chief sponsor:

\textsuperscript{74} Id.

\textsuperscript{75} Id. at 882. The exemption for religious organizations under Title VII is somewhat narrower than the exemption under the Fair Housing Act. 42 U.S.C. 2000e-1(a) (2002) provides that: “This subsection shall not apply ... to a religious corporation, association, educational institution, or society with respect to the employment of individuals of a particular religion to perform work connected with the carrying on by such corporation, association, educational institution, or society of its activities.”

Many of the cases interpreting section 2000e-1 involve schools. In \textit{Killinger v. Samford University}, 113 F.3d 196, 199 (11th Cir. 1997), a university was allowed to claim the exemption because it was controlled in substantial part by and received over $4 million annually from the state Baptist Convention. This amount was 7% of the University’s budget and was the largest single source of its funding. Similarly, in \textit{Hall v. Baptist Health Care Corp.}, 215 F.3d 618, 624-25 (6th Cir. 2000), a nursing school was found to be covered by the exemption because it was founded by a sectarian organization, had a religious mission, and was closely associated with the Arkansas, Mississippi, and Tennessee Baptist Conventions and their affiliated churches. In \textit{EEOC v. Kamehameha Schools}, 990 F.2d 458, 461 n.7 (9th Cir. 1993), the Court found that a school was not exempt on the basis of religion because the school was primarily secular. The Court observed:

“The Schools maintain a cooperative relationship with the Bishop Memorial Church, which receives financial support from the Bishop Estate and is a member of the Hawaii Conference of the United Church of Christ. However the Schools themselves are not affiliated with the Church of Christ, and the parties stipulated that no Protestant denomination, including the Church of Christ, ‘owns, supports, controls or manages, in whole or in part, the Bishop Estate or the Kamehameha Schools.’

“In view of the narrow reach of the section 2000e-1 exemption, it is not surprising that we have found no case holding the exemption to be applicable where the institution was not wholly or partially owned by a church...”

In \textit{Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos}, 483 U.S. 327, 330 (1987), where the Supreme Court held that the exemption did not violate the Establishment Clause of the First Amendment, the school in question was a nonprofit facility, open to the public, run by the Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-day Saints and the Corporation of the President of the Church of Jesus Christ of Latter-day Saints, both of which were religious entities associated with the Church, an unincorporated religious association.

The Courts have been somewhat more relaxed in applying the National Labor Relations Act. In \textit{NLRB v. Bishop Ford Central Catholic High School}, 623 F.2d 818, 823 (2d Cir. 1980), the Court held that a religious mission was sufficient to justify preference of co-religionists even though the school was no longer affiliated with a religious organization.
There is an exemption to permit religious institutions or schools, etc., affiliated with them, to give preference in housing to persons of their own religion despite the Act.’ 114 Cong. Rec. 2273 (Feb. 6, 1968) (emphasis added). 76

A dissenting opinion by Judge Mansmann argued that the majority had unduly minimized the significant connections between the Columbus Country Club and the Catholic Church. 77 He argued that a formal relationship was not required under a literal reading of the statutory language. 78 He saw the religious dimension of the Club as substantial and not as mere subterfuge to evade the requirements [*14] of the Fair Housing Act. 79 He feared that subjecting the Club to the Fair Housing Act would “destroy its character as a religious community where like-minded individuals are able to support one another, communally express their beliefs and model their values to their children.” 80 Undoubtedly, the majority in Columbus Country Club read section 3607(a) very narrowly, but in light of the fact that the purpose of the Act is to eliminate religious discrimination, the Court’s decision would appear to be correct.

United States v. Lorantffy Care Center 81 presented a more difficult question concerning the definition of a “religious organization” however, the Court found it unnecessary to provide an answer. The case concerned a church-established care center for elderly immigrants from Hungary. 82 The care facility was found to have violated the Fair Housing Act because it discriminated on the basis of race and national origin and, therefore, could not claim the exemption under the Fair Housing Act. 83 Even if there had been no record of racial discrimination, it is doubtful that the Lorantffy Care Center would have qualified as a religious organization. A minister with the support of his church’s council and congregation established the Center as an independent legal entity. 84 The Church’s members gave money to the Center, and the Church and the Center shared facilities and personnel. 85 Church members were given priority to the facility, and there was an agreement that if the Center were to cease operations, all its assets were to go to the Church. 86 Nonetheless, residents paid for their housing

76 Columbus Country Club, 915 F.2d at 882.
77 Id. at 885.
78 Id.
79 Id. at 888.
80 Id. However, the defendants were unable to make a persuasive argument on remand that opening the housing to outsiders adversely affected the practice of their religion in any way. See United States v. Columbus Country Club, No. 87-8164, 1992 U.S. Dist. LEXIS 16438 (E.D. Pa. Oct. 22, 1992).
82 Id. at 1040.
83 Id. at 1044.
84 Id. at 1040.
85 Id.
86 Id. at 1040-41.
as they would in any commercial venture, and it was not readily apparent that removing the discriminatory requirements that gave preference to Church members would negatively impact anyone’s practice of religion.  

Similarly, in *Bachman v. St. Monica’s Congregation*, a suit was filed for racial discrimination under the 1866 Civil Rights Act. The Church sold the house to a Catholic couple not from the [\*15] parish. A Jewish couple unsuccessfully claimed discrimination on the basis of race. The Court stated that it was an open question whether, had the case been filed for religious discrimination under the Fair Housing Act, the property would have been entitled to the 3607(a) exemption. However, given the commercial nature of the transaction and the fact that it was an outright sale, one would not have expected the defendants to prevail had they raised this issue.

Based on these precedents, it appears that most housing operated by religious organizations will not be able to claim the religious exemption in 3607(a). The housing itself will not be a “religious organization.” And because usually the housing will have only loose ties to a church, it will not be able to show that it is operated “in conjunction” with a religious organization.

**D. No Duty to Provide a Reasonable Accommodation for Religion**

The Fair Housing Act requires housing providers to make reasonable accommodations for persons with disabilities. No similar requirement exists for persons with religious needs. Thus, a faith-based complex that serves meals but does not meet the religious requirements of a tenant, or institutes a neutral rule that prohibits the consumption of alcohol on the premises and is interpreted to preclude the use of wine at a Catholic mass on the premises, would not have to yield to accommodate the religious beliefs or practices of tenants, unless there is

---

87 *See generally, Id. at 1041.*
88 902 F.2d 1259 (7th Cir. 1990).
89 *Id.* at 1260.
90 *Id.*
91 *Id.* at 1261.
93 In this respect, the Fair Housing Act differs from Title VII, which was amended in 1972 to provide:

“The term ‘religion’ includes all aspects of religious observance and practice, as well as belief, unless an employer demonstrates that he is unable to reasonably accommodate to an employee’s or prospective employee’s religious observance or practice without undue hardship on the conduct of the employer’s business.” 42 U.S.C. 2000e(j) (2000).

In *EEOC v. Townley Eng’g and Mfg. Co.*, 859 F.2d 610, 618 (9th Cir. 1988), the Court of Appeals held that an employer must excuse employees from devotional services held once a week during work hours under 42 U.S.C. 2000e(j).
independent proof of discrimination on the basis of religion in the provision of these services.\footnote{See Hack v. President and Fellows of Yale College, 16 F. Supp. 2d 183 (D. Conn. 1998), aff’d, 237 F.3d 81 (2d Cir. 2000) (college had no duty under the Fair Housing Act to accommodate the religious beliefs of students who objected to living in co-educational dorms). In his partial dissent in the Court of Appeals, Judge Moran distinguished the Fair Housing Act from Title VII which requires employers to accommodate the religious practices of their employees and the 1988 Amendments to the Fair Housing Act that requires housing providers to accommodate the needs of persons with disabilities. 237 F.3d at 103-04. Nonetheless, Judge Moran unsuccessfully argued that even though there was no duty to accommodate religion, the Orthodox Jewish students had stated a cause of action because the facially neutral Yale policy that required undergraduate students to live in co-educational residence halls had a discriminatory impact on their religion. Id. at 92. The majority opinion rejected the impact argument on the ground that the students had made no claim that the Yale policy would result in the under-representation of Orthodox Jews in Yale housing. 237 F.3d at 90-91. The majority opinion also made the dubious observation that because the students were seeking exclusion from housing and not inclusion, they did not state a claim under the Fair Housing Act. 237 F.3d at 90.}

\footnote{The Fair Housing Act broadly defines the term handicap. 42 U.S.C. 3602(h). “Handicap” means a person who:
1. has “a physical or mental impairment which substantially limits one or more of such person’s major life activities”;  
2. has “a record of having such an impairment”; or  
3. is “regarded as having such an impairment.”

The Act not only covers persons with disabilities but also anyone associated with them, such as family members or caregivers. 42 U.S.C. 3604(f)(1)(C).

The Act does allow a housing provider to deny a unit to any person whose tenancy would pose a “direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others.” 42 U.S.C. 3604(f)(9). However, a “direct threat” must be established by “objective evidence of overt acts that caused harm, or acts which directly threaten harm.” Wirtz Realty Corp. v. Freund, 721 N.E.2d 589, 597 (Ill. App. Ct. 1999). \textit{But see}, Key Youth Servs. v. City of Olathe, 248 F.3d 1267, 1276 (10th Cir. 2001) (holding that the denial of a special use permit to a group home for troubled youth where some of the youth suffered from mental impairments did not give rise to a fair housing violation where it was shown that the city denied the request because of public safety concerns).

The same definition is contained in the 1973 Rehabilitation Act, 29 U.S.C. 705(8)(B), and in the Americans with Disabilities Act, 42 U.S.C. 12102(2).

In employment cases, the Supreme Court has held that a person whose impairment can be corrected by medication or corrective devices is not handicapped. Sutton v. United Airlines, 527 U.S. 471, 482-83 (1999) (ADA); Murphy v. United Parcel Serv., 527 U.S. 516, 521 (1999) (ADA). These cases also hold that a disability must have a major impact on the person’s ability to perform activities that are of “central importance to daily life.” These cases have not been of concern in most housing discrimination cases. Almost by definition, if a person with a disability needs an accommodation to use or enjoy housing, the impact of the disability on the person would necessarily be of “central importance” to that person’s daily life. The impairment must also be permanent or long-term. Toyota Motor Mfg., KY v. Williams, 534 U.S. 184, 198 (2002).}

Nonetheless, if the request for a reasonable accommodation were related to the special needs of disabled persons\footnote{The Fair Housing Act broadly defines the term handicap. 42 U.S.C. 3602(h). “Handicap” means a person who:
1. has “a physical or mental impairment which substantially limits one or more of such person’s major life activities”;  
2. has “a record of having such an impairment”; or  
3. is “regarded as having such an impairment.”

The Act not only covers persons with disabilities but also anyone associated with them, such as family members or caregivers. 42 U.S.C. 3604(f)(1)(C).

The Act does allow a housing provider to deny a unit to any person whose tenancy would pose a “direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others.” 42 U.S.C. 3604(f)(9). However, a “direct threat” must be established by “objective evidence of overt acts that caused harm, or acts which directly threaten harm.” Wirtz Realty Corp. v. Freund, 721 N.E.2d 589, 597 (Ill. App. Ct. 1999). \textit{But see}, Key Youth Servs. v. City of Olathe, 248 F.3d 1267, 1276 (10th Cir. 2001) (holding that the denial of a special use permit to a group home for troubled youth where some of the youth suffered from mental impairments did not give rise to a fair housing violation where it was shown that the city denied the request because of public safety concerns).

The same definition is contained in the 1973 Rehabilitation Act, 29 U.S.C. 705(8)(B), and in the Americans with Disabilities Act, 42 U.S.C. 12102(2).

In employment cases, the Supreme Court has held that a person whose impairment can be corrected by medication or corrective devices is not handicapped. Sutton v. United Airlines, 527 U.S. 471, 482-83 (1999) (ADA); Murphy v. United Parcel Serv., 527 U.S. 516, 521 (1999) (ADA). These cases also hold that a disability must have a major impact on the person’s ability to perform activities that are of “central importance to daily life.” These cases have not been of concern in most housing discrimination cases. Almost by definition, if a person with a disability needs an accommodation to use or enjoy housing, the impact of the disability on the person would necessarily be of “central importance” to that person’s daily life. The impairment must also be permanent or long-term. Toyota Motor Mfg., KY v. Williams, 534 U.S. 184, 198 (2002).} in the complex, a discrimination claim should be successful if the accommodation does not pose an undue cost or
administrative burden and is necessary for the person to use or enjoy the dwelling and not merely a preference.96

Thus if a person with a disability needs to be accommodated by having a ramp built to a Chapel in the complex, has a dietary need associated with her disability, or cannot attend regular church services and needs to hold a religious service in her unit, a housing provider cannot refuse this request without establishing that it would be administratively or financially burdensome.97

[*17] These requirements are not meant to accommodate the religious needs of the tenant or unit owner but to accommodate that person’s disability so that the person can enjoy equal access to the unit and the services connected with it.98

II. The First Amendment

Section 3601 of the Fair Housing Act specifically provides that the Act must be read in conformity with the Constitution.99 Therefore, all clauses in the Fair Housing Act must conform to the requirements of the First Amendment.100

97 See United States v. Cal. Mobile Home Park, 29 F.3d 1413 (9th Cir. 1994) (landlord must waive overnight guest fee to accommodate the needs of a disabled resident who needed a care giver to sleep over); Shapiro v. Cadman Towers, 51 F.3d 328 (2d Cir. 1995) (condo association must move a disabled tenant to the head of the list for a parking space needed to accommodate the tenant’s disability); Green v. Housing Authority of Clackamas County, 994 F. Supp. 1253 (D. Ore. 1998) (management must waive “no pet” policy to accommodate a person with a disability); Giebeler v. M & B Associates, 343 F.3d 1143 (9th Cir. 2003) (apartment owner must accommodate a tenant’s disability by allowing a cosigner on the lease). In HUD v. Ocean Sands, Inc., 2A Fair Hous.-Fair Lending (Aspen) 25,530 (H.U.D. A.L.J. Sept. 3, 1993), a housing provider was found liable for refusing to allow a disabled resident to install a wheelchair lift and walkways and make other minor changes in a unit.
98 Under the Fair Housing Act, municipalities cannot directly discriminate against group homes for persons with disabilities. E.g., Alliance for Mentally Ill v. Naperville, 923 F. Supp. 1057, 1078 (N.D. Ill. 1996) (A municipality cannot impose fire code provisions aimed specifically at homes for persons with disabilities if there are no special needs that justify treating these homes differently.) Municipalities may also have an affirmative duty to accommodate homes for persons with disabilities when they are being excluded because of zoning or other land use requirements. E.g., Hovsons, Inc. v. Township of Brick, 89 F.3d 1096 (3d Cir. 1996) (nursing home given zoning variance to locate in residential area); Smith & Lee Assocs. v. Taylor, 102 F.3d 781 (6th Cir. 1996) (group home for elderly disabled persons could expand facility from six to twelve residents over city’s objection that expansion was inconsistent with single family character of neighborhood); Oconomowoc Residential Programs Inc. v. City of Milwaukee, 300 F.3d 775 (7th Cir. 2002) (group home for developmentally disabled adults allowed a variance from an ordinance restricting group homes from operating within 2,500 feet of another community living arrangement); Tsombanidis v. West Haven Fire Department, 352 F.3d 565 (2d Cir. 2003) (group home for recovering alcoholics could operate in a single family neighborhood).
100 The First Amendment, which protects the free exercise of religion, only applies if there is governmental action. Therefore, while the Fair Housing Act itself must be read in accordance with the Constitution, the acts of private housing providers will not normally violate the First
A. Burdening the Free Exercise of Religion

1. Accommodating the Religious Practices of Residents

Government interference with the free exercise of religion violates the First Amendment. The HUD directive on Faith-Based Initiatives provides that religiously affiliated organizations are eligible to receive funding in their programs so long as the funds are not used for “inherently religious activities,” such as worship, religious instruction, or proselytism.

Under this rule, inherently religious activities must be offered separately, in time or location, from the programs, activities, or services supported by direct HUD funds and participation must be voluntary by the beneficiaries of the programs. The term “time or location” is left undefined, but the HUD comments specify that HUD believes separation on the basis of time and location is legally unnecessary and would impose a harsh burden on small faith-based organizations. Nonetheless, if religious and state-sponsored secular activities are not sufficiently separated, a violation of the Establishment Clause of the First Amendment could be alleged.

Even apart from the provisions of the Fair Housing Act, requiring a religious test for residency in any public housing unit could not be justified under the United States Constitution. A more difficult question is whether a public housing unit is required to make exemptions in otherwise neutral regulations to accommodate the religious practices of residents.

Employment Division v. Smith holds that a facially neutral law will be judged under the rationality standard of review normally employed by the

101
102
103
104
105

Amendment unless they are compelled or otherwise supported by governmental action. Mere financial support received by a private nursing home will normally not make the home a state actor to bring it under the First or Fourteenth Amendment. Blum v. Yaretsky, 457 U.S. 991, 1012 (1982) (private nursing home does not have to follow due process restrictions when discharging or transferring a patient). See also the Religious Freedom Restoration Act, 42 U.S.C. 1997(1)(A) and (2) (defining a “state institution”).


5 C.F.R. 5.109(c).

Id.


494 U.S. 872, 882 (1990). Justice Scalia, who wrote the opinion, refused to follow Sherbert v. Verner, 374 U.S. 398 (1963) (holding that the denial of unemployment benefits to a woman who was fired because of her refusal to work on the Sabbath infringed on her First Amendment rights) and Wisconsin v. Yoder, 406 U.S. 205 (1972) (reversing the conviction of parents who refused to comply with a state compulsory education law because of their religious beliefs). Instead he relied on an older line of cases that applied minimal judicial scrutiny to free exercise claims, including Reynolds v. United States, 98 U.S. 145 (1879) (upholding a bigamy conviction against a person of the Mormon faith); Prince v. Massachusetts, 321 U.S. 158 (1944); (holding that a child labor law could be applied to prevent a minor from distributing religious literature); and Braunfeld v. Brown, 366 U.S. 599 (1961) (upholding a Sunday closing law as applied to Orthodox Jews who did not work on the Sabbath).
Supreme Court in economic and social cases. Thus, one could argue that a neutral regulation that infringes on a resident’s free exercise of religion will be upheld so long as it is justified by a good reason. However, the application of the rationality standard to review facially neutral laws that restrict the practice of religion has been widely criticized.  

Almost immediately [19] after the Smith decision, Congress with overwhelming bi-partisan support passed the Religious Freedom Restoration Act (RFRA), which required laws that substantially burden the free exercise of religion to be justified by a compelling governmental interest.

The Supreme Court declared RFRA unconstitutional as applied to states and local governments in City of Boerne v. Flores. The opinion is not the model of clarity. The Court held that Congress had no power under Section 5 of the Fourteenth Amendment to impose the RFRA against states and local governments. However, Boerne did not directly address the issue of the Act’s constitutionality as applied to federal action, and lower courts have applied RFRA when reviewing acts of the federal government.

After the Supreme Court struck down RFRA, Congress passed the Religious Land Use and Institutionalized Persons Act of 2000 (RLUIPA), which attempted to reinstate some of RFRA’s requirements on the states in cases involving land use or the rights of institutionalized persons. Rather than relying on section 5 of the Fourteenth Amendment to pass the 2000 Act, as it had done in passing RFRA, Congress relied on the Spending and Commerce Clauses in Article 1, Section 8. The Supreme Court has upheld RLUIPA against a challenge that it violates the Establishment Clause.

If persons are in a state institution for the mentally ill, disabled, retarded, chronically ill, or handicapped, or in skilled nursing, intermediate or long-term care, or in a custodial or residential care facility, RLUIPA protects them. The State must have a compelling justification if it infringes upon their free exercise of religion. Thus, a public housing project for “institutionalized” persons that supplies meals to its residents may be required to accommodate the special dietary needs imposed by a particular resident’s religious practices.

---


108 See id. at 2117.

109 See supra note 111.

110 Wilkinson, 125 S.Ct. at 2118.

111 See Guam v. Guerrero, 290 F.3d 1210, 1219-21 (9th Cir. 2002); O’Bryan v. Bureau of Prisons, 349 F.3d 399, 401 (7th Cir. 2003).


113 See id. at 2117.

114 A federal judge has ruled that the RLUIPA was violated when prison officials refused to supply an inmate with a vegetarian diet based solely on his assertion that his religious beliefs required the
[*20] Some states have passed equivalents of RFRA, which they presumably have the right to do under their own constitutions. For instance, Illinois passed the Illinois Religious Freedom Restoration Act that provides that the government may not substantially burden a person’s exercise of religion, even through rules of general application, without showing that it used the least restrictive means to further a compelling governmental interest. These laws impose more stringent standards for reviewing state interferences with religious practices than would be required under the federal Constitution.

Apart from RFRA or a state equivalent, there seems to be no independent basis under existing constitutional jurisprudence to require a public housing authority or other public funding entity to provide special assistance to enable residents to practice their religion. Indeed the neutrality required in some state constitutions toward religion may well justify a state’s not making money available to support religious activities.

In Locke v. Davey, the United States Supreme Court held that a state that establishes a scholarship program to assist academically gifted students with postsecondary school expenses may exclude those students who are pursuing a degree in devotional theology. The student argued that the exclusion violated the Court’s decision in Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah because it was based on the state’s hostility toward religion. The Supreme Court rejected this inference and held that the State was merely choosing not to fund a special diet. Agrawal v. Briley, 2004 WL 1977581 (N.D. Ill. Aug. 25, 2004). The judge further held that the beliefs were protected even if they were not held by all members of the same religious group, stating that: “RLUIPA addresses the imposition of ‘a substantial burden on the religious exercise of a person,’ not a member of a religious group, and Congress enacted RLUIPA in the context of Supreme Court decisions holding that the First Amendment’s free exercise clause protects an individual’s right to follow his or her sincerely held religious belief.” Id. at 3. The judge rejected arguments that any burden imposed on the inmate was justified by cost considerations or storage problems and concerns that providing the extra fruits and vegetables that come with meatless meals would lead to the production of more illicit alcohol. Id. at 9. She further rejected the idea that the special diet was so desirable that it would encourage other inmates to make false claims of religious need. Id. at 10.

115 States may expand rights beyond the minimum protected by the United States Constitution, so long as in doing so, they do not violate the rights of others. See Pruneyard Shopping Center v. Robins, 447 U.S. 74, 79 (1980) (California extended the right of free speech to a private shopping center). See also Michigan v. Long, 463 U.S. 1032 (1983) (Michigan courts can expand the definition of an unreasonable search and seizure under state law, so long as the decision is clearly independent of federal law).

116 775 ILCS 35/15. What a “substantial burden on the free exercise of religion” is has been narrowly construed. Diggs v. Snyder, 775 N.E.2d 40, 45 (Ill. App. Ct. 2002), appeal denied, 202 Ill.2d 601, 787 N.E.2d 156 (“To constitute a showing of a substantial burden on religious practice, [the claimant] must demonstrate that the governmental action ‘prevents him from engaging in conduct or having a religious experience that his faith mandates.’”).


118 508 U.S. 520 (1993) (held that the city had intentionally singled out religion when it penalized the ritual killing of animals).
distinct category of instruction.\textsuperscript{119} The State of Washington had inserted in its state constitution a specific prohibition against using tax funds to support the ministry, a prohibition that was broader than required by the [*21] Federal Constitution.\textsuperscript{120} The Court found that far from evincing hostility toward religion, the Washington laws and corresponding programs permitted students to attend pervasively religious schools and to take devotional theology courses.\textsuperscript{121} The restriction on paying for devotional theology degrees was based on the distinction embodied in the Washington Constitution that training for a religious profession and training for a secular profession are not fungible.\textsuperscript{122}

While the Federal Constitution may not require a state to spend money in support of a religious activity as held in Davey,\textsuperscript{123} a state cannot discriminate against religion in those facilities it makes generally available to the public.\textsuperscript{124} For instance, if a publicly supported complex has a meeting room that it regularly makes available for private meetings, it cannot deny the facility to groups who want to conduct religious meetings or services in the room.\textsuperscript{125}

2. Investigating Religious Organizations

The United States Supreme Court has held that the mere investigation of a religious organization by a state Human Rights agency to determine whether a violation of the law has occurred does not pose an undue burden on the practice of religion.\textsuperscript{126} In \textit{Ohio Civil Rights Commission v. Dayton Christian Schools},\textsuperscript{127} the Supreme Court held that the mere investigation of a private religious school for discharging an employee on the basis of gender does not violate the First Amendment. Although the decision was concerned primarily with whether a federal court could enjoin the Commission under \textit{Younger v. Harris}\textsuperscript{128} abstention principles, the Court commented that:

Even religious schools cannot claim to be wholly free from some state regulation. Wisconsin v. Yoder, 406 U.S. 205, 213 (1972). We therefore think that however Dayton’s constitutional claim should be decided on the merits, the Commission violates no constitutional rights by merely investigating the circumstances of Hoskinson’s discharge in this [*22] case, if only to ascertain

\textsuperscript{119} \textit{Supra} note 117 at 720-21.
\textsuperscript{120} \textit{Id.} at 719, 722.
\textsuperscript{121} \textit{Id.} at 724-25.
\textsuperscript{122} \textit{Id.} at 721.
\textsuperscript{123} \textit{Id.} at 725.
\textsuperscript{124} \textit{Good News Club v. Milford}, 533 U.S. 98, 106 (2001) (equal access to school premises after school hours).
\textsuperscript{125} \textit{Id.} at 113-120.
\textsuperscript{127} \textit{Id.} at 628.
\textsuperscript{128} 401 U.S. 37 (1971).
whether the ascribed religious-based reason was in fact the reason for the discharge.\textsuperscript{129}

However, if the investigation is unduly intrusive into the religious activities of the defendant or if it continues after the investigator should have known that no violation of the Act occurred, there could be a violation of the First Amendment. In \textit{White v. Lee},\textsuperscript{130} pursuant to the filing of a complaint by the developer of a proposed group home, HUD investigators conducted a prolonged investigation against neighbors who protested the construction of the home. The neighbors had leafleted and filed protests with the city council, as well as filed a lawsuit against the home.\textsuperscript{131} The Court of Appeals held that the activities of the neighbors were legitimate free speech and petition activities and that the HUD investigators, by conducting an investigation long after they should have realized that these activities were protected by the First Amendment, could be held personally liable for damages in a civil rights action.\textsuperscript{132}

Harassing persons because of their religious beliefs would likewise be illegal and a civil rights violation.

3. The Fair Housing Exemption for Religion

A question might be raised whether the exemption in 3607(a) is sufficiently broad, as interpreted by the Courts, to protect First Amendment Rights. This question was raised on remand in \textit{Columbus Country Club}, discussed in Part II C, above. The District Court considered whether extending the protection of the Fair Housing Act to a private club that wanted to restrict entrance to members of the same religion violated the Free Exercise Clause of the First Amendment.\textsuperscript{133} The District Court rejected this argument, finding that compliance with the Fair Housing Act imposed no significant intrusion into the religious beliefs and practices of the Catholic members of the Club.\textsuperscript{134}

If a rule or regulation is neutral on its face and does not single out religious practices for special disadvantages, the Supreme Court has said that it will be upheld so long as it is otherwise [*23] constitutional.\textsuperscript{135} Conversely, if the rule or regulation specifically singles out religious practices and proscribes or otherwise restricts them, there may be a violation of the First Amendment.\textsuperscript{136}

\begin{thebibliography}{10}
\footnotesize

\bibitem{129} \textit{Supra} note 127 at 628.
\bibitem{130} 227 F.3d 1214 (9th Cir. 2000).
\bibitem{131} \textit{Id.} at 1220-21.
\bibitem{132} \textit{Id.} at 1238-40.
\bibitem{134} \textit{Id.} at 17.099.
\end{thebibliography}
similar result would occur if some other fundamental right such as free speech or assembly were implicated.\textsuperscript{137}

A recent case involving free exercise issues relevant to this discussion is the California Supreme Court decision in \textit{Catholic Charities v. Superior Court.}\textsuperscript{138} Catholic Charities was required by California law to provide insurance which covered prescription contraceptives for its employees if it provided insurance coverage for other prescription drugs.\textsuperscript{139} Catholic Charities raised a number of state and federal objections.\textsuperscript{140} California law exempted “religious employers,” but it was an undisputed fact that Catholic Charities was not a “religious employer” as defined in the statute.\textsuperscript{141}

Catholic Charities first argued that the law interfered with matters of religious doctrine and internal church governance, but the Court held that the case did not implicate internal church governance, only the relationship between a nonprofit public benefit corporation and its employees, most of whom did not even belong to the Catholic Church.\textsuperscript{142} The Court also rejected Catholic Charities’ argument that the government could not properly distinguish between secular and religious entities and activities.\textsuperscript{143} Under the circumstances of this case, the Court held that there was no inquiry into the employer’s religious purpose and its employees’ and clients’ religious beliefs that would involve the government in an entanglement with religion.\textsuperscript{144}

Catholic Charities also argued that the law was not neutral because the practical effect of the law would reach only Catholic employers.\textsuperscript{145} Even though the law was facially neutral, the Court recognized that the context in which a law operates could destroy its “neutrality.”\textsuperscript{146} However, the Court found that while most religious employers did not object to the contraception coverage, the exception in the law was a justifiable accommodation to protect the beliefs of Catholics.\textsuperscript{147} That the exemption was not so broad as to cover all organizations affiliated with the Catholic Church did not mean that the law discriminated against the Catholic Church.\textsuperscript{148} The law simply treated some Catholic employers differently from other employers.\textsuperscript{149}

\begin{itemize}
  \item \textsuperscript{137} In \textit{Employment Division v. Smith}, 494 U.S. 872, 881-82 (1990), Justice Scalia referred to these cases as hybrid cases.
  \item \textsuperscript{138} 85 P.3d 67 (Cal. 2004), \textit{cert. denied}, 125 S.Ct. 53 (2004).
  \item \textsuperscript{139} \textit{Id.} at 74.
  \item \textsuperscript{140} \textit{Id.} at 76.
  \item \textsuperscript{141} \textit{Id.}.
  \item \textsuperscript{142} \textit{Id.} at 77.
  \item \textsuperscript{143} \textit{Id.} at 80.
  \item \textsuperscript{144} \textit{Id.} at 80-81.
  \item \textsuperscript{145} \textit{Id.} at 82.
  \item \textsuperscript{146} \textit{Id.} at 84.
  \item \textsuperscript{147} \textit{Id.}.
  \item \textsuperscript{148} \textit{Id.}.
  \item \textsuperscript{149} \textit{Id.} at 85.
\end{itemize}
The California Supreme Court also rejected the argument that the law implicated a hybrid right under *Employment Division v. Smith*, finding that “Catholic Charities’ compliance with a law regulating health care benefits [was] not speech.” The California Supreme Court acknowledged that the California Constitution’s protection of the free exercise of religion might be more strict than the federal standard announced by Justice Scalia in *Smith*. However, the Court found that the state law did not in fact burden Catholic Charities’ religious beliefs; the conflict could be avoided simply by not offering coverage for prescription drugs. Even assuming that there was a burden, the Court found that the State had a compelling state interest in eliminating gender discrimination and that the law was narrowly tailored to achieve that interest. The United States Supreme Court has declined to review the decision of the California Supreme Court.

Although the issues in *Catholic Charities* were more broadly framed, the resolution of that case is consistent with the narrower arguments that were made under the exemptions to the Fair Housing Act in *United States v. Columbus Country Club*. Housing that is used directly for religious activities is exempt; housing that generates revenue and is otherwise indistinguishable from other “commercially” operated properties is not exempt from the Act.

A more troublesome opinion is the United States Supreme Court’s decision in *Boy Scouts v. Dale*, where it held that New Jersey could not extend its public accommodations law to require the Boy Scouts to reinstate a homosexual as an assistant scoutmaster. The Boy Scouts argued that New Jersey’s decision requiring the Boy Scouts to reinstate the complainant violated the Boy Scouts’ First Amendment right to free expression.

[*25*] The Supreme Court held that the determination depends upon whether the group engages in “expressive association.” The association need not be an advocacy group so long as it engages in some form of expression. The Court found that the general mission of the Boy Scouts was “to instill values in young people.” As such, the Boy Scouts convinced a majority of the Justices that homosexual conduct was inconsistent with the Boy Scouts’ message of “clean living” and that a homosexual would not provide a desirable role model for the Scouts.

---

151 *Catholic Charities*, 85 P.3d at 89.
152 *Id.* at 89-91.
153 *Id.* at 91.
154 *Id.* at 93-94.
158 *Id.* at 644.
159 *Id.* at 648.
160 *Id.*
161 *Id.*
162 *Id.* at 653-54.
The Supreme Court distinguished Dale from *Roberts v. United States Jaycees*,\(^{163}\) where it held that Minnesota could require the Jaycees to admit women because there was no evidence in the record to show how the admission of women would impede the organization’s ability to engage in activities protected by the First Amendment or to disseminate its preferred views. It also distinguished *Dale* from *Rotary International v. Rotary Club of Duarte*,\(^{164}\) where the Court held that a state antidiscrimination law requiring women be admitted as members of a local Rotary Club did not deny freedom of intimate association or freedom of expression to the club. In *Rotary Club of Duarte*, the Court held that even if there was a slight infringement on the club’s expressive association, it was justified by the “compelling interest in eliminating discrimination against women.”\(^{165}\)

The Supreme Court further distinguished the Boy Scouts organization from traditional places of public accommodation, such as facilities like inns, trains, and restaurants.\(^{166}\) These were traditionally places where the public was invited.\(^{167}\) Here, New Jersey broadly defined the term “public accommodation” to cover private membership organizations, which included non-commercial expressive organizations that were unassociated with any physical location.\(^{168}\)

The Fair Housing Act’s exemption for religious organizations and exclusion of commercial transactions from that exemption draws a distinction similar to the distinction recognized by the Supreme Court between traditional places of public accommodation, where the court’s have traditionally allowed antidiscrimination laws to apply,\(^{169}\) and the broader definition of public accommodations adopted by New Jersey, which included associations that engage in expressive activities. Religious organizations that are providing housing as part of a commercial enterprise are not expressive organizations. They are more analogous to persons who operate inns or restaurants and who can be prohibited from refusing service to persons protected by the public accommodation laws.

Justice Powell drew a similar distinction in his concurring opinion in *Runyon v. McCrary*,\(^{170}\) where the Court interpreted the reach of the Civil Rights

---


\(^{165}\) *Id.* at 549.

\(^{166}\) *Dale*, 530 U.S. at 656.

\(^{167}\) *Id.* at 657.

\(^{168}\) *Id.*

\(^{169}\) See Pruneyard Shopping Center v. Robins, 447 U.S. 74, 84-88 (1980) (rejecting private property owners’ argument that they were being required to participate in disseminating ideological messages that they might oppose); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 259 (1964) (hotel owner “has no ‘right’ to select its guests as it sees fit, free from government regulation”).


11 Tex. J. on C.L. & C.R. 1 (Fall 2005)
Act of 1866\textsuperscript{171} to forbid a private school from discriminating on the basis of race in its admissions. Justice Powell distinguished between a contract made by parents with a private school to educate their children, which was covered by the Act, and a contract made by parents with a tutor or babysitter, which he termed a “personal contractual relationship” that he believed was not covered by the Act.\textsuperscript{172}

Writing for the majority in \textit{Runyon}, Justice Stewart expressly recognized that the school was not a religious school and that it raised no religious defense.\textsuperscript{173} However, Justice Stewart rejected arguments that applying the Civil Rights Act to the admissions practices of private schools violated any right of association or any privacy right of parents to direct the upbringing and education of their children.\textsuperscript{174} His rejection of these associational and privacy arguments effectively disposed of any defense based on religion as well. Justice Scalia’s opinion in \textit{Employment Division v. Smith} expressly held that restrictions on religious practice are accorded a lower level of scrutiny by the courts than those that also involve restrictions on speech or associational rights.\textsuperscript{175}

Thus, Congress drew the proper line between religious practice and commercial activity in the Fair Housing Act. Congress left the courts with the delicate task of applying the religious exemption to individual cases. Their decisions will necessarily be informed by the Supreme Court’s First Amendment jurisprudence, but the lower [*27] courts should go no further than this jurisprudence requires in applying the exemption.

4. Religion as a Defense to Discrimination - Conscientious Objection

Religion may also be raised as a defense to a charge of discrimination. What if the protected status of a housing resident conflicts with the religious beliefs of a provider of private housing? For instance, what if a couple wants to cohabit and cohabitation by unmarried persons conflicts with the religious beliefs of their landlord?\textsuperscript{176}

Clearly if the objection is based on what the Supreme Court has found to be a suspect classification under the Constitution such as race or gender, the government has a compelling justification to override the convictions of the housing provider.\textsuperscript{177} However, if the discrimination is based on marital status,

\textsuperscript{172} Supra note 170 at 187-88.
\textsuperscript{173} Id. at 167.
\textsuperscript{174} Id. at 175-79.
\textsuperscript{175} Smith, 494 U.S. at 881-82.
\textsuperscript{176} Discrimination based on marital status does not violate the federal Fair Housing Act, but it may violate a number of state and local human rights laws and ordinances.
sexual orientation, or even disability, the answer will be more complex, and lower courts have differed on the outcome.

In *Gay Rights Coalition v. Georgetown University*, the Court of Appeals of the District of Columbia held that the District of Columbia, by placing sexual orientation discrimination in its human rights ordinance along with race, color, religion, national origin, and sex, had determined that “all forms of discrimination based on anything other than individual merit are equally injurious to the immediate victims and to society as a whole” and that the inclusion was justified by “a compelling governmental interest.”

Similarly in *Smith v. Fair Employment & Housing Commission*, the Supreme Court of California held that religiously motivated landlords in California could not discriminate against gays when such discrimination is unlawful under state law. However, in *Attorney General v. Desilets*, the Supreme Court of Massachusetts held that a landlord could validly object to renting to an unmarried couple in violation of a state law forbidding discrimination on the basis of marital status.

[*28] In situations where the Supreme Court has not recognized classes to be suspect under the Fourteenth Amendment, such as in cases involving discrimination against unmarried couples or against homosexuals, housing providers will argue that the government has insufficient reason to intrude on their religious beliefs. On the other hand, when housing providers have voluntarily entered the commercial housing market, they should be required to comply with the anti-discrimination laws that govern their businesses or leave the market. If they have religious scruples, they can invest their money and talent in another business or profession. There is no right under due process for any individual to engage in a particular business or profession.

The outcome of any discussion of the free exercise clause will depend on how closely the courts review the restriction. Justice Scalia’s opinion in *Employment Division v. Smith*, holding that the rationality standard applies to laws that are neutral on their face even when they restrict the practice of religion,

---


181 For instance, in *Board of Trustees v. Garrett*, 531 U.S. 356 (2001), the Supreme Court held that Congress did not have power to authorize damage suits against State agencies for discrimination against persons with disabilities under the Americans with Disabilities Act.


has been widely criticized.\textsuperscript{185} Almost immediately after that decision, Congress, with overwhelming bi-partisan support, passed the Religious Freedom Restoration Act (RFRA), which required laws that substantially burden the free exercise of religion to be justified by a compelling governmental interest.\textsuperscript{186}

As discussed above, there is considerable debate as to whether RFRA applies to federal legislation that restricts the practice of religion and whether the newer amendments to RFRA in the Religious Land Use and Institutionalized Persons Act of 2000\textsuperscript{187} are legal under the Spending and Commerce Clauses of the Constitution. If RFRA does not apply, there is the additional question of whether state equivalents of RFRA that provide a higher protection to religion than the Constitution, conflict with the Fair Housing Act and are thus preempted. If they are not preempted, one can legitimately argue that fair housing referrals by HUD to state or local human rights agencies pursuant to Section 3610(f) are improper because state requirements that provide for a broader review on the question of interference with religion are not substantially equivalent to those under federal law.\textsuperscript{188}

Regardless of the proper standard of review, one can argue that eliminating discrimination is a “compelling” governmental objective and that the religious beliefs of housing providers who decide to pursue an occupation in real estate are not a justification to discriminate in violation of the fair housing laws.

\textbf{B. Protecting Against the Establishment of Religion}

Trying to reconcile the Establishment Clause decisions of the United States Supreme Court requires a great amount of finesse. Whether there is indeed a wall of separation between Church and State\textsuperscript{189} has been subject to varying interpretations by the Justices. Nonetheless there is no question that the government cannot support distinctly religious activities however the Court chooses to define them.

Although it may be motivated by a conviction founded on religion, the activity of housing persons is not in itself a distinctly religious activity. Therefore, there should be no problem under the Establishment Clause for the government to give money to private groups, whether religiously affiliated or secular, to develop housing.\textsuperscript{190} However, if the money was used directly to construct a chapel or

\begin{footnotesize}
\textsuperscript{185} Supra note 106.  \\
\textsuperscript{186} 42 U.S.C. 2000bb-1 et seq. (2000).  \\
\textsuperscript{188} See, 42 U.S.C. 3610(f) (2000).  \\
\textsuperscript{189} See, Everson v. Board of Education, 330 U.S. 1, 16 (1947).  \\
\textsuperscript{190} Cf., Bradfield v. Roberts, 175 U.S. 291 (1899) (government support for religiously operated hospitals is allowed).
\end{footnotesize}
other place of worship for the residents, there would be a problem. Such a use of funds is expressly prohibited by the HUD Faith-Based Initiatives directive.

[*30] Creating regulatory exemptions for religiously affiliated organizations will not necessarily violate the Establishment Clause. Justice Stevens argued in his concurring opinion in City of Boerne v. Flores, that the RFRA violated the Establishment Cause because: "governmental preference for religion, as opposed to irreligion, is forbidden by the First Amendment." However, no other justice concurred with Justice Stevens.

In many instances, legislation that gives a special exemption to religious organizations is not really establishing a preference; it is simply accommodating the right of free exercise guaranteed by the First Amendment. For instance, legislation exempting religiously affiliated employers from the religious discrimination provisions of Equal Employment Opportunity Act does not breach

---

191 Cf., Roemer v. Board of Public Works, 426 U.S. 736, 747 (1976) (holding that state funds could be given to private colleges, including those that are religiously affiliated, subject to the restriction that the funds not be used for "sectarian purposes.").

Of course, with federal and state funding come restrictions. Whether organizations want to meet these restrictions is a serious question that each organization must answer before it becomes dependent on governmental subsidies. Compare, Harris v. McRae, 448 U.S. 297 (1980), (upholding the Hyde Amendment that prohibits Medicaid funds to be used to fund abortions); Rust v. Sullivan, 500 U.S. 173 (1991) (prohibiting recipients of federal funds to engage in abortion counseling services); National Endowment for the Arts v. Finley, 524 U.S. 569, 572 (1998) (National Endowment for the Arts can consider “general standards of decency and respect for the diverse beliefs and values of the American public” as criteria for considering grant applications); United States v. Am. Library Ass’n, 539 U.S. 194 (2003) (libraries that receive federal funds must install software to block images that constitute obscenity or child pornography and to prevent minors from obtaining access to material that is harmful to them); with, Rosenberger v. Rector and Visitors of the Univ. of Virginia, 515 U.S. 819 (1995) (public university cannot decline to authorize disbursement of funds to finance the printing of a Christian student newspaper when it funds other student publications); Legal Servs. Corp. v. Velazquez, 531 U.S. 533 (2001) (Congress cannot restrict legal services lawyers from representing clients in efforts to amend or otherwise challenge existing welfare laws). The Charitable Choice provisions of the 1996 Welfare Reform Act, 42 U.S.C. 604a, attempts to lift some restrictions that have traditionally prevented government funding for those faith-based projects that are included in the Act. However, the Act still must be read in conformity with the strictures of the First Amendment.

192 See, Equal Participation of Faith-Based Organizations, 69 Fed. Reg. 41,712 (July 9, 2004). The Directive states that “HUD funds may be used for the acquisition, construction, or rehabilitation of structures only to the extent that those structures are used for conducting eligible activities under a HUD program or activity.” Id. Sanctuaries, chapels, and other rooms that a HUD-funded religious congregation uses as its principal place of worship are ineligible for HUD-funded improvements. Id. However, “where a structure is used for both eligible and inherently religious activities, HUD funds may not exceed the cost of those portions of the acquisition, construction, or rehabilitation that are attributable to eligible activities in accordance with the cost accounting requirements applicable to the HUD program or activity.” Id. This qualification could obviously be challenged in its application to individual funding requests where it is shown that federal funds are being directed toward the support of religious activities.


194 Id. at 537.
The Establishment Clause. The Supreme Court stated in *Corporation of the Presiding Bishop v. Amos* that:

This Court has long recognized that the government may (and sometimes must) accommodate religious practices and that it may do so without violating the Establishment Clause. ... It is well established, too, that “the limits of permissible state accommodation to religion are by no means co-extensive with the noninterference mandated by the Free Exercise Clause.” ... There is ample room under the Establishment Clause for “benevolent neutrality which will permit religious exercise to exist without sponsorship and without interference”, ... At some point accommodation may devolve into “an unlawful fostering of religion”.

[∗31] It can be argued that faith-based initiatives, which promote the participation of religiously affiliated organizations in government funded programs, move the fine line between neutrality and government support of religion too far in favor of the latter. However, whether faith-based initiatives violate the Establishment Clause of the First Amendment will depend upon how each individual initiative is structured.

---


197 *Id.* at 334.

198 Douglas Kauper observed almost a half century ago that:

> “The overlapping of state and church functions in some respects and the necessity in some situations of making a choice between the free exercise and the nonestablishment limitations makes clear that many of the problems in this area are too complicated to admit of solution by simply invoking some rigid principle of separation of church and state.”

*Kauper, FRONTIERS OF CONSTITUTIONAL LIBERTY* (1956) at 131.

The solution suggested by Kauper still rings true today:

> “Both the free exercise and the nonestablishment principles combine to outlaw any official church or religion of the state. All religious groups must be dealt with on an equal basis. The liberty of dissenters and unbelievers must be protected. The state may properly act to further religious interests or to promote general legislative policies without the necessity of discriminating against religion, if in so doing it does not grant a preference and does not act to coerce the conscience of others. To appropriate money for churches even on a non-preferential basis too clearly violates the nonestablishment principle to permit validation of the theory that the legislature is promoting the free exercise of religion, since it is not the function of a state to operate churches. On the other hand, financial assistance to auxiliary enterprises that represent overlapping functions of church and state can be justified, since by hypothesis no clear separation of function can be recognized.”
HUD’s Faith-Based Initiative directive is fairly fine-tuned, but still presents some questions about how it might be implemented. The HUD directive has been criticized for failing to provide sufficient oversight mechanisms or “firewalls” to prevent religious use of government funds. However, HUD has responded that:

“Inappropriate use of HUD funds or failure to comply with HUD requirements is not a possibility that arises only when program participants are faith-based organizations. Failure of any organization receiving Federal funds to ensure that the Federal portion of their funding is not used for prohibited purposes will subject the organization or the imposition of sanctions or penalties.”

The directive provides that religiously affiliated organizations are qualified to receive federal funding, and specifically refers to housing programs for the elderly and persons with disabilities. Federal monies may not be used to fund “inherently religious [*32] activities,” which are defined as “worship, religious instruction, or proselytization.” While this definition may not encompass all activities that run afoul of the First Amendment, it does not appear on its face to be unduly vague or under inclusive. The directive also provides that participation in any activity must be voluntary for beneficiaries of the programs.

Recent Supreme Court opinions hold that the government may not exclude religious groups from programs that are generally open to the public. In Board of Education v. Mergens, the Supreme Court held that public school officials could not exclude a religious club at a public school under the Equal Access Act. The Court held that the Equal Access Act did not violate the Establishment Clause under the three-part test developed in Lemon v. Kurtzman, because it had a secular purpose, did not have a primary effect of advancing religion, and did not involve the government in excessive entanglement. The Act simply allowed religious groups the same privileges afforded all other groups.

Similarly, in Rosenberger v. Rector and Visitors of the University of Virginia, the Supreme Court held that a University that paid outside contractors for the printing costs of a variety of student publications could not withhold authorization for payments on behalf of a student paper that primarily advocated religious beliefs. The Court stated that having government officials determine

Id. at 132-3.

202 403 U.S. 602 (1971).
which papers were religious and which were not unduly involved the government in the entanglement of religion.\footnote{Id. at 845-46.}

Also, in \textit{Capitol Square Review and Advisory Board v. Pinette},\footnote{515 U.S. 753 (1995).} the Court held that it does not violate the Establishment Clause when, pursuant to a religiously neutral state policy, the state permits a private party to display an unattended religious symbol in a traditional public forum located next to its capital building.

In a case upholding governmental aid for primary or secondary education, \textit{Zelman v. Simmons-Harris},\footnote{536 U.S. 639 (2002).} where the State of Ohio offered tuition aid that is distributed directly to parents according to financial need for students in both public and private schools, whether religious or non religious, the Court found that the program had a secular purpose and effect and was “entirely neutral with respect to religion.”\footnote{Id. at 662.}

\footnote{Id. at 662.} \textit{Cutter v. Wilkinson}\footnote{125 S.Ct. 2113 (2005).} clearly holds that a law passed by Congress to accommodate religion does not automatically violate the Establishment Clause of the First Amendment. The Court upheld that Religious Land Use and Institutionalized Persons Act of 2000 (RLUIPA) which prohibits states from imposing substantial burdens on the exercise of religion by persons confined in an institution unless they can be justified by “a compelling governmental interest.” While the Court acknowledged that “at some point, accommodation may devolve into “an unlawful fostering of religion,”” RLUIPA did not, on its face, “exceed the limits of permissible government accommodation of religious practices.”\footnote{Id. at 2117.}

The Court commented that Congress had documented that “‘frivolous or arbitrary’ barriers impeded institutionalized persons’ religious exercise,”\footnote{Id. at 2119.} and found that the law alleviated exceptional government-created burdens on private religious exercise.\footnote{Id. at 2121.} The accommodation did not override other significant interests,\footnote{Id. at 2122.} and the Court deferred to the States to apply the law in a balanced and sensitive way.\footnote{Id. at 2123.} Finally, the Court emphasized that the law did not differentiate among bona fide faiths. No religious sect was elevated above any other sect.\footnote{Id.}

When the government steps over the line and promotes or endorses religious beliefs, it violates the Establishment Clause. In \textit{County of Allegheny v. American Civil Liberties Union},\footnote{492 U.S. 573 (1989).} the Supreme Court held that a display of a
creche inside of a county building violated the Establishment Clause, but that a display of a Chanukah menorah outside the building next to a Christmas tree did not. The Court acknowledged that:

Precisely because of the religious diversity that is our national heritage, the Founders added to the Constitution a Bill of Rights, the very first words of which declare: “Congress shall make no law respecting an establishment of religion, or [*34] prohibit the free exercise thereof... .” Perhaps in the early days of the Republic these words were understood to protect only the diversity within Christianity, but today they are recognized as guaranteeing religious liberty and equality to “the infidel, the atheist, or the adherent of a non-Christian faith such as Islam or Judaism.” Wallace v. Jaffree, 472 U.S., at 52. It is settled law that no government official in this Nation may violate these fundamental constitutional rights regarding matters of conscience. Id., at 49. 216

The Court concluded that:

“Whether the key word is “endorsement,” “favoritism,” or “promotion,” the essential principle remains the same. The Establishment Clause, at the very least, prohibits government from appearing to take a position on questions of religious belief or from “making adherence to a religion relevant in any way to a person’s standing in the political community.” Lynch v. Donnelly, 465 U.S. at 687 (O’Connor, J., concurring).” 217

In Corporation of Presiding Bishop v. Amos, 218 the Court held that the religious exemption in Title VII did not breach the Establishment Clause because it did not advance religion:

Undoubtedly, religious organizations are better able now to advance their purposes than they were prior to the 1972 amendment to 702. But religious groups have been better able to

Commandments in their courthouses. 125 S.Ct. 2722 (2005). The purpose of the display was to promote religion and the Commandments were fully set out so that they stood alone and not as part of an arguably secular display. Id. at 2738. However, in Van Orden v. Perry, the Court upheld the display of the Ten Commandments on the lawn of the Texas State Capital. 125 S.Ct. 2854 (2005). The Court found that while the Ten Commandments were undoubtedly religious, the nature of the display and the Commandment’s tie to our Nation’s history were found under the particular circumstances of that case to convey a predominantly secular message that did not breach the First Amendment. Id. at 2864.

216 492 U.S. at 589-590.

217 Id. at 593-94.

advance their purposes on account of many laws that pave passed constitutional muster: for example, the property tax exemption at issue in *Walz v. Tax Comm’n*, [394 U.S. 664 (1970)], or the loans of school books to school children, including parochial school students, upheld in *Board of Education v. Allen*, 392 U.S. 236... (1968). A law is not unconstitutional simply because it allows churches to advance religion, which is their very purpose. For a law to have forbidden “effects” under *Lemon*, it must be fair to say the government itself has advanced religion through its own activities and influence. As the Court observed in *Walz*, “for the men who wrote the Religion Causes of the First Amendment the establishment of a religion connoted sponsorship, financial support, and active involvement of the [*35*] sovereign in religious activity. 397 U.S., at 668, ... Accord, *Lemon*, 403 U.S., at 612, ... .

What is significant in *Amos* is that the Supreme Court specifically found that there was no evidence in the record that the Title VII exemption gave the Church an advantage in propagating its religious mission that it did not possess before, stating that:

We find no persuasive evidence in the record before us that the Church’s ability to propagate its religious doctrine through the Gymnasium is any greater now than it was prior to the passage of the Civil Rights Act in 1964. In such circumstances, we do not see how any advancement of religion achieved by the Gymnasium can be fairly attributed to the Government, as opposed to the Church.\(^{219}\)

HUD faith-based initiatives program involves direct public subsidies to religious organizations, but these subsidies are to be kept separate and apart from secular activities and not for religious proselytism.\(^{220}\) It is unlikely under such circumstances that the Court would assume an advantage to the religious mission of the organization because of the receipt of the public funds alone.\(^{221}\) Therefore,

---

\(^{219}\) Id.

\(^{220}\) Equal Participation of Faith-Based Organizations, 69 Fed. Reg. at 41,713.

\(^{221}\) The Supreme Court has held that while religiously affiliated organizations are not disabled from participating in publicly sponsored social welfare programs, the government may not fund “pervasively sectarian” institutions. Bowen v. Kendrick, 487 U.S. 589, 609-610 (1988) (the Supreme Court upheld a federal grant program that provided funding for services relating to adolescent sexuality and pregnancy to organizations with institutional ties to a religious denomination, but emphasized that the institution was not “pervasively sectarian”). However, a more recent decision questions this exclusion. In *Mitchell v. Helms*, a plurality opinion, the Court upheld Chapter 2 of the Education Consolidation and Improvement Act of 1981, under which
to attack the program as a violation of the Establishment Clause, actual proof would be required that the Government is indeed advancing religion.

The Department does not fund religious organizations directly. Faith-based groups are generally not-for-profit tax exempt organizations under section 501(c)(3) of the Internal Revenue Code. This would suggest that the Department applies the law neutrally. However, based on the fact that HUD singles out faith-based groups and designates personnel to assist such groups in their missions, a reasonable person could reach the conclusion that faith-based groups are preferred. For instance, in the Department’s Notice of Funding Availability for Fiscal Year 2004, extra points are awarded “if you are a grassroots faith-based or other community-based organization, [or] propose to partner or sub-contract with grassroots faith-based or other community-based organizations.” This preference is included in its 2005 funding request as well.

In HUD funding notices, it is suggested that the reason for singling out faith-based groups is to overcome past discrimination against these groups. However, whether the government has a “compelling governmental interest” in overcoming past discrimination against religious groups is discounted by two Supreme Court decisions. The first case, City of Boerne v. Flores, held that the Religious Freedom Restoration Act was unconstitutional as applied to the states under section 5 of the Fourteenth Amendment because Congress did not have sufficient evidence of recent instances where states had discriminated on the basis of religion. Furthermore, a government may be justified in withholding funds from activities that run a risk of creating an appearance that it is favoring religion.

Federal funds were distributed to states to lend educational materials directly to private schools, including parochial schools. 530 U.S. 793, 825-29 (2000).

The White House takes the position that faith-based groups have a constitutionally-protected right to maintain their religious identity through hiring. See, e.g., http://www.whitehouse.gov/news/releases/2002/12/20021212-6.html. This would exempt them from Title VII’s prohibitions on religious discrimination in hiring. 42 U.S.C. 2000e. See also Corporation of the Presiding Bishop v. Amos, 483 U.S. 327, 339 (1987) and the Charitable Choice Act of 1996, 42 U.S.C. 604a(f), which provides that: “a religious organization’s exemption provided under section 200e-a of this title regarding employment practices shall not be affected by its participation in, or receipt of funds from, programs described in subsection (a)(2) of this section.”


In its 2005 NOFA, HUD stated that its final rule was issued “to remove barriers to the participation of faith-based organizations in eight HUD programs.” (Emphasis supplied.) 70 Fed. Reg. 13,579 (March 21, 2005). In its discussion of the public comments to the proposed HUD rule providing for equal participation of faith-based organizations, it was stated that “HUD’s general objective is to eliminate barriers to faith-based organizations, to welcome their participation in HUD programs, and most important, to ensure they are treated like other program participants.” 69 Fed. Reg. 41,714 (July 9, 2004).

even if the funding itself might not be in strict violation of the Establishment Clause. The second case, *Locke v. Davey*, held that deference would be given to a state refusal to fund a religious project in order to avoid the appearance of supporting religion. These cases place a heavy burden on the Department to justify overcoming past discrimination through an executive-imposed, as opposed to a legislatively-imposed, faith-based initiative program.

Affirmatively promoting faith-based initiatives also opens the door to problems not only of decreased neutrality, but also of governmental entanglement with religion. Determining what is or is not a faith-based organization and whether a faith-based organization is using its funds for improper sectarian purposes can raise entanglement problems. Whether neutral standards applicable to all grantees and particular delicacy in administering these programs can alleviate them is of utmost importance to those who see the First Amendment as the bedrock of the American experience.

III. Conclusions

At first blush, the First Amendment would probably not win many popularity contests today. A block of Justices on the Supreme Court would give both the Establishment and the Free Exercise Clauses a very narrow interpretation. Members of Congress, the President, and state officials regularly speak out in favor of prayer in the public schools, more public funding for religious organizations, and greater tolerance for public displays of religious symbols. Public officials do not win elections by urging a strict separation of

---

229 See, e.g., *United States v. Ballard*, 322 U.S. 78, 87 (1944) (holding that the courts cannot inquire into the truth or falsity of religious beliefs); *Cantwell v. Connecticut*, 310 U.S. 296, 307 (1940) (invalidating a state law that gave public officials the power to determine what were religious causes because it was a censorship of religion). What is a religion is far from clear. In *Davis v. Beason*, the Supreme Court states that the term religion references one’s views on his relationship to his Creator, 133 U.S. 333, 341 (1890); however, in *Torcaso v. Watkins*, the Court recognized that a religious belief need not be equated with a belief in God. 367 U.S. 488, 495 (1961). In construing the Selective Service Act, the Supreme Court held that a religious belief was a “sincere and meaningful belief which occupies in the life of its possessor a place parallel to that filled by the God of those admittedly qualifying for the exemption.” *United States v. Seeger*, 380 U.S. 163, 176 (1965); Welsh v. United States, 398 U.S. 333 (1970). Presumably there is nothing wrong with testing the sincerity of a person’s religious beliefs. *Thomas v. Review Board*, 450 U.S. 707 (1981); *Frazee v. Illinois Department of Employment Security*, 489 U.S. 829 (1989).
230 Cf. Agostini v. Felton, 521 U.S. 203, 233 (1997) (The Court held that the Title I program, which allowed public school teachers and guidance counselors to provide teaching and counseling services in sectarian schools, did not unduly entangle the government with religion because it did not require “pervasive monitoring by public authorities” to ensure that public employees did not inculcate religion).
231 These problems can, however, be overcome through sensitive administration. In *Cutter v. Wilkinson*, the Supreme Court assumed that the law would be applied in an appropriately balanced way. 125 S.Ct. 2113, 2123 (2005).
Church and State. Recent Supreme Court decisions reflect this public mood\textsuperscript{232} and have raised heated public debates about the Court’s role [*38] in interpreting the Constitution. But on reflection, the First Amendment religion clauses work. They ensure the effective operation of our democratic system and explain why our pluralistic society has avoided many of the religious conflicts that have engulfed the rest of the world. It is my belief that America is one of the most religiously diverse countries in the world, and this may be due, in part, to the separation of Church and State.

The Fair Housing Act’s promise of fair and equal housing for all persons, and the First Amendment’s promise of government neutrality in matters of religion are not incompatible. We are a nation of great diversity. Unfortunately our housing patterns do not always reflect this fact. Proper enforcement of the Fair Housing Act’s promise of equal housing opportunity and of the First Amendment’s guarantee to protect the practice of religion without the government establishing religion can help ensure that all persons live comfortably together in our pluralist society and that all persons have access to safe, decent, and sanitary housing where they can exercise their right to worship or not to worship as they choose.

\textsuperscript{232} Justice Breyer acknowledged the role of public sentiment in his concurring opinion in \textit{Van Orden v. Perry}:

“But the Establishment Clause does not compel the government to purge from the public sphere all that in any way partakes of the religious... Such absolutism is not only inconsistent with our national traditions, ... but would also tend to promote the kind of social conflict the Establishment Clause seeks to avoid.” 125 S.Ct. 2854, 2868 (2004).

He concludes his opinion, which upholds the display of the Ten Commandments on the Texas Capital Grounds, by stating that:

“This display has stood apparently uncontested for nearly two generations. This experience helps us understand that as a practical matter of degree this display is unlikely to prove divisive. And this matter of degree is, I believe, critical in a borderline case such as this one... At the same time, to reach a contrary conclusion here, based primarily upon the religious nature of the tablets’ text would, I fear, lead the law to exhibit a hostility toward religion that has no place in our Establishment Clause traditions. Such a holding might well encourage disputes concerning the removal of longstanding depictions of the Ten Commandments from public buildings across the nation. And it could thereby create the very kind of religiously based divisiveness that the Establishment Clause seeks to avoid.” \textit{Id.} at 2871.

It is a sad day when a Justice of the Supreme Court acknowledges that his decision was shaped by which side is likely to yell the loudest. Decisions interpreting the First Amendment should not by influenced by the shrill criticism of zealous “true believers” who would lower the wall of separation between Church and State through intimidation and threats and not through the persuasiveness of their arguments.
Addendum to The Fair Housing Act and Religious Freedom

Professor Michael P. Seng

The Texas Journal on Civil Liberties & Civil Rights originally published Professor Seng’s article in its Fall 2005 issue. This article appears in our online Commentary as well as in print. Please note the original article should be cited as 11 Tex. J. on C.L. & C.R. 1 (Fall 2005). The Addendum can be cited as 2 JMLS F&A Hous. Comm. 1.

Copyright © 2006 The John Marshall Law School
Addendum to The Fair Housing Act and Religious Freedom

By
Professor Michael P. Seng *

Introduction

Since this article was published in the Texas Journal on Civil Liberties and Civil Rights one year ago, there have been two developments in the law that are worthy of note, neither of which change appreciably the conclusions reached in the original article.

First, the United States Supreme Court has confirmed that the Religious Freedom Restoration Act of 1993 \(^1\) (RFRA) requires the federal government to demonstrate a “compelling” interest when individuals claim an exception from federal laws of general application to accommodate their religious practices. \(Gonzales v. O Centro Espirita Beneficente Uniao Do Vegetal\). \(^2\)

Second, the Court of Appeals for the Seventh Circuit’s holding in \(Halprin v. Prairie Single Family Homes of Dearborn Park Ass’n\) \(^3\) that Sections 804(a) and (b) of the Fair Housing Act \(^4\) apply only to pre-sale or pre-rental discrimination continues to cause uncertainty, at least in that Circuit, about the illegality of discrimination that occurs after a homeowner or tenant acquires housing. Whether the Court of Appeals properly interpreted the Fair Housing Act is open to serious question. However, even if \(Halprin\) is correct, it should not cause courts to dismiss most of the claims described in the original article.

RFRA

In \(Gonzales v. O Centro Espirita Beneficente Uniao Do Vegetal\), \(^5\) the United States Supreme Court affirmed that RFRA places a burden on the federal government, which under the Court’s decision in \(City of Boerne v. Flores\), \(^6\) it cannot place on the states. The Court held that a religious sect could seek a preliminary injunction against the federal government from enforcing the Controlled Substances Act \(^7\) to prevent the sect form using hallucinogens in their religious ceremonies. Chief Justice Roberts declared that the government’s ban would substantially burden a sincere religious exercise and that the government

---

\(^1\) 42 U.S.C. § 2000bb-1(b).
\(^3\) 388 F.3d 327 (7th Cir. 2004).
\(^4\) 42 U.S.C. § 3604 (a) and (b).
\(^7\) 21 U.S.C. § 812 (c).
had not met its burden under RFRA of demonstrating that the health risks of using such a drug were compelling.

To the government’s argument that an exception for religious practices would destroy uniformity in enforcement, Justice Roberts countered that a case-by-case consideration of religious exemptions to generally applicable rules was feasible under the Controlled Substances Act. Justice Roberts admitted that the task assigned by Congress to the courts in RFRA was not an easy one; nonetheless, he stated that:

“. . . Congress has determined that courts should strike sensible balances, pursuant to a compelling interest test that requires the Government to address the particular practice at issue. Applying that test, we conclude that the courts below did not err in determining that the Government failed to demonstrate, at the preliminary injunction stage, a compelling interest in barring the UDV’s sacramental use of hoasca. “

Pursuant to Gonzales, if a defendant is arguing that the application of the Fair Housing Act substantially burdens the free exercise of religion, there would have to be an individualized showing under RFRA that Congress had “compelling” reasons to eliminate discrimination in that case. As demonstrated in the Texas Journal article, eliminating discrimination based on race, color, national origin, sex, and religion is clearly a “compelling” governmental objective, and a good argument can be made that Congress had a “compelling” governmental objective to eliminate discrimination on the basis of handicap and familial status. Therefore, a finding of discrimination should be possible in most cases where a housing provider claims an exemption for religious practice. Under City of Boerne v. Flores, a state or local government would not be required to demonstrate a “compelling” governmental objective to ban housing discrimination under state and local human rights laws and ordinances unless the state has enacted its own equivalent of RFRA.

Halprin

To put it gently, the Halprin decision is strange. While Judge Posner spoke broadly, it would seem that he was talking about the facts of that case and the case really should not be read broader than its facts. Halprin was a Chicago lawyer who was having trouble getting along with his neighbors. The neighbors exhibited anti-Semitic behavior and Halprin and his wife sued them under the Fair Housing Act.

---

8 126 S.Ct. at 1225.
11 388 F.3d 327 (7th Cir. 2004).
The Court of Appeals held that the Fair Housing Act should not be used to resolve disputes among neighbors. We could live with that. The conflict in *Halprin* was between neighbors and not with the housing provider. Even if the conduct was based on religion or national origin, there was no allegation that the Halprins were about to vacate their premises. However, the Court went on to state that sections 804(a) and (b) do not apply to post-acquisition disputes. It did hold that the Halprins stated a claim under section 818 because HUD had adopted regulations that covered post-acquisition harassment. The Court questioned whether HUD had gone beyond its congressional mandate by exercising its rule-making ability to cover this situation, but because the issue was not raised by the defendants, the Court held that the validity of the rule was not before it.

Despite the Court of Appeals broad language concerning sections 804(a) and (b), *Halprin* involved an action against neighbors and not against a housing provider. If someone moves into a unit and then is denied the full right to enjoy that unit by the housing provider and especially if the result of that discrimination is that the owner or renter cannot remain there, there would seem to be a clear violation of Sections 804(a) and (b). This is confirmed by existing case law both in the Seventh Circuit and elsewhere. The Court of Appeals itself acknowledged this.

---

12 388 F.3d at 330.
13 42 U.S.C. § 3604 (a) and (b).
14 Congress rejected a similarly constrained interpretation of 42 U.S.C. § 1981 by the United States Supreme Court. In Patterson v. McLean Credit Union, 491 U.S. 164, 105 L.Ed.2d 132, 109 S.Ct. 2363 (1989), the United States Supreme Court held that discriminatory conduct that occurs after the formation of a contract or that does not interfere with the right to enforce established contract obligations does not violate § 1981. However, Congress responded to the Patterson decision by amending § 1981 to include a provision that the term “make and enforce contracts” includes “the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship.” 42 U.S.C. §§ 1981(b). There is every reason to believe that Congress intended the same broad coverage to apply under the Fair Housing Act.
16 24 C.F.R. § 100.400(c)(2).
17 388 F.3d at 330.
18 Section 3604(a) covers not only refusals to rent or sell, but also to “otherwise make unavailable or deny, a dwelling to any person.” 3604(b) covers not only discrimination in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith.”
19 The Court of Appeals stated:

“Acts of post-sale discrimination have been litigated successfully under the Act in two reported cases, *Trafficante v. Metropolitan Life Ins. Co.*, 409 U.S. 205, 93 S.Ct. 364, 34 L.Ed.2d 415 (1972); *Kruger v. Cuomo*, 115 F.3d 487 (7th Cir. 1997), but in neither was the Act’s applicability to such discrimination discussed – apparently the issue hadn’t been raised. In several other cases the Act has been held to forbid harassment amounting to
Furthermore, section 804(b) makes it illegal for a housing provider to discriminate in the services or facilities related to occupancy. Particularly if a housing provider is intentionally failing to prove services necessary to a tenant because of the tenant’s religion, there should be a violation of this section even after the owner or tenant has moved into the unit.

Harassment or retaliation for exercising one’s Fair Housing rights is clearly prohibited by Section 818. Neighbors should be liable for these illegal acts and a landlord or property manager should equally be liable if it knows of the actions by third persons, is in a position to stop or prevent those actions, and does not do so.

constructive eviction by analogy to “constructive discharge,” a form of discrimination recognized in Title VII cases. DiCenso v. Cisneros, 96 F.3d 1004, 1008 (7th Cir. 1996); Neudecker v. Boisclair Corp., 351 F.3d 361, 364-65, (8th Cir. 2003 (per curium); Honce v. Vigil, 1 F.3d 1085, 1090 (10th Cir. 1993). But in none of these cases did the court consider the difference in language between the two statutes. None of the five cases contains a considered holding on the scope of the Fair Housing Act in general or its application to a case like the present one in particular.” 388 F.3d at 329.

The Court of Appeals summary conclusion that the language of § 804(a) and (b) does not support post-acquisition discrimination is itself not “considered” and its summary dismissal of existing precedent is extraordinary. The cases cited by Judge Posner that conflict with his decision barely represent the myriad of precedents that point in the other direction from his extraordinary holding. For instance, the Fair Housing Act has been extended to retaliation against tenants because they entertained African-American guests, which obviously occurred after the tenancy commenced. Woods-Drake v. Lundy, 667 F.2d 1198, 1201 (5th Cir. 1982).

20 In Concerned Tenants Association of Indian Trails Apartments v. Indian Trails Apartments, 496 F.Supp. 522, 525 (N.D. Ill. 1980), it was held that the failure to provide the same service to black tenants that was formerly provided to white tenants may violate the Fair Housing Act. Judge Roszkowski stated that the defendant’s argument that their activities did not bear upon the availability of housing was “ludicrous and runs counter to the plain and unequivocal language of the statute.”

21 See, e.g., Reeves v. Carrollsburg Condominium Unit Owners Ass’n, 1997 WL 1877201 (D.D.C. 1997) (harassment by neighbors due to race and sex and failure of condominium association to stop this conduct when it had notice is actionable); Sofarelli v. Pinellas County, 931 F.2d 718, 721-22 (11th Cir 1991) (fair housing claim upheld against neighbors who harassed a housing provider because he provided housing to African-Americans); Cambell v. City of Berwyn, 815 F.Supp. 1138 (N.D. Ill. 1993) (claim was stated against municipality because it did not protect new black residents from harassment by neighbors.)
Service and Emotional Support Animals as Reasonable Accommodations Under the Fair Housing Act

Frank W. Young

Copyright © 2006 The John Marshall Law School
Service and Emotional Support Animals as Reasonable Accommodations Under the Fair Housing Act

By
Frank W. Young

Introduction

Under the 1988 amendments to the Fair Housing Act, landlords, condominium associations, and other housing providers are prohibited “from discriminating against applicants or residents because of their disability or the disability of anyone associated with them and from treating persons with disabilities less favorably than others because of their disability.” The Act prohibits discrimination against individuals with disabilities by preventing housing providers from refusing “to make reasonable accommodations in rules, policies, practices, or services when such accommodations may be necessary to afford a person with a disability the equal opportunity to use and enjoy a dwelling.” Significantly, housing providers must make reasonable accommodations in terms of “no pets” policies to let disabled individuals have service animals.

---

* Frank Young graduated from the John Marshall Law School in May 2006.


2 Joint Statement, Reasonable Accommodations at 1; Also see U.S.C. § 3604(f)(3)(B).

3 The HUD website provides the following example.

John has been diagnosed with severe depression and is disabled as defined by the Fair Housing Act. His doctor prescribes John a dog to help alleviate some of his symptoms. John asks his landlord if he can have a dog as a reasonable accommodation for his disability. His landlord says yes, but tells John he’ll need to pay a $250 pet deposit and must provide proof that the animal is trained.

Question: Did John’s landlord correctly handle John’s request under the Fair Housing Act? What if John wanted a cat or a ferret instead?

Answer: No, John’s landlord did not handle his request correctly. The landlord cannot charge John a pet deposit for his animal because it is not a pet, but rather a service/companion animal required for disability. Further, the landlord cannot ask for proof that the animal is trained. Lastly, service/companion animals do not have to be just dogs; they can also be other animals, such as cats or ferrets.

A recent study noted that 62 percent of American households include a pet. While pet owners state there are numerous intangible benefits of having an animal, many disabled individuals require service animals. Service animals are individually trained to perform tasks for the benefit of persons with disabilities. Service animals can be any breed or size, possibly wearing “specialized equipment such as a backpack, harness, special collar or leash,” but there are no legal requirements. Service animals are “allowed anywhere you could take another medical device, such as a wheelchair.” It should be noted that service animals should be distinguished from therapy animals and emotional support animals. Healthcare professionals utilize therapy animals as part of a treatment plan, and therapy animals do not have access to public places. Emotional support animals “provide companionship, relief from loneliness [, and] depression;” emotional support animals may be allowed in housing with “no pet” restrictions, but they do not have access to public places.

Housing providers “may restrict or prohibit the harboring of an animal in a rental unit” or condominium. However, housing providers are limited by the Fair Housing Act to a certain extent, whereby disabled individuals with service animals, and in some cases emotional support animals, may be “allowed to stay in housing despite “no pet” clauses.” A recent article stated that “[o]ne of the most prevalent and controversial accommodations under the [Fair Housing Act] concerns the necessity of pets for certain medicinal or service-oriented

---

5 Disability Law Center of Alaska, http://www.dlcak.org/publications/mentalhealth/04serviceanimals.htm (accessed Apr. 14, 2006). Service animals perform a wide variety of tasks for people with a wide variety of disabilities, including the following: guiding a person who is blind; alerting a person who is deaf or hard of hearing to noises such as alarms, doorbells, a baby crying, etc.; assisting wheelchair users by retrieving dropped items, opening doors, pulling a wheelchair, or carrying supplies; sensing and warning about a person’s oncoming seizure; and providing support or balance for someone with an unsteady gait.
6 Id.
8 Id.
9 Id.
10 Huss, 11 Animal L. at 72.
11 Id. at 70.
functions.” Clearly, an individual’s right to have the housing provider to make an accommodation is without question in cases of visual or hearing impairment. However, there is a great deal of uncertainty “when dealing with requests to waive pet restrictions based upon claims that a pet is necessary for everything from companionship to relieving symptoms of depression and arthritis” among others.  

This paper will discuss the following topics: 1) a brief overview of the Fair Housing Act; 2) what constitutes a reasonable accommodation for service or support animals under the Fair Housing Act; 3) animals that are classified as service or support animals; and 4) the types of disabilities that allow an individual to have a service or support animal.

I. The Fair Housing Act

The Fair Housing Act was part of the Civil Rights Act of 1968, providing protection from discrimination in housing on the basis of race, color, national origin, or gender. In 1988, the Fair Housing Act was amended, expanding protection from housing discrimination for new classes, including disability and familial status. John Marshall Law School Professor F. Willis Caruso noted that Congress passed the Fair Housing Amendments Act of 1988 to ensure that [disabled] members of society have an equal opportunity to reside and enjoy their living environment in the same manner as all members of society . . . recognize[ing] that sometimes landlords and other housing providers have to take affirmative steps to ensure that handicapped individuals have an equal opportunity to enjoy their living environment.

The Fair Housing Act affords wide protection for individuals with disabilities, including: having a physical or mental disability that substantially limits one or more major life activities, having a record of such a disability, or

---

13 Id. “Emotional support animals have been proven extremely effective at ameliorating the symptoms of these disabilities, such as depression and post-traumatic stress disorder, by providing therapeutic nurture and support.” Bazelon Center for Mental Health Law, Fair Housing Information Sheet # 6 Right To Emotional Support Animals In “No Pet” Housing, http://www.bazelon.org/issues/housing/infosheets/fhinfosheet6.html (accessed Apr. 14, 2006).
being regarded as having such a disability. A wide range of disabilities are covered under the Act; as “physical or mental impairment” includes the following: orthopedic, visual, speech and hearing impairments; as well as, cerebral palsy, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, HIV/AIDS, mental incapacity, emotional illness, drug addiction (other than addiction caused by current, illegal use of a controlled substance), and alcoholism. Significantly, a housing provider may not refuse to let a disabled individual make reasonable modifications to their dwelling or common areas or refuse to make reasonable accommodations in rules, policies, practices, or services for the disabled individual to use the housing. For this discussion, the key provision of the amended statute makes it “unlawful to refuse to make reasonable accommodations to afford a handicapped person equal opportunity to use and enjoy a dwelling.”

17 42 U.S.C. 3602(h); U.S. Department of Housing and Urban Development, Fair Housing, 3 (Jan. 2002). Disabilities include hearing, mobility, and vision; chronic alcoholism; chronic mental illness; HIV/AIDS; AIDS Related Complex; and mental retardation.
18 Joint Statement, Reasonable Accommodations at 3.
19 HUD, Fair Housing at 3.
20 42 U.S.C.A. § 3604(f)(3)(B). The applicable sections of the Fair Housing Act as amended under 42 U.S.C.A. § 3604(f) provide as follows:

§ 3604. Discrimination in the sale or rental of housing and other prohibited practices. As made applicable by section 3603 of this title and except as exempted by sections 3603(b) and 3607 of this title, it shall be unlawful--

(a) through (e) omitted

(f)(1) To discriminate in the sale or rental, or to otherwise make unavailable or deny, a dwelling to any buyer or renter because of a handicap of--

(A) that buyer or renter,

(B) a person residing in or intending to reside in that dwelling after it is so sold, rented, or made available; or

(C) any person associated with that buyer or renter.

(2) To discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection with such dwelling, because of a handicap of--

(A) that person; or

(B) a person residing in or intending to reside in that dwelling after it is so sold, rented, or made available; or

(C) any person associated with that person.

(3) For purposes of this subsection, discrimination includes--

(A) a refusal to permit, at the expense of the handicapped person, reasonable modifications of existing premises occupied or to be occupied by such person if such modifications may be necessary to afford such person full enjoyment of the premises except that, in the case of a rental, the landlord may where it is reasonable to do so condition permission for a modification on the renter agreeing to restore the interior of the premises to the condition that existed before the modification, reasonable wear and tear excepted.
(B) a refusal to make reasonable accommodations in rules, policies, practices, or services, when such accommodations may be necessary to afford such person equal opportunity to use and enjoy a dwelling; or

(C) in connection with the design and construction of covered multifamily dwellings for first occupancy after the date that is 30 months after September 13, 1988, a failure to design and construct those dwellings in such a manner that--

(i) the public use and common use portions of such dwellings are readily accessible to and usable by handicapped persons;

(ii) all the doors designed to allow passage into and within all premises within such dwellings are sufficiently wide to allow passage by handicapped persons in wheelchairs; and

(iii) all premises within such dwellings contain the following features of adaptive design:

(I) an accessible route into and through the dwelling;

(II) light switches, electrical outlets, thermostats, and other environmental controls in accessible locations;

(III) reinforcements in bathroom walls to allow later installation of grab bars; and

(IV) usable kitchens and bathrooms such that an individual in a wheelchair can maneuver about the space.

(4) Compliance with the appropriate requirements of the American National Standard for buildings and facilities providing accessibility and usability for physically handicapped people (commonly cited as “ANSI A117.1”) suffices to satisfy the requirements of paragraph (3)(C)(iii).

(5)(A) If a State or unit of general local government has incorporated into its laws the requirements set forth in paragraph (3)(C), compliance with such laws shall be deemed to satisfy the requirements of that paragraph.

(B) A State or unit of general local government may review and approve newly constructed covered multifamily dwellings for the purpose of making determinations as to whether the design and construction requirements of paragraph (3)(C) are met.

(C) The Secretary shall encourage, but may not require, States and units of local government to include in their existing procedures for the review and approval of newly constructed covered multifamily dwellings, determinations as to whether the design and construction of such dwellings are consistent with paragraph (3)(C), and shall provide technical assistance to States and units of local government and other persons to implement the requirements of paragraph (3)(C).

(D) Nothing in this subchapter shall be construed to require the Secretary to review or approve the plans, designs or construction of all covered multifamily dwellings, to determine whether the design and construction of such dwellings are consistent with the requirements of paragraph 3(C).

(6)(A) Nothing in paragraph (5) shall be construed to affect the authority and responsibility of the Secretary or a State or local public agency certified pursuant to section 3610(f)(3) of this title to receive and process complaints or otherwise engage in enforcement activities under this subchapter.

(B) Determinations by a State or a unit of general local government under paragraphs (5)(A) and (B) shall not be conclusive in enforcement proceedings under this subchapter.

(7) As used in this subsection, the term “covered multifamily dwellings” means--
Plaintiffs can prevail under the Fair Housing Act by proving discriminatory intent on the part of the defendant or on the theory that the defendant’s conduct has a disparate impact on individuals with disabilities. Discriminatory intent cases are straightforward, as the housing provider refuses to provide housing to an individual solely because of that person’s race, color, national origin, gender, familial status, or disability. Courts follow the burden shifting method in analyzing disparate impact cases. In the case of a disabled person, the plaintiff must first establish a prima facie case of housing discrimination, showing the following four elements: 1) the plaintiff suffers from a disability; 2) the housing provider knew of the disability or should reasonably be expected to know of it; 3) the accommodation of the disability may be necessary to afford the plaintiff an equal opportunity to use and enjoy the dwelling; and 4) the housing provider refused to make such accommodation.

Victims of housing discrimination have a number of options under the Fair Housing Act; a complainant “may commence action under the federal act, in state or federal court, [or] by filing an administrative complaint with the Department of Housing and Urban Development (HUD).” Additionally, state and local laws also prohibit discrimination based on handicap or disability such as the provisions found in the Illinois Human Rights Act or the Chicago Fair Housing Ordinance.

It should be noted that plaintiffs are not required to exhaust administrative remedies before resorting to the courts. So, plaintiffs may initiate an action in federal or state courts without referring the matter to HUD or a state or local agency, such as the Illinois Department of Human Rights or the Chicago Commission on Human Relations. As stated previously, disabled individuals may be able to keep their service or support animals despite a “no pets” policy under the reasonable accommodation provision of the Fair Housing Act.

(A) buildings consisting of four or more units if such buildings have one or more elevators; and

(B) ground floor units in other buildings consisting of four or more units.

(8) Nothing in this subchapter shall be construed to invalidate or limit any law of a State or political subdivision of a State, or other jurisdiction in which this subchapter shall be effective, that requires dwellings to be designed and constructed in a manner that affords handicapped persons greater access than is required by this subchapter.

(9) Nothing in this subsection requires that a dwelling be made available to an individual whose tenancy would constitute a direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others.

24 Id.
II. Reasonable Accommodations

Professor Caruso noted that three categories of disability-based discrimination exist. The first category is straightforward, where a housing provider expressly will not rent to an individual solely because of that individual’s physical or mental disability. The second category occurs when the housing provider refuses to make a reasonable modification in terms of facilities, i.e., grab bars in a bathroom. The final category occurs when the landlord or condominium association refuses to make a reasonable accommodation in its policies or rules. Here, the final category will be discussed—looking at what types of service and support animals are considered reasonable accommodations and what types of disabilities are entitled to a service or support animal.

Under the Fair Housing Act, the definition of housing discrimination includes refusing to make “reasonable accommodation in rules, policies, practices, or services, when such accommodations may be necessary to afford such person equal opportunity to use and enjoy a dwelling.” As a general rule, the “waiver of no-pet rule to allow disabled resident [the] assistance of [a] service animal constitutes reasonable accommodation of handicap under [the] Fair Housing Act.” Courts have concluded that a reasonable accommodation analysis “requires a flexible standard, based on the needs of the particular tenant.” Further, case law required that a disabled individual must establish the following to obtain a waiver of a “no pets” policy as a reasonable accommodation: 1) the accommodation must facilitate the disabled person’s ability to function; and 2) the accommodation must pass a cost-benefit balancing test that takes both parties’ needs into account.

Additionally, the plaintiff must establish a nexus between the animal and the disability in order to establish a valid claim under federal law. The HUD-DOJ Joint Statement explained that this idea as “an identifiable relationship, or nexus, between the requested accommodation and the individual’s disability.” An example of such a nexus was where a

tenant was in fact mentally disabled and that there was a link between the tenant’s ability to function and the emotional support provided by the presence of the cat. The court further noted that

---

26 Caruso, 29 John Marshall L. Rev. at 331.
27 Id. at 332.
28 Id.
29 Id.
31 Danne, 148 A.L.R. Fed. at 140.
32 See Bronk v. Inichen, 54 F.3d 425, 428-429 (7th Cir. 1995).
33 Id. at 431.
35 Joint Statement, Reasonable Accommodations at 6.
reasonable accommodations are necessary under the law, but accommodations that cause undue financial or administrative burdens on the housing authority need not be provided.\textsuperscript{36}

While courts noted that the nexus analysis was fact-specific, courts created rules stating whether specific training was necessary for an animal to be a reasonable accommodation.\textsuperscript{37}

As mentioned previously, the key provision under the Act for this discussion presents a significant affirmative obligation on the housing provider, requiring “that reasonable accommodations be made in rules, policies, practices, or services when such may be necessary to afford a [disabled] person equal opportunity to use and enjoy a dwelling.”\textsuperscript{38} In interpreting the provision, courts have noted that

Congress borrowed this reasonable accommodation language from regulations and case law interpreting . . . the Rehabilitation Act . . . and intended for such case law to supply the governing standard for what accommodations are reasonable under the FHAA . . . and some courts have made general pronouncements concerning what constitutes a reasonable accommodation.\textsuperscript{39}

Generally, courts have applied a broad rule that a reasonable accommodation does not impose undue financial or administrative burdens on the housing provider making the accommodation.\textsuperscript{40}

Specifically, a reasonable accommodation has been defined as “a change, exception, or adjustment to a rule, policy, practice, or service that may be necessary for a person with a disability to have an equal opportunity to use and enjoy a dwelling, including public and common use spaces.”\textsuperscript{41} The HUD-DOJ Joint Statement also noted that

[s]ince rules, policies, practices, and services may have a different effect on persons with disabilities than on other persons, treating persons with disabilities exactly the same as others will sometimes deny them an equal opportunity to use and enjoy a dwelling.\textsuperscript{42}

\textsuperscript{37} Id.
\textsuperscript{38} Danne, 148 ALR Fed. at 43.
\textsuperscript{39} Id.
\textsuperscript{40} Id. at 44.
\textsuperscript{41} Joint Statement, Reasonable Accommodations at 6.
\textsuperscript{42} Id.
As such, under the reasonable accommodation provision of the Act, a housing provider must make a reasonable accommodation “to rules, policies, practices, or services when such accommodations may be necessary to afford persons with disabilities an equal opportunity to use and enjoy a dwelling.” In making a reasonable accommodation, a housing provider may ask for supporting materials, which document the need for an emotional support animal. However, the Fair Housing Act does not require the disabled individual “to provide proof of training or certification of the animal.” Certification of service and support animals will be discussed in the following section.

III. Types of Animals

Federal statutes and regulations do not attempt to define the animals that can be used as service or support animals. According to the Americans with Disabilities Act (ADA), “a service animal is any guide dog, signal dog, or other animal individually trained to provide assistance to an individual with a disability.” This includes also “guiding individual with impaired vision, alerting individuals with impaired hearing to intruders or sounds, providing minimal protection or rescue work, pulling a wheelchair, or fetching dropped items.” Under the ADA’s definition, service animals are broadly defined, and courts have not ruled on what types of animals may be service or support animals. Rather, the proper inquiry is whether the animal in question is a reasonable accommodation. Disabled persons are not restricted to using only dogs and cats as support animals, as other species have assisted disabled persons, including monkeys, horses, birds, and pot-bellied pigs. Monkey Helpers for the Disabled states that monkeys are

---

43 Id. at 6-7. The Joint Report provides the following example of a reasonable accommodation: “A housing provider has a ‘no pets’ policy. A tenant who is deaf requests that the provider allow him to keep a dog in his unit as a reasonable accommodation. The tenant explains that the dog is an assistance animal that will alert him to several sounds, including knocks at the door, sounding of the smoke detector, the telephone ringing, and cars coming into the driveway. The housing provider must make an exception to its “no pets” policy to accommodate this tenant.” End quote?
45 Id. Two courts addressed this issue holding that the only requirements to be classified as a service animal under federal regulations are that the animal be 1) individually trained, and 2) work for the benefit of an individual with a disability. See Bronk, 54 F.3d at 430; Green v. Hous. Auth. of Clackamas County, 994 F.Supp. 1253, 1256 (D. Or. 1998).
46 Huss, 11 Animal L. at 83.
48 28 C.F.R. § 36.104.
49 Huss, 11 Animal L. at 83 (noting Susan D. Semmel, When Pigs Fly, They Go First Class: Service Animals in the Twenty-First Century, 3 Barry L. Rev. 39, 40 (2002). The Semmel article discussed the evolution of support animals in the United States, the variety of species being used, and the variety of tasks for which they may be utilized. She described a case of a 300-pound pot-bellied pig that was used as a support animal. Id. at 39. In that case, an individual flew from New
trained to provide assistance to serve “quadriplegic and other people with severe spinal cord injuries or mobility-impairments.”\textsuperscript{50} The Guide Horse Foundation purports to “provide a safe, cost-effective and reliable mobility alternative for visually impaired people.”\textsuperscript{51}

Under the ADA’s definition, “animals are considered service animals under the ADA regardless of whether they have been licensed or certified by a state or local government.”\textsuperscript{52} However, “housing providers may ask an applicant or tenant to provide documentation from a qualified professional that the individual has a disability and requires a service animal as an accommodation.”\textsuperscript{53} Such documentation might include the following: details about the tenant’s disability; tenant’s medical records; and the animal’s proof of training (such as a training certificate).\textsuperscript{54} According to Valparaiso Law School Professor Barbara Huss,

\begin{quote}
[t]here is excepted . . . seeing-eye and [hearing-aid] dogs or any other trained dog, provided the animal is properly trained and certified for the particular disability, licensed and provided further that the stockholder or resident has a certificate or authorization request from a licensed physician specializing in the field of subject disability.\textsuperscript{55}
\end{quote}

Nevertheless, the only requirements in the federal regulations are that the support animal is 1) individually trained and 2) work for the benefit of the disabled person.\textsuperscript{56} Further, the owner may provide the animal’s training; the key is to satisfy the second prong so that the animal works for the benefit of the disabled person by aiding him to cope with his disability.\textsuperscript{57}

\begin{footnotes}
\footnote{Helping Hands, http://www.helpinghandsmonkeys.org/ (accessed Apr. 16, 2006).}
\footnote{Disability Law Center of Alaska, http://www.dlcak.org/publications/mentalhealth/04serviceanimals.htm (last accessed Apr. 14, 2006).}
\footnote{Id.}
\footnote{Huss, 11 Animal L. at 78.}
\footnote{Poliakoff, 17 Prob. & Prop. at 39.}
\footnote{Id.}
\end{footnotes}
While housing providers can ask to review certification, courts have rejected the idea “that only certified animals may be reasonable accommodations.” Rather, courts follow a fact-specific reasonable accommodation analysis to determine “whether the animal lessens the effects of the specific person’s disability, and does not depend on the animal receiving professional training.” A number of courts have discussed service and support animals, as well as certification, in the reasonable accommodation context. The following key cases in this area will be discussed briefly: *Bronk v. Ineichen*, *Green v. Housing Authority of Clackamas County*, *Prindable v. Association Apartment Owners*, and *In re: Kenna Homes*. Additionally, two cases involving miniature horses will be discussed; and while not fair housing cases, these cases can be applied in a fair housing context.

One of the most significant cases in this area was the Seventh Circuit case *Bronk v. Ineichen*. In *Bronk*, the plaintiffs, two “profoundly” deaf women, alleged a violation of the Fair Housing Act, *inter alia*, against their former landlord, who refused “to allow them to keep a dog in their rented townhouse.” The plaintiffs sought to have a hearing-aid dog to assist them, but the defendant refused to modify his “no pets” policy. The court noted that a plaintiff’s brother had trained the dog as a hearing-aid dog: “to alert his owners to the ringing of the doorbell, telephone or smoke alarm, and to carry notes.” The defendant argued that the dog “had received no training beyond that purportedly provided by one of the plaintiff's brother, an amateur with no demonstrated experience in training hearing dogs” and that “no facility had ever certified [the dog] as a hearing dog.” The jury found for the defendant, finding that the defendant did not discriminate against the plaintiffs “by failing to reasonably accommodate their disability.”

On appeal, the Seventh Circuit noted that “a deaf individual’s need for the accommodation afforded by a hearing dog is, we think, per se reasonable within the meaning of the statute.” However, the parties contested the question of the dog’s skill level, and the court noted that “it was well within the province of a rational jury to conclude that [the dog’s] utility to plaintiffs was as simple house pet and weapon against cranky landlord.” However, the Seventh Circuit vacated the trial court’s verdict, ordering a new trial. The Seventh Circuit disagreed with the trial court’s jury instruction, *inter alia*, that stated: “[i]t is not discriminatory or unreasonable for a landlord to require a tenant wishing to keep a

---

59 Id.
60 *Bronk*, 54 F.3d at 426-427.
61 Id. at 427.
62 Id. at 427 n. 4.
63 Id. at 428.
64 Id.
65 Id. at 429.
66 Id.
67 Id. at 432.
hearing dog to show the landlord training credentials from a school.”

The Seventh Circuit held that in determining a reasonable accommodation, “a disabled individual’s ability to function must survive a cost-benefit balancing that takes both parties’ needs into account.” Significantly, “[p]rofessional credentials may be part of that sum; they are not its *sine qua non*.”

A subsequent federal case also dealt with a dispute over a hearing-aid dog; however, a public housing provider was the defendant. In following *Bronk*, the District Court of Oregon noted that “[t]he only requirements to be classified as a service animal under federal regulations are that the animal be 1) individually trained, and 2) work for the benefit of a disabled individual.” The court concluded that the defendant “did not accommodate plaintiffs by modifying its [“no pets” policy] despite the fact that there was no undue burden on it.” While the “no professional training” requirement was significant for the court in reaching its disposition, the court noted another significant fact: the defendant admitted that “it was told that the dog alerted [the plaintiff’s] son to knocks at the door and to the sounding of the smoke alarm.” However, the court cited *Bronk*, noting that “the accommodation must facilitate the disabled person’s ability to function, and survive a balancing of the tenant’s needs against the burdens placed on the landlord.” Further, the court held that no undue burden was placed on the defendant by allowing the dog in the apartment, and the defendant violated the Fair Housing Act by failing to accommodate the plaintiffs’ request.

Recent decisions have restricted reasonable accommodation by focusing on the animals’ training or certification. The *Kenna Homes* case presented a situation, where an apartment complex changed its by-laws, implementing a “no pets” policy. The new policy would phase out pets; whereby when the animals died, they could not be replaced. The policy included an exception for service animals, so long as the animal was “properly trained and certified for the

---

68 Id. at 430.
69 Id. at 431.
70 Id. While professional training is not required, a landlord may require verification of training. See *HUD v. Blue Meadows Limited Partnership*, No. HUD ALJ 10-99-0200-8, 10-99-0391-8 (July 5, 2000). In *Blue Meadows*, a tenant brought suit against the landlord for failing to allow a tenant to keep a pet on the property. *Id.* The landlord asked the tenant to provide verification that the pet was trained/certified, which the tenant failed to produce; the ALJ ruled in favor of the landlord. *Id.*
72 Id. at 1256. The court also noted that “There is no requirement as to the amount or type of training a service animal must undergo. Further, there is no requirement as to the amount or type of work a service animal must provide for the benefit of the disabled person.” 28 C.F.R. § 36.104. The regulations establish minimum requirements for service animals.
73 Id. at 1257.
74 Id. at 1256.
75 Id.
76 Id. at 1256-1257.
78 Id. at 385.
particular disability,” among other criteria. After a resident couple’s dog died, they sought to replace the dog but their permit was denied. Both individuals were diagnosed with various ailments and offered a physician’s statement that it was a medical necessity for these residents to keep their pets “to suppress both the physical and mental need for companionship as well as the confinement due to various illnesses.” After rejecting the request, the housing providers filed a petition for declaratory judgment as to the validity of its regulations.

The residents argued that the regulation violated the Fair Housing Act, because it failed to provide a reasonable accommodation “unless the dogs at issue are properly trained, certified, licensed, and an authorization request from a physician specializing in the field of the subject disability is produced.” The West Virginia Supreme Court noted the Bronk and Green cases in reaching its conclusion that “a requirement that a service dog be ‘properly trained’ does not conflict with federal or state law.” In following Bronk and Green, the West Virginia Supreme Court concluded that the Fair Housing Act does not require “professional training,” but it recognized that “some type of training is necessary to transform a pet into a service animal.” As to the certification provision, the court noted that there were “no uniform standards or credentialing criteria applied to all service animals or service animal trainers.” However, the court ruled that a tenant should make a bona fide effort to locate a certifying authority. Finally, the West Virginia Supreme Court concluded that the physician authorization requirement was reasonable, as the “requirement has attributes of a causation requirement.”

In a subsequent case, the defendant condominium association had a “no pets” policy without an exception for service animals. One plaintiff requested a reasonable accommodation, as to the “no pets” policy, requesting “a dog for his personal safety.” According to the plaintiff’s physician, the plaintiff needed a dog “to cope with the stress, poor sleep patterns [and] problematic ailments” resulting from trauma from an earlier assault. Subsequently, the plaintiff’s partner “submitted a note handwritten on a prescription pad from the Waikiki...
Health Center [reading] ‘[the plaintiff] has a medical illness for which a dog is necessary for his improvement.’”91 The District Court of Hawaii noted that only one of the plaintiffs was appropriately considered to be “disabled” under the Fair Housing Act, concluding that there was evidence that the latter plaintiff suffered from depression. 92 However, in following Bronk and noting Kenna Homes, the court noted that “most animals are not equipped ‘to do work or perform tasks for the benefit of an individual with a disability’. … There must instead be something—evidence of individual training—to set the service animal apart from the ordinary pet.”93

The court concluded that “the animal at issue must be peculiarly suited to ameliorate the unique problems of the mentally disabled.”94 In following Kenna Homes, the court noted that

[unsupported averments from [the plaintiff] and slight anecdotal evidence of service are not enough… to satisfy Plaintiffs’ burden in opposition to summary judgment. … Plaintiffs needed something more—an affidavit detailing [the dog’s] training, a declaration from [the dog’s] veterinarian or a certificate from any licensed training school—to survive summary judgment.95

In granting summary judgment for the defendants, the court concluded that “there is no evidence that would lead a reasonable jury to conclude that [the dog] is an individually trained service animal and, therefore, nothing to show that an accommodation for [the dog] may be necessary to afford [the plaintiff] an equal opportunity to use and enjoy the dwelling.”96

There are two recent cases involving miniature horses that build on the analysis discussed in the previous cases. These cases were not under the Fair Housing Act, but involved a restrictive covenant and a municipal ordinance. However, the disabled individuals could have argued for reasonable accommodations under the Fair Housing Act. One case was filed against the owners of a miniature horse, alleging a violation of a restrictive covenant.97 In the other case, the plaintiffs challenged a municipal decision that denied the issuance of permit as violative of the ADA.98

---

91 Id. at 1249-1250.
92 Id. at 1255.
94 Id. at 1256.
95 Id. at 1257 (citing In re Kenna Homes, 210 W.Va. at 390-391).
96 Id. at 1260.
In *Ridgewood Homeowners Association v. Mignacca*, the plaintiff homeowners association and residents alleged that the defendants violated a restrictive covenant, because they kept a miniature horse. The trial court noted that the restrictive covenant was ambiguous as to its scope, noting that its purpose was to prevent individuals from “keeping and raising animals in a ‘farm-like’ setting for commercial purposes.” The trial court concluded that “the restrictive covenant would not apply to the miniature horse in this case.” On appeal, the Rhode Island Supreme Court reversed, concluding that “[t]he restrictive covenant was not ambiguous and had not been enforced arbitrarily.” The Rhode Island Supreme Court ordered that the defendants should be permanently enjoined “from keeping the miniature horse on their property.”

Professor Huss indicated that a different effect or outcome might have resulted if the defendants raised the Fair Housing Act. She noted that “if [the defendant] was disabled, and the horse was a service animal, the analysis could be whether a reasonable accommodation would need to be made to the restrictive covenant.” It also should be noted that individuals have challenged municipal ordinances, with mixed results, as violations of the Fair Housing Act.

In another miniature horse case, the plaintiff sought declarative and injunctive relief under the ADA to prohibit the defendant municipality from discriminating against a disabled individual. The defendant attacked the plaintiff’s allegations, *inter alia*, on the grounds that the plaintiff’s physician testified at deposition that the plaintiff was “not a qualified individual with a disability.” In that case, the plaintiff suffered “from the congenital birth defect of spina bifida…she has cervical meningocele which is an open spine in the area of her neck…[she] also has hydrocephalus, commonly known as water on the brain.” The plaintiff walked with difficulty and used a wheelchair on occasion. A benefactor gave the plaintiff a miniature horse, and thereafter sought a permit from the defendant to keep the animal. However, the plaintiff did not inform the defendant “that she intended to utilize the horse as a service...
animal for [the plaintiff] under the ADA." Further, "[p]rior to the delivery of the horse . . . none of [the plaintiff’s] treating physicians had ever prescribed or recommended that [the plaintiff] utilize a miniature horse as a service animal." Significantly, the court noted that "[t]here is no proof the horse had received prior training as a service animal for purposes of the ADA." Nevertheless, the plaintiffs contended that

"they provided the [defendant] with extensive documents showing that [the plaintiff] is disabled and the horse is being utilized by [the plaintiff] as a service animal under the ADA. Despite this information, the [defendant] continued to deny the permit." However, the court concluded that the plaintiffs did not submit sufficient “proof clarifying and explaining precisely what the horse has been trained to do to assist [the plaintiff] as a service animal under the ADA." Further, the plaintiff’s physician testified that the miniature horse helped the plaintiff perform tasks that she would not otherwise be able to do; however, the physician did not “explain what specific tasks the horse actually performs for [the plaintiff] as a service animal under the ADA.” The court noted the Green disposition, concluding that "[t]here is no requirement as to the amount or type of work or assistance that a service animal must provide for the benefit of a disabled person." However, the court ultimately concluded that “[t]here are genuine issues of material fact in dispute on this final element of the plaintiffs’ claim which will have to be resolved at trial."

The Bronk, Green, Kenna Homes, and Prindable cases, as well as the miniature horse cases, provide examples of how courts will analyze whether a service or support animal will be considered as a reasonable accommodation under the Act. Under this analysis, the type of animal is not relevant, as the case law has noted that ADA and HUD regulations construe service animals broadly. The Seventh Circuit standard from Bronk has carried a lot of weight with other jurisdictions. The key principles from Bronk are that 1) the accommodation must aid the disabled individual’s ability to function and 2) the accommodation must survive a cost-benefit balancing that accounts for both parties’ needs.

Additinally, Bronk and subsequent cases support the proposition that an animal

111 Id.
112 Id.
113 Id.
114 Id. at 4.
115 Id.
116 Id.
117 Id. at 7.
118 Id.
120 Bronk, 54 F.3d at 430.
does not have to be professionally trained, but a housing provider may require that the animal be trained or certified. However, it is important that the animal receive some type of training to transform a pet into a service animal. The Bronk analysis will be critical in the context of which types of disabilities are entitled to service or support animals.

IV. Types of Disabilities

A disability that may require a service or support animal has expanded over the past several years. Case law and regulations provide that a reasonable accommodation under the Fair Housing Act may require a landlord or condominium association to allow a tenant to keep a service or support animal, such as a seeing-eye dog. However, the idea of a service or support animal under the Fair Housing Act is not limited to a seeing-eye dog. The West Virginia Supreme Court noted that “there are several other types of service dogs,” which aid hearing-impaired individuals, mobility-impaired individuals, individuals with autism, and individuals with seizures. Many recent cases have discussed the applicability of Fair Housing Act protection to individuals with such disabilities as hearing impairment, epilepsy, depression, mental anxiety, panic disorder, HIV/AIDS, and physical disabilities. Significantly, recent studies have demonstrated the affects of companion animals on humans. Some examples show that interaction with companion animals decrease human’s blood pressure, lowers human’s cholesterol and triglycerides, and helps to treat some forms of

---

121 See Bronk, 54 F.3d 425; In re: Kenna Homes, 210 W. Va. 380.
122 Id. at 390.
123 42 U.S.C.A. § 3604(f)(3)(B); Danne, 148 ALR Fed. at 146-147. The ALR article notes that one court has speculated that such an obligation would cease once the animal endangers other tenants. An example from HUD’s regulations provides “that where a blind applicant for rental housing desires to live in a dwelling unit with a seeing-eye dog, but the building has a ‘no pets’ policy, it is unlawful for the owner or manager of the apartment complex to refuse to permit the applicant to live in the apartment with a seeing-eye dog because, without the dog, the blind person will not have an equal opportunity to use and enjoy the dwelling.” 24 CFR 100.204(b). Also, HUD’s Fair Housing booklet provides the specific example of “[a] building with a ‘no pets’ policy must allow a visually impaired tenant to keep a guide dog.”
124 In re: Kenna Homes, 210 W.Va at 388 n. 7. Autistic individuals are assisted by “[a]n ‘SSigDog’ [which] is trained to assist persons with autism by alerting its partner to distracting repetitive movements common among those with autism, and thus allowing the person to stop the movement. Also, an autistic person may have difficulty with sensory input and need the same support services from a dog that a dog might give to a person who is blind or deaf.” Id. Also, “Seizure Response Dogs . . . are trained to assist a person with a seizure disorder. For example, the dog may stand guard over the person during a seizure, or the dog may go for help. A few dogs have learned to predict a seizure and warn the person in advance.” Id. (citing The Board of Regents of the University of Wisconsin System, University of Wisconsin Service Animal Policy, http://www.wisc.edu/adac/physical/servicedog.html (accessed Apr. 22, 2006).
125 Huss, 11 Animal L. at 70.
mental illnesses. Additionally, there have been news reports and articles on trained dogs that guard their owners during a seizure, activate medical alerts, or get help when necessary. The following sub-sections will discuss the types of disabilities and whether service or support animals have been allowed as a reasonable accommodation.

A. Visual Impairment

HUD regulations express clearly that a seeing-eye dog is a reasonable accommodation under the Fair Housing Act. Similarly, case law supports this proposition, where the Ninth Circuit held that the Fair Housing Act requires a housing provider to waive a “no pets” rule for a blind tenant, who required a seeing-eye dog. The Ninth Circuit noted that housing providers might impose fees in certain circumstances, but “such a fee could effectively prevent the handicapped tenant from obtaining the needed benefit.” Clearly, seeing-eye dogs will pass muster under a reasonable accommodation analysis, because such an animal requires training in order to assist a visually impaired individual and clearly works for the benefit of the disabled individual. However, a court has acknowledged that a housing provider’s refusal to allow a blind tenant to have a seeing-eye dog may not amount to a failure to accommodate where the dog endangers other tenants. The Rakuz court observed that although an example in the HUD regulations indicated that it was a violation of the reasonable accommodation requirement of the Fair Housing Act for a landlord with a “no pets” policy to refuse to allow a seeing-eye dog to live with a tenant with blindness. However, the court concluded that it is questionable whether the landlord must continue to tolerate a situation in which the seeing-eye dog bites other tenants.

B. Hearing Impairment

A hearing-aid dog is trained to assist a deaf individual in his or her daily activities, as by alerting the individual to the ring of a doorbell, telephone or

128 24 C.F.R. 100.204.
129 U.S. v. California Mobile Home Park Mgt. Co., 29 F.3d 1413, 1416-1417 (9th Cir. 1994)
130 Id. at 1419.
132 Id. (citing 24 CFR § 100.204, example one).
133 Id.
smoke alarm. The Seventh Circuit noted that “a deaf individual’s need for the accommodation afforded by a hearing dog is...per se reasonable within the meaning of the [Fair Housing Act].” The Seventh Circuit noted that denying a tenant a hearing-aid dog could be found to constitute not only a violation of the reasonable accommodation requirement of the Act, but a violation of the basic obligation imposed by § 3604(f)(2) of the Act not to discriminate on the basis of disability in the terms, conditions or privileges of sale or rental of a dwelling.

The Bronk court noted that HUD’s regulations give as an example of a reasonable accommodation allowing a blind applicant for rental housing to keep her seeing-eye dog in a building with a “no pets” policy, and said that clearly the situation of a deaf resident who wishes to keep a hearing-aid dog is analogous. Similarly, a hearing-impaired tenant sued the county housing authority for refusing to allow the tenant to keep a service dog for hearing assistance purposes. In that case, the Green court found that the housing authority failed to accommodate the tenant by modifying the no pet policy despite the fact that there was no undue burden. That court reinforced the position that hearing-aid dogs are reasonable accommodations under the Act. In an interesting twist, the John Marshall Law School Fair Housing Legal Clinic represented a plaintiff, who claimed a condominium’s “no pet” policy prohibited her from having a hearing cat. While this case settled, there would be no reason to conclude that the hearing-impaired plaintiff would not prevail, so long as the cat was adequately trained to assist the plaintiff.

C. Epilepsy

The Department of Justice notes that service animals can “alert people with epilepsy to an impending seizure.” Such an example is a clear indication that an individual who suffers from epilepsy would be able to keep a service animal as a reasonable accommodation. However, a recent court decision demonstrated that the plaintiffs still must put their housing provider on notice of their disability and need for a service animal. In Evans v. Watson, the plaintiff alleged, inter alia, that the defendants “failed to accommodate her epileptic condition by refusing her request for permission to have a dog.” The defendants contended that the plaintiff “faked epilepsy in order to get money from the government,” as well as arguing that the plaintiff never requested any

134 Bronk, 54 F.3d at 427 n. 4.
135 Id. at 429.
136 Id. 429-430.
137 Id. at 429 n. 6.
138 Green, 994 F. Supp. at 1254-1255.
139 Id. at 1257.
accommodation for her condition. The Oregon District Court denied both the plaintiff’s motion for partial summary judgment and the defendants’ motion for summary judgment, observing that “[s]everal issues must be resolved by the trier of fact regarding [the plaintiff’s] claim of discrimination based upon her [disability].” Essentially, the plaintiff should have informed the defendant of her condition and that she required a service animal.

D. HIV/AIDS

In Zatopa v. Lowe, a tenant suffering from AIDS and long-term clinical depression acquired a dog to help alleviate his symptoms in violation of a “no pets” provision in his lease; the plaintiff adopted a pit bull mix. The defendant conceded that the plaintiff was disabled and an emotional support animal was a reasonable accommodation. However, the dispute was over the type of animal chosen by the plaintiff. The defendant argued that the dog in question, a pit bull mix, was a nuisance, creating “a substantial interference with the comfort, safety or enjoyment of the landlord and tenants in the building.” While the defendant agreed to let the plaintiff to keep a dog that was of a “safe and gentle” breed, the focus for the Northern District Court of California was whether the defendant was required to allow the plaintiff to keep that “particular dog as a reasonable accommodation.” In resolving this case, the court noted that “an accommodation need not satisfy the particular preference of the disabled person in order to be held reasonable.” As a result, the court concluded that the defendant’s offer of a “safe and gentle” dog breed was a reasonable accommodation under the Fair Housing Act.

E. Mental Disabilities

The Kenna Homes and Prindable cases have shaped the jurisprudence for emotional support animals. Professor Huss noted

[i]f the standards set by [Kenna Homes], and adopted by Prindable, are supported by subsequent decisions interpreting the [Fair Housing Act], persons asserting their rights under the [Fair Housing Act] will need to establish a clear record of their

\[\text{143 Id. at 1-2.}\]
\[\text{144 Id. at 3.}\]
\[\text{145 Zatopa v. Lowe, No. C 02-02543, 2, 10 (N.D. Cal. Aug. 7, 2002).}\]
\[\text{146 Id. at 5.}\]
\[\text{147 Id. at 3-6.}\]
\[\text{148 Id. at 4.}\]
\[\text{149 Id. at 12.}\]
\[\text{150 Id.}\]
\[\text{151 Id. at 15.}\]
\[\text{152 See Kenna Homes, 210 W.Va. 380; Prindable, 304 F.Supp.2d 1245.}\]
disabilities, as well as the status of the animal, to have a service
animal in housing where a “no pets” policy applies.\footnote{Huss, 11 Animal L. at 81.}

As noted previously, the \textit{Bronk} analysis was still at the core of the \textit{Kenna Homes}
and \textit{Prindable} cases; so the key determination of whether an emotional support
animal is a reasonable accommodation depends on the Seventh Circuit’s analysis
in \textit{Bronk}.

The West Virginia Supreme Court required that a tenant show that the pet
possessed specific training or provided services other than companionship that
facilitated the disabled individual’s ability to function.\footnote{In re \textit{Kenna Homes}, 210 W. Va. at 393.}
In \textit{Kenna Homes}, the condominium association sought a declaratory judgment regarding its occupancy
regulation prohibiting animals, except for service animals.\footnote{\textit{Id.} at 385.}
The regulation further provided that such service animals must be properly trained and certified
for the particular disability and required that the resident seeking to house the
service animal provide the cooperative with a certificate from a physician
specializing in the field of the claimed disability, certifying that the resident
suffers from the claimed disability.\footnote{\textit{Id.} at 385-386.}
The court stated that the purpose of the Fair Housing Act is to ensure that disabled individuals are provided the same
opportunity to use the housing, but it does not require accommodations that
increase the benefit to a disabled individual above and beyond that provided to
non-disabled individuals for matters unrelated to the disability.\footnote{\textit{Id.} at 386.}

In \textit{Prindable}, an “unsupported averment” by a condominium resident who
was allegedly disabled by depression and anxiety that his dog was “individually
trained to provide emotional support” was insufficient to make the dog a “service
animal” for purposes of Fair Housing Act requirement for reasonable
accommodation of disability. The court noted that there was no evidence that dog
had been individually trained to provide assistance to the plaintiff, and the
plaintiff’s counsel admitted that dog possessed no abilities unassignable to the
breed or to dogs in general.\footnote{Prindable, 304 F. Supp. 2d at 1260.}
Conversely, a decision was rendered in a HUD administrative hearing with an opposite conclusion, involving a tenant suffering
from depression who sought to keep a dog.\footnote{\textit{HUD v. Riverbay}, No. HUD ALJ 02-93-0320-1 (Sept. 8, 1994.).}
However, it should be noted that the HUD decision was issued several years before the \textit{Kenna Homes} and
\textit{Prindable} cases. In that case, the ALJ agreed with the tenant that her depression
was a mental handicap protected by the Act’s anti-discrimination provisions, also
agreeing with the tenant’s expert witnesses who opined that the tenant’s dog was
a necessary therapeutic device to alleviate the tenant’s symptoms.\footnote{\textit{Id.}.}
Nevertheless, that HUD claim might have survived scrutiny even after *Kenna Homes* and *Prindable*, as the plaintiff must provide more than just a self-serving statement that the animal is necessary for emotional support.

A recent case from the John Marshall Law School Fair Housing Legal Clinic tested the limits of the Fair Housing Act’s applicability to a disabled person’s right to have an emotional support animal. In that case, the plaintiff alleged that a condominium requirement prohibited him from keeping his dog, which was purchased “to address his therapeutic needs in dealing with his disabling depression.”[161] The plaintiff had a history of depression, and his psychiatrist “stated that it is essential to [p]laintiff’s mental health that he keeps his present dog . . . to assist with his depression.”[162] The condominium requirements had a weight limit restriction for dogs, and the plaintiff’s dog exceeded the limit by a large amount.[163] In following the *Kenna Homes* and *Prindable* cases, it would be unclear whether the *Senerchia* plaintiff would be entitled to a reasonable accommodation. The key question is what kind of training is required for an emotional support animal? As the *Kenna Homes* court held that some type of training is necessary to transform a pet into a service animal.[164] However, according to Professor Caruso, the parties were able to reach a settlement, whereby the plaintiff would keep his present dog, as well as being able to replace the dog when it died with a similar breed of dog and damages.[165]

Depression and anxiety cases have resulted in mixed results for plaintiffs. Despite the line of cases enforcing “no pet” provisions, the courts have sided with the pet owner in a number of cases. In a New York case, summary judgment was precluded on the issue of whether keeping a cat was necessary to assist a tenant in coping with a mental illness, specifically panic disorder with agoraphobia, mixed personality disorder, as well as chronic anxiety with a history of episodic alcohol abuse.[166] Once again, this decision was issued before *Kenna Homes* and *Prindable*. In noting the applicability of both the Rehabilitation Act and the Fair Housing Act, the court stated that the plaintiff “must demonstrate that he has an emotional and psychological dependence on the cat which requires him to keep the cat in the apartment.”[167] The plaintiff submitted evidence from his physician, among other experts, supporting his contention that he “received therapeutic benefits from keeping and caring for his cat,” thus, the cat helped him to use and enjoy the dwelling by alleviating the manifestations of his mental illness.[168] In another administrative hearing (once again pre-*Kenna Homes* and *Prindable*), the

---

162 *Id.*
163 *Id.* at 390.
166 *Id.* at 1006.
167 *Id.* at 1007.
complainant sought to keep a cat to alleviate his mental anxiety, pain, and depression, which resulted from a medical disability known as fibromyalgia, a musculoskeletal condition. The complainant presented expert physician testimony that his cat provided therapeutic benefits by relieving his anxiety and depression. The ALJ ruled against the housing provider, which had refused to waive its “no pet” policy.

In another recent case, the plaintiff suffered from a severe mental health disability, and her physician testified that the “plaintiff’s pets, two birds and two cats, lessen the effects of this disability by providing her with companionship and are necessary to her mental health.” The plaintiff had signed a leased with a low-income apartment building with a “no pets” policy; however, the plaintiff did not inform the defendant of her animals. The plaintiff alleged that the defendant refused to make a reasonable accommodation, while the defendant claimed that it was willing to accommodate partially her request. When the plaintiff failed to provide vaccination documentation, the defendant moved to evict; however, the plaintiff moved out and initiated her lawsuit. The defendant moved to dismiss, and alternately for summary judgment.

In rejecting the defendant’s motion to dismiss, the Northern District Court of California noted that federal regulations provide a broad definition for service animal. The court noted that the plaintiff sufficiently pleaded her case in order to survive a motion to dismiss. Additionally, the court held that “[a]s plaintiff has adequately plead that she is [disabled], that defendants knew of her [disability], that accommodation of the [disability] may be necessary and that defendants refused to make such accommodation, defendants’ motion to dismiss is denied.” Further, the court rejected the defendants’ motion for summary judgment, because the plaintiff had not conducted discovery; specifically, “to discover the likely costs, or administrative burdens that would be imposed on the defendants if they were to accommodate her.” What remained unclear was whether the plaintiff would be able to keep all of her animals—the two birds and two cats. Also, while Janush preceded Kenna Homes by one year and Prindable by three years, it would have conceivably equal precedential value, at least until the federal circuit courts address this issue.

170 Id.
171 Id.
172 Janush, 169 F.Supp.2d at 1134.
173 Id.
174 Id.
175 Id.
176 Id.
177 Id. at 1136.
178 Id.
179 Id.
180 Id.
F. Physical Disabilities

Just like in cases involving individuals with mental disabilities, the *Bronk* analysis plays a key role in cases involving physical disabilities. In a HUD administrative hearing, a complainant alleged that the respondent “failed to make a reasonable accommodation of his [disability] by refusing to waive its [“no pets”] policy.”\(^{181}\) The complainant’s [physician] noted that he had “a long-time severe physical disability and it is medically necessary that he [keeps] his emotional support companion animals, his cats, to control the frequency and severity of his physical disability.”\(^{182}\) According to his physician, the plaintiff suffered from severe emotional disabilities that also triggered asthma attacks.\(^{183}\) However, the ALJ noted that “[complainant] failed to establish that his two untrained cats are necessary for him to have equal opportunity to use and enjoy his dwelling within the meaning of the [Fair Housing Act].”\(^{184}\) The ALJ concluded that “[t]here was no direct linkage between being able to use and enjoy his unit.”\(^{185}\)

In another case, a physically disabled plaintiff alleged a violation of the Fair Housing Act against a housing authority when, *inter alia*, it refused to allow him to keep his dog as a reasonable accommodation.\(^{186}\) The plaintiff was a 48-year-old “paraplegic who suffered lower extremity paralysis in a motorcycle accident in 1977.”\(^{187}\) In that case, the plaintiff appealed the lower court’s grant of summary judgment in favor of the defendant.\(^{188}\) As to the dog in that case, the housing authority imposed a weight restriction of 20 pounds for dogs; the plaintiff’s dog weighed 47 pounds.\(^{189}\) While the defendant argued that keeping a dog that violated the lease agreement, the appellate court noted that

> even were it established that plaintiff was aware of the pet policy at the time he entered into the lease, that does not mean that he would be precluded from keeping a pet in his unit if he needed the pet to accommodate his disability. Despite its pet policy, the [defendant] remains obligated to accommodate plaintiff’s disability “to the extent necessary to provide the handicapped person with an opportunity to use and occupy the dwelling unit equal to a non-handicapped person.”\(^{190}\)

---


\(^{182}\) *Id.* at 2.

\(^{183}\) *Id.* at 3.

\(^{184}\) *Id.* at 4.

\(^{185}\) *Id.* at 5.

\(^{186}\) *Oras*, 373 N.J.Super. at 306..

\(^{187}\) *Id.*

\(^{188}\) *Id.*

\(^{189}\) *Id.* at 307-308.

\(^{190}\) *Id.* at 314 (citing 24 C.F.R. § 966.7(a)).
The appellate court noted that “[w]hether a pet is of sufficient assistance to a tenant to require a landlord to relax its pet policy so as to reasonably accommodate the tenant’s disability requires a fact-sensitive examination.”\footnote{191} Significantly, the appellate court stated that the trial court failed to give any consideration to the plaintiff’s needs when it granted summary judgment in favor of the defendants.\footnote{192} The court noted that “a reasonable accommodation ‘means changing some rule that is generally applicable to everyone so as to make its burden less onerous on the handicapped individual.’”\footnote{193} As a result, the appellate court concluded that the plaintiff was requesting a reasonable accommodation “when he requested that [the defendant] relax its policy of limiting dogs to [20] pounds, and allow him to keep his [47] pound dog, which two doctors indicated would assist his physical and mental well being.”\footnote{194} As such, the appellate court reversed and remanded, but ordered the plaintiff to “prove that the requested accommodation was necessary to afford him an equal opportunity to use and enjoy his dwelling.”\footnote{195}

In a subsequent case, the Washington Court of Appeals followed the analysis of \textit{Green} and \textit{Prindable} as to the amount of training necessary for a service animal.\footnote{196} In that case, the Washington State Human Rights Commission filed a complaint on behalf of an individual who was expelled from a trailer park, allegedly “because of her disability and use of a service animal.”\footnote{197} The individual experienced severe migraine headaches about three times a week, and she trained her dog to alert other individuals when she was suffering from the severe migraines.\footnote{198} The complainant provided all of the dog’s training, and when the dog “was seven to nine months old, [it] began responding to [the complainant’s] migraines.”\footnote{199}

After an administrative hearing, the ALJ concluded that the defendant’s reasons for denying the complainant’s application were pretextual, and the
defendant violated the Fair Housing Act by denying her rental application because the complainant used a service animal. The ALJ concluded that [n]ot much [training] is required of an alert dog, that [the dog] had a propensity to alert others to [the complainant’s] needs, and that [the dog] achieves what she wants—attention to [the complainant]—[which] is in itself positive reinforcement of desired behavior and thus a form of training.

On appeal, the Washington Court of Appeals noted the Green court’s conclusion that there was no requirement “as to the amount or type of training a service animal must undergo” or the “type of work a service animal must provide for the benefit of the disabled person.” However, the appellate court acknowledged that there must be some training to set a service animal apart from an ordinary pet. As such, the appellate court noted that the ALJ found that the dog was not trained specifically to alert others when the complainant was incapacitated by a migraine headache, and such a conclusion was at odds with the legal conclusion that the dog was a service animal. The appellate court reversed the ALJ’s decision, concluding that the dog “was not a service animal . . . [as the dog’s] training consisted of getting what she wanted—attention from [the complainant]—[such a conclusion would] make any family pet into a service animal.”

In reviewing a sample of reasonable accommodation cases, it is evident that individuals with various disabilities, mental and physical, may be entitled to a service or support animal as a reasonable accommodation under the Fair Housing Act. In analyzing these cases, courts have noted consistently that some type of training is necessary to transform a pet into a service animal. Significantly, there must be some kind of evidence as to the animal’s skill, but self-serving statements by a plaintiff are not sufficient.

**Conclusion**

Professor Caruso noted that “[i]n a [broad] sense, the Fair Housing Act requires communities as well as individual [housing providers] to recognize equal opportunities for [disabled] members of group homes or handicapped individual homeowners.” Significantly, the Fair Housing Act provides that housing providers must take affirmative steps to ensure that disabled individuals have an

---

200 Id. at 898.  
201 Id. at 901.  
202 Id. (citing Green, 994 F.Supp. at 1256; C.F.R. § 36.104).  
203 Id. at 901-902 (citing Prindable, 304 F.Supp.2d at 1256).  
204 Id. at 902.  
205 Id.  
206 Id. at 390.  
equal opportunity to enjoy their living environment.\textsuperscript{208} Under the Act, housing providers must make changes “in long-standing rules and the imposition of reasonable financial burdens are not unreasonable means for providing equal opportunity housing for [disabled] individuals.”\textsuperscript{209} According to the case law, the reasonable accommodation analysis is fact intensive. A wide range of disabilities may be entitled to a reasonable accommodation of a service or support animal. Clearly, seeing-eye and hearing-aid dogs are reasonable accommodations. However, emotional support animals can provide assistance for disabled individuals “by lessening the effects of the disability and increasing their quality of life.”\textsuperscript{210} Disabled individuals are not limited to certain types of animals, as service or support animals. Traditionally, the seeing-eye dog is the example that most people envision. However, the type of animal is not relevant in a reasonable accommodation analysis. As he Seventh Circuit concluded in \textit{Bronk}: “1) the accommodation must facilitate the disabled person’s ability to function; and 2) the accommodation must survive a cost-benefit balancing that takes both parties’ needs into account.”\textsuperscript{211} Additionally, \textit{Bronk} and subsequent cases support the proposition that an animal does not have to be professionally trained, but a housing provider may require that the animal be trained or certified.\textsuperscript{212}

The \textit{Kenna Homes} and \textit{Prindable} cases will play key roles in a reasonable accommodation analysis. The \textit{Kenna Homes} court concluded that a housing provider does not violate the Act by asking a disabled individual for proof of training or certification of the service or support animal.\textsuperscript{213} While \textit{Kenna Homes} is a state court case, the Hawaii District Court followed it, concluding that some training is necessary to transform a pet into a service or support animal.\textsuperscript{214} As Professor Huss noted disabled individuals arguing for a reasonable accommodation under the Fair Housing Act must establish a clear record of their disabilities, as well as the status of the animal, to have a service or support animal in housing where a “no pets” policy applies.\textsuperscript{215}

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.}
\item \textit{Id.}
\item Brewer, \textit{Emotional Support Animals} at 14.
\item \textit{Bronk}, 54 F.3d at 430.
\item \textit{See Bronk}, 54 F.3d 425; \textit{In re: Kenna Homes}, 210 W. Va. 380.
\item \textit{See Kenna Homes}, 210 W. Va. 380.
\item \textit{See Prindable}, 304 F.Supp.2d 1245.
\item Huss, 11 Animal L. at 81.
\end{enumerate}
\end{footnotesize}
Assessing the Value of Affordability:
Ad Valorem Taxation of Properties Participating in the
Low Income Housing Tax Credit Program

By Joseph Rosenblum

Copyright © Joseph Rosenblum 2006
Assessing the Value of Affordability:
*Ad Valorem* Taxation of Properties Participating in the Low Income Housing Tax Credit Program

By
By Joseph Rosenblum*

I. Introduction

Valuation of Low Income Housing Tax Credit (LIHTC) properties for property taxation is a complex issue due to unusual rules and restrictions imposed upon such properties by federal and state regulation. Accounting for such restrictions presents special difficulties because of the limited number of these properties, the potential value of the related tax credits, and the severity of the restrictions, including a lack of residual value, restricted rental rates, and a compliance period of more than 30 years. Both assessors and courts have struggled with a number of issues regarding how best to value LIHTC properties. These difficulties focus on two general questions. First, whether to base a valuation on a property’s restricted rents or market rents. Second, whether tax credits are properly used as a factor in determining the fair market value of the real property upon which they were awarded.

As a result of conflicting state court decisions and often vague statutes, valuation of LIHTC properties remain uncertain. Consequently LIHTC property owners are faced with potentially significant and unpredictable economic costs. The concern is thus, that without consistent methodology for valuing LIHTC properties, owners will not have confidence in the financial viability of their properties and they will bare a greater risk of default.

Part I of this paper briefly summarizes the LIHTC program and examines the methods used by states and localities for assessing the value of LIHTC properties for *ad valorem* taxation. Part II explores the current split among state courts examining the appropriate methodology for valuing LIHTC properties – the relevant issues and the courts’ reasoning. Part III addresses the recent increase in state statutes addressing valuation of LIHTC properties. This section categorizes and attempts to assess the clarity and consistency of the varied statutory schemes. Part IV suggests both a need for states to enact clarifying statutes and for those statutes to broadly address LIHTC valuation issues in order to provide increased uniformity and predictability of LIHTC property valuation for property owners, assessors, and local governments.

* Joseph Rosenblum received his J.D. from the University of Colorado School of Law, and a Master’s in Regional Planning from the University of Massachusetts Amherst.
A. Low-Income Housing Tax Credits Generally

The low-income housing tax credit (LIHTC) program codified as section 42 of title 26, the Internal Revenue Code (“Code”), is the primary federal program for subsidized affordable housing production, with nearly 22,000 projects and more than 1,141,000 housing units placed in service in between 1987 and 2002. Section 42 allows eligible taxpayers to take a dollar for dollar credit against federal income taxes. A tax payer becomes eligible for Low-Income Housing Tax Credits (LIHTCs) by holding an ownership interest in a qualified low-income housing project awarded by a state housing agency. Tax credits can be claimed annually over a 10-year period by the owners, 10 percent annually for 10 years. Typically, however, developers need current equity to fund development costs. Consequently, developers will sell the rights to the future credits in exchange for cash, a process called syndication.

As a matter of tax law, the credit purchasers must be part of the property ownership entity. Usually this is accomplished by creating either a limited partnership in which the credit purchaser is a 99.9 percent limited partner and the developer, as general partner, holds a de minimus 0.01 percent interest. Alternatively, the same result can be reached using a limited liability company in which the credit purchaser is a 99.9 percent non-managing member with the developer holding a de minimus. The general partner, developer, is responsible for managing the project, while the limited partners are passive investors. Profits, losses, deductions and tax credits are shared pro-rata according to the partners’ percentage ownership interests.

In return for tax credits, project owners agree to operate the project in accordance with restrictions contained in Section 42 and related IRS regulations.

---

4 See generally 26 U.S.C. § 42.
7 HERBERT STEVENS & THOMAS TRACY, DEVELOPER’S GUIDE TO THE LOW INCOME HOUSING TAX CREDIT 18, 81 (2000).
8 Id. (Noting that it is “not uncommon to see only .01% of the Tax Credits, losses, and income allocated to the general partner or managing member and 99.99% of these items allocated to limited partner(s) or other members.”)
9 Id.
10 Id.
As a condition of receiving LIHTC, the owner must enter into a recorded regulatory agreement restricting the use of the property. In order for a project to qualify for tax credits, it needs to provide a minimum set aside, which can be satisfied either by providing that, 20 percent of the units be occupied by individuals with incomes of 20 percent or less of area median income,\(^{11}\) or 40 percent of the units be occupied by individuals with incomes of 60 percent or less of area median income.\(^{12}\)

For all LIHTC units rents cannot exceed 30 percent of an imputed income limit based upon the household size occupying the unit.\(^{13}\) In addition to the federal restrictions, LIHTC projects are also subject to agreements with state housing agencies to restrict rents for a period of at least 15 years in excess of the 15-year federal restrictions.\(^{14}\)

**B. Methods For Assessing Ad valorem Taxes Generally**

In valuing property, assessors and courts rely on the following traditional appraisal methods: market sales, cost less depreciation, and income capitalization.\(^{15}\) Some jurisdictions allow assessors to use a combination of methods while others do not. Of the three methods, the cost less depreciation approach and the income approach are likely to provide the best estimates of an LIHTC property’s value.\(^{16}\) Of the three methods, the income approach is used most often by courts, assessors, and legislatures for valuing LIHTC properties.

The market sales approach, the most commonly employed method for estimating property values of multi-family market rate properties, uses

---


\(^{12}\) 26 USC § 42 (g)(1)(B). This is often called the 40-60 test. *Affordable Housing Lexicon*, supra note 11.

\(^{13}\) 26 USC § 42(g)(2)(A).


\(^{16}\) Richard E. Polton, *Valuing Property Developed with Low-Income Housing Tax Credits*, 62 APPRAISAL J. 446, 452 (1994)
comparable sales to estimate the subject properties market value. This is accomplished by comparing the subject property to other properties recently sold, with similar structure and size, improvements, and location. Recent sale prices of comparable properties are then used to estimate the value of the subject property. Courts and the appraisal literature are generally in agreement that the market sales approach “is likely to be of little value because comparable sales are highly unlikely,” and thus “units of comparison” are not available for comparison and adjustment of value.

The second accepted assessment method, the cost approach, “estimates the cost of producing a new or substitute property and adjusts this estimated cost for differences in age, utility and condition between the subject property and a new property.” Under this method an assessor will first determine the total cost to construct a replacement facility. The assessor will then deduct the amount of physical depreciation that the property has experienced, as well as the value of related personal property, finally adding the value of the land to determine a total estimated property market value.

The final method, income capitalization, generally provides “the critical methods of analysis” for valuing LIHTC properties. This “approach analyzes a property’s ability to generate income and reversion and converts these benefits into an indication of present value.” First the net operating income, income expected to be earned, “is estimated, allowing for reasonable expenses, vacancy, and/or collection loss . . .” Present value is then calculated by dividing the net operating income by a capitalization rate, with the capitalization rate “reflecting the annual rate of return necessary to attract investment capital.” The capitalization rate is determined by such factors as “apparent risk, market attitudes toward future inflation, the prospective rates of return for alternative investments, the rates of return earned by comparable properties in the past, the supply of and demand for mortgage funds, and the availability of tax shelters.” Although determining net operating income is usually quite straight forward, determining

---

18 Powell, supra note 15.
19 Id.
20 Richard E. Polton, supra note 16, at 452; Deerfield 95 Investor Assocs., 1999 Conn. Super. LEXIS 1747 (“The market sales approach is of little help since there is a dearth of comparable sales to the subject given the conditions and limitations placed upon the subject.”); Wilsonville Heights Assoc. v. Dep’t of Revenue, 339 Ore. 462, 465 (Or. 2005).
23 Cascade Court LTD. P’ship, 105 Wn. App. at 565.
the appropriate capitalization rate for LIHTC properties is potentially contentious.\textsuperscript{26}

\textbf{C. Valuation and Assessment of Properties in the LIHTC Program}

Applying any of the three standard appraisal techniques to LIHTC property is a complicated and uncertain task. As the Massachusetts Supreme Court recognized in 1973\textsuperscript{27} “[t]he great dilemma in assessing federally assisted housing projects is that the ‘value’ of these projects is inherently ambiguous . . . since in the absence of subsidy the rental stream produced by the property would not justify the actual expenditure on construction.”\textsuperscript{28}

The legal character of LIHTC properties raises significant difficulties for real property assessors. Four characteristics pose significant difficulty to an appraiser or court valuing LIHTC properties. These characteristics are government-mandated restrictions on rent and rental, additional costs and expenses, illiquidity, and difficulty in attributing the value of the principal benefits of LIHCT projects to the related properties. These principal benefits are low-income housing tax credits, cash flow, depreciation losses, and residual value.\textsuperscript{29}

As noted earlier, LIHTC properties are operating under limited gross potential income because of the restrictions imposed by both the Service and state agencies associated with LIHTC regulations. The restrictions are long term and penalties for violations are severe. From the investor’s perspective, there are multiple risks resulting from the investment in a tax credit project.\textsuperscript{30} In the event of non-compliance, the investor could face a recapture of the LIHTCs claimed, a repayment of income taxes previously offset with credits, penalties and interest on the underpaid tax liability, as well as a loss of the equity invested.\textsuperscript{31} If the project sponsor fails to adequately manage the property and the project lender forecloses and assumes title, the investor will face the loss of the invested capital, the

\textsuperscript{26}\textit{See supra} Section (IV)(C), Calculating Capitalization Rates.
\textsuperscript{27}The Massachusetts Supreme Court was deciding the appropriate valuation of a property funded in part by The Housing and Community Development Act of 1974, Pub L No 93-383, 201(a), 88 Stat 633, 653 (1974), codified at 42 USC 1437 \textit{et seq.} (1976), as amended at 42 USC 1437f \textit{et seq.} (1988), a supply-oriented program that provided assistance to private developers by subsidizing the interest rate paid on loans used to acquire or build low cost housing. Michael H. Schill, \textit{Distressed Public Housing: Where Do We Go From Here?} 60 U. Chi. L. REV. 497, 524 (1993)
\textsuperscript{28}\textit{Community Development Co. v. Board of Assessors}, 377 Mass. 351, 354-355 (Mass. 1979) (quoting \textsc{George E. Peterson, Et. Al., Property Taxes, Housing and the Cities} 73 (1973)).
\textsuperscript{30}26 USC § 42(j).
\textsuperscript{31}\textit{Id.}
recapture of a portion of the LIHTC previously claimed, and the loss of access to the future stream of credits.\(^\text{32}\)

In most cases these compliance periods are further extended because “[a]ffordable housing owners tend to be public agencies, nonprofit organizations, and limited partnerships . . . [who] have made long-term commitments to provide affordable housing as part of their mission or because of the restrictions of their funding sources.”\(^\text{33}\) Rent restrictions cause rental rates per unit to be much lower than in comparable conventional properties.\(^\text{34}\) Resident restrictions result in additional risk and effort. “For these reasons, very few affordable housing developments are sold during their compliance periods.”\(^\text{35}\)

Second, expenses are higher for LIHTC owners because they must meet certain reporting, record keeping and documentation edicts beyond conventional practice.\(^\text{36}\) Rents are limited but expenses are not. Expenses growing at the rate of inflation can cause net operating income to decrease if inflation exceeds the growth in the median income upon which the rents are based.\(^\text{37}\) Specifically, affordable developments are limited in the amount of revenue they can generate “[b]ecause of the rent and income restrictions imposed by their funding sources.”\(^\text{38}\) While revenues are limited, operating expenses for affordable housing tend to be similar or higher than those for market-rate units. Annual certification of tenant income and eligibility, as well as regulatory reporting to various funding sources can be time-consuming and staff-intensive. Additionally, maintenance costs may be higher in affordable developments due to high turnover rates and larger households.\(^\text{39}\)

Third, illiquidity poses a significant obstacle to assessment. LIHTC owners cannot transfer LIHTC properties without first complying with specific conditions and regulations.\(^\text{40}\) Although tax credits have been exhausted after ten years, restrictions remain for at least another 20-years, in some projects and in certain jurisdictions this compliance period is significantly longer.\(^\text{41}\) In the case of

\(^{32}\) The recapture of LIHTC claimed is calculated as the difference in the amount of credits that would have been available if they had been earned over a 15fifteen-year period and the amount claimed according to the ten-year schedule.


\(^{34}\) 26 USC § 42(j).

\(^{35}\) David. C. Nahas, Appraising Affordable Multifamily Housing, 63 APPRAISAL J. 455, 455 (1994).

\(^{36}\) See 26 USC § 42(l).

\(^{37}\) Nahas, supra note 35.

\(^{38}\) Id.

\(^{39}\) Id.

\(^{40}\) Gilbert D. Davila, Reduce Your LIHTC Property Tax Assessments, AFFORDABLE HOUSING Finance 60 (Sept. 2004).

\(^{41}\) Id.
a sale, a purchaser would acquire only the restrictions without the benefit of LIHTCs. This results in an extremely illiquid asset.

Finally, the nature of the ownership structure and the tax credits pose a significant dilemma to assessors and appraisers. From an assessor’s perspective, “the total project value is derived from the real estate and the tax benefits.” Whether both of these benefits are included for tax assessment is often unclear and thus left to the assessor. The majority view among assessors is to categorize these two benefits as tangible value, attributable to the real estate, and intangible value, attributable to the LIHTC. Although this appears to be the majority approach for real estate assessment, some appraisal theorists have proposed alternate characterization methodologies for LIHTC properties, often contending that tax credits are not intangible.

Whether the appraisal community has reached a clear consensus as to how to best value LIHTC projects is somewhat unclear. Regardless, the burden falls on LIHTC property owners and their attorneys to both understand whether their state has a formal policy for assessing LIHTC properties and if so, their state’s mandated method for assessment under case law, statute, and executive policy. LIHTC property owners and their attorneys need to individually apply these policies to determine whether to appeal their property tax assessments and collectively need to determine when to lobby for legislation and what statutory models exist for LIHTC assessment requirements.

Jurisdictions treat LIHTCs differently. Some value them solely on the basis of actual net income and capitalization. Other jurisdictions value the unencumbered fee simple interest on the premise that valuation for ad valorem purposes should not involve voluntary rent restrictions, creative financing, and tax credits. Whether tax credits are benefits attributable to the real estate or whether they are intangible property attributable only to the partnership greatly impacts a determination of the market-value assessment.

D. The Economic Costs of Valuing LIHTCs

---

42 Id.
43 Id.
44 Id.
45 The Dictionary of Real Estate Appraisal defines an intangible benefit as “[a] value that cannot be imputed to any part of the physical property, e.g., the value attributable to good will.” DICTIONARY OF REAL ESTATE APPRAISAL 186 (3d ed. 1993).
46 See George E. Jordan, Appraising the Assets of Low-Income Housing Tax Credit Properties, 67 APPRAISAL J. 41, 46 (1999); Nahas, supra note 35 at 455-462; but see Michael W. Collins, Another Ad Valorem View of Low-Income Housing Tax Credit Properties 67 APPRAISAL J. 306 (1999).
For an LIHTC project “[p]roperty taxes may well be the largest single expense line item in the operating statement. . . .” Typical property tax estimates for market housing are between 20 percent and 25 percent of gross rents. For LIHTC properties the percentage of gross rents devoted to property taxes are typically significantly higher. In fact, failing LIHTC projects spend on average twice as much of their effective gross income on property taxes as successful projects.

Because the typical operating budget of an LIHTC property includes little or no cash flow and rental rates are restricted by statute, nonprofit developers must sometimes abandon projects before they get off the drawing board. Unlike other types of developed property, appraisers have in some cases prepared assessments of LIHTC properties later found to be “more than double the market value of the property.” For example, the assessment of Meridian West, an LIHTC apartment complex located in Miami, Florida, was initially assessed at over $15,000,000. After preliminary negotiations this was reduced to $9,967,111. “Finally, after submittal of 90 pages of evidence, including actual income, income analyses, appraisal journal literature, argument of the special statutes applied by the Legislature solely to LIHTC properties,” the assessment was reduced to $6,300,000 representing “a 58% reduction from the preliminary assessment. . . .”

The concern is thus that units will be taxed at a rate that LIHTC projects cannot absorb. In such cases, “real estate valuation procedures jeopardize the ongoing economic viability of projects created in recent years under the Federal Low-Income Housing Tax Credit program.” Additionally, “[e]xcessive real estate valuation can discourage the development of needed affordable housing and contribute to mortgage defaults or poor maintenance.”

The inclusion or exclusion of tax credits in valuation of LIHTC properties can have a significant economic impact on property owners. For example, the Tennessee Supreme Court addressing the issue of inclusion of tax credits in LIHTC property valuation concluded that for three contested properties

---

48 RICHARD E. POLTON, VALUATION AND MARKET STUDIES FOR AFFORDABLE HOUSING 96 (2002).
49 Philip Halpern, Strategies for Financing Affordable Housing, 24 REAL ESTATE REV. 47 (Spring 1994).
50 Id.
54 Id.
55 Id.
56 Id.
57 GOVERNOR’S HOUSING TASK FORCE, supra note 47, at 65.
assessments excluding LIHTCs were between $1,528,450 and $2,896,960 less than assessment including LIHTCs, as shown in Figure 1: Impact of Tax Credits on Total Value Assessed for Disputed Properties. In these cases the inclusion of LIHTCs in property valuation increased taxes due by between $22,131 and $51,478 annually, as shown in Figure 2: Impact of Tax Credits on the Real Property Tax Due and Payable.

**Figure 1: Impact of Tax Credits on Total Value Assessed for Disputed Properties**

<table>
<thead>
<tr>
<th>PROPERTY</th>
<th>TOTAL VALUE WITHOUT TAX CREDITS CONSIDERED</th>
<th>TOTAL VALUE WITH TAX CREDITS CONSIDERED</th>
<th>ASSESSMENT IN DISPUTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spring Hill</td>
<td>$2,551,987</td>
<td>$4,440,300</td>
<td>$1,775,120</td>
</tr>
<tr>
<td>Greentree</td>
<td>$3,512,078</td>
<td>$7,242,400</td>
<td>$2,896,960</td>
</tr>
<tr>
<td>Acorn</td>
<td>$1,407,244</td>
<td>$3,821,000</td>
<td>$1,528,450</td>
</tr>
</tbody>
</table>

**Figure 2: Impact of Tax Credits on the Real Property Tax Due and Payable**

<table>
<thead>
<tr>
<th>PROPERTY</th>
<th>PROPERTY TAX DUE WITH TAX CREDITS</th>
<th>PROPERTY TAX DUE WITHOUT TAX CREDITS</th>
<th>DIFFERENCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spring Hill</td>
<td>$79,156.88</td>
<td>$52,040.32</td>
<td>$22,131.03</td>
</tr>
<tr>
<td>Greentree</td>
<td>$104,134.80</td>
<td>$48,466.68</td>
<td>$51,478.44</td>
</tr>
<tr>
<td>Acorn</td>
<td>$23,697.99</td>
<td>$64,345.64</td>
<td>$40,647.65</td>
</tr>
</tbody>
</table>

Determination of whether market rates or restricted rates are used for capitalization rates poses a similarly significant burden on project owners. For example, in one Connecticut case, despite agreement on all other issues, the property owner alleged an overvaluation of $1,900,000, based on a dispute over the applicable capitalization rate. As a result of the trial court’s decision, using a capitalization rate based on market value apartments, the owners’ property taxes were reduced by more than $30,000 annually.

On the other hand, some counties rely on property taxes for more than 50 percent of their budget. This number has increased over the last five years as local property taxes have been forced to bare a lot of the brunt of decreasing

---


59 Id.


Consequently property taxes across America have been increasing by an average of more than ten percent annually. Thus, “[w]ith operating budgets being squeezed and development/ acquisition sources harder to find, real estate taxes, especially those levied based on *ad valorem* assessment, loom ever-larger in transaction and property viability.”

Although analysis of the impact on governments of valuation methodology is not readily available, at least one state has done a full impact analysis of excluding LIHTCs from property valuation. To determine the revenue impact of California Revenue & Tax Code § 402.95, the California Property Tax Department compiled a spreadsheet of the present value of all outstanding Low Income Housing Tax Credits. The value of outstanding LIHTC, affected by the legislation, amounted to $1.75 billion. The revenue impact of which was “at most $17.5 million ($1.75 billion x 1%) in property tax revenue loss.”

These economic costs, for both governments and property owners, are exacerbated by the uncertainty associated with often vague state statutes, and state court decisions which are conflicting and often difficult to predict. The result in many states is an uncertainty in property valuation of LIHTC properties, resulting in potentially significant economic costs to developers and owners. The concern is thus, that without consistent methodology for valuing LIHTC properties, owners will not have confidence in the financial viability of their properties or they will bear a greater risk of default.

II. Judicial Valuation of Low-Income Housing Tax Credit Properties

Courts have struggled with a number of issues regarding how best to value LIHTC properties, focusing on two general questions. First, when applying the income approach to value a project, whether to use a property’s restricted rents or market rents. Second, whether tax credits are properly used as a factor in determining the fair market value of the real property upon which they were awarded. This second question is in turn heavily influenced by determination of whether tax credits are categorized as intangible benefits. This is particularly

---


63 Id.


66 Id. at 3.

67 Id.

68 *Town Square Ltd. P’ship v. Clay County Bd. of Equalization*, 704 N.W.2d 896, 901 (S.D. 2005) (“some of these [state court] . . . decisions hinge solely on the question whether tax credits are intangibles.”).
important because many jurisdictions prohibit inclusion of intangible values in a property’s assessed value. 69

The question of valuation of LIHTC properties falls firmly within the bounds of state law. Reviewing courts have easily and consistently concluded that including tax credits in property valuation neither violates the Supremacy Clause nor Federal case law. 70

Eighteen states have court decisions addressing the property tax assessment of LIHTC properties. These states are Arizona, Connecticut, Georgia, Idaho, Illinois, Indiana, Kansas, Michigan, Missouri, Montana, New Hampshire, North Carolina, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, and Washington. 71 Of these 18 states, seven have subsequently passed statutes addressing valuation of LIHTC properties. 72 An additional 15 states, despite having no relevant court decisions, have passed statutes addressing valuation of LIHTC properties, for a total of 22 states that have statute addressing at least some portion of the LIHTC valuation issue. Only 17 states have not addressed any of the aspects of valuation of LIHTC properties through either statute or case

69 See INCLUSION OF INTANGIBLE ASSET VALUES IN TANGIBLE PROPERTY TAX ASSESSMENTS 90 A.L.R.5th 547 (2005).
70 See Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York County, 711 A.2d 607, 611 (PaCommwCt 1998) (distinguishing Xerox Corporation v. County of Harris, 459 U.S. 145 (1982) finding no Supremacy clause violation because “there is no comprehensive federal scheme encompassing the [low-income housing] tax credit program as the tax credit program is administered by the individual states); Pine Pointe Hous., L.P. v. Lowndes County Bd. of Tax Assessors, 254 Ga. App., 197, 202 (Ga. Ct. App. 2002)(distinguishing Randall v. Loftsgaarden, 478 U.S. 647 (1986), which held that federal income tax credits have no value in and of themselves, because “that does not mean that the tax credits do not influence a property’s fair market value”).
72 These states are Georgia, Illinois, Indiana, Montana, Oregon, Pennsylvania, and Rhode Island.
Of these 17 states, the state supreme courts of an additional three have made, what appear to be, broad pronouncements concerning the valuation of federally rent restricted affordable housing properties.

These numbers, however, mask a continued level of uncertainty. Although, 22 states have addressed LIHTC valuation through statute, few have addressed both whether LIHTCs can be valued and whether restricted rents should be used. Further, only two have addressed the proper capitalization rate for valuing LIHTC properties. Thus, despite a growing number of court decisions and statutes the law in many states remains unclear. Further, although the majority of statutes are favorable to LIHTC property owners a large number of court decisions are not. In most cases the outcome hinges on whether the court feels that LIHTC provides intrinsic value to the property, and thus should be included in the valuation equation, or whether they treat them as non-taxable, intangible property.

A. Valuation of Tax Credits

In 1995, the Oregon Supreme Court was the first court of record to issue a decision as to the valuation of LIHTC properties. In *Bayridge Assoc. Ltd. Partnership v. Department of Revenue*, 892 P.2d 1002 (1995), the court found for the taxpayer holding that the rent restrictions present in an LIHTC property are “governmental restriction as to use” requiring a reduction in the valuation of the property for assessment purposes, even though the restrictions were voluntary.

According to the Bayridge Court, the taxpayer’s agreement to limit rentals to low income tenants were governmental restrictions like zoning and therefore must be included in valuation. In short, the court held that “appraisal based on actual or contract rents [is] more accurate in determining the true cash value of the properties than the appraisal based on market rents. . . .” The [C]ourt also agreed that the federal tax credits produced by the project should not be added to the income of the property as no buyer would receive the benefit of those credits and they would be recaptured if the property was not maintained as a federal project.

---

73 An additional 16 states have court decisions addressing valuation of other HUD rent restricted properties.
74 *Alliance Towers Ltd. v. Bd. of Revision*, 523 N.E.2d 826 (Ohio 1988); *Community Development Co. v. Board of Assessors*, 385 N.E.2d 1376 (Mass. 1979); *Glenridge Development Co. v. City of Augusta*, 662 A.2d 928 (Me. 1995).
75 Court decisions have more consistently addressed both issues. See generally *Bayridge Associates Ltd. Partnership*, 892 P.2d 1002; *Town Square Ltd. P’ship*, 704 N.W.2d 896.
76 *Bayridge Assoc. Ltd. Partnership*, 892 P.2d 1002.
77 Id. at 1006.
78 Id. at 1006.
79 Id. at 1003.
80 *Wilsonville Heights Assoc., LTD*, 17 OTR at 143 (explaining *Bayridge Assoc. Ltd. Partnership* 892 P.2d at 1007).
Shortly after the Oregon Supreme Court decided *Bayridge*, the Idaho Supreme Court reached a similar decision in *Greenfield Village Apartments*. In *Greenfield Village Apartments* the court held that restricted rents should be used for valuation of LIHTC properties, while tax credits should not. The court remanded to the lower court “for valuation considering the actual and functional use of the property as low-income, rent-restricted property.”

In 1997, a Montana District Court issued another taxpayer friendly holding. The court in *Kalispell Associates* suggested that Montana Supreme Court precedent likely required consideration of restricted rather than market rate rents. Consequently, the court remanded to the State Tax Appeals Board to consider “use restriction in determining market value…” of an LIHTC project.

After these initial decisions disallowing consideration of LIHTCs, a Pennsylvania appellate court issued the first decision finding for local government. In 1998, the Pennsylvania Commonwealth Court held that the value of LIHTC credits should be included in property valuation. The court in *Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York County*, 711 A.2d 607, 611 (PaCommwCt 1998), found that LIHTCs are properly included in a property assessment because the credits were “part of the economic reality.” The court concluded that “[t]ax related benefits associated with investment property ownership inherently affect value and the court is not constrained to determine [fair market value] as though the property lacked tax shelter features.” Thus, LIHTC credits should be included in valuation; however, restricted rents rather than market rents should be used.

Shortly after *Parkside Townhomes*, a Connecticut trial court reached a similar conclusion in *Deerfield 95 Investor Associates v. Town of East Lyme*, 25 Conn. L. Rptr. 51 (Conn. Super. Ct. 1999). The *Deerfield 95* court held that section 42 tax credits were a benefit to the owners of the properties rather than a government restriction and, as such, should be added to the net operating income.

---

82 *Id.*
83 *Id.* at 210.
85 *Id.*
86 *Id.* On remand, the State Tax Appeal Board of the State Of Montana held that “tax credits themselves are not part of the valuation process for the subject property; however, the amount of equity generated through the sale of those tax credits most certainly affects the value of the subject property when using the income approach.” *Kalispell Assoc. Lmtd v. DOR*, State Tax Appeals Board, DOCKET NO: PT-1995-21, 14 (1998), available at http://stab.mt.gov/pdf/dump/kalassoc.pdf.
87 *Id.*
88 *Id.*
89 *Id.* However a new Connecticut case, *Saranor Apts. Ltd. P’ship v. City of Milford*, 2005 Conn. Super. LEXIS 911 (Conn. Super. Ct. 2005), adds an interesting twist to the question of LIHTC valuation in Connecticut. In *Saranor* both the city’s expert and the taxpayers’ experts were in
Other jurisdictions have reached similar conclusions, holding that the value of section 42 tax credits are properly considered in assessing the fair market value of the properties. For example, in the most recently decided case, *Town Square Ltd. P'ship v. Clay County Bd. of Equalization*, 704 N.W.2d 896 (S.D. 2005), the Supreme Court of South Dakota considered whether LIHTCs, restricted rents, and other Section 42 requirements, must be measured when determining the market value of apartment complexes totaling 70 units. The Court held that the value of LIHTCs must be included in the property valuation. Because the benefits associated with LIHTC properties would be included in a potential buyer’s evaluation of the project, credits are naturally part of the true market value. The Court concluded that “tax credits make ownership of the property more desirable. And because the tax credits can be transferred to purchasers, they enhance the value of the property in the marketplace.” Courts in Michigan, New Hampshire, Tennessee, North Carolina, South Dakota, and Kansas have reached similar conclusions.

In only six court decisions have courts held that tax credits should not be considered when valuing LIHTC properties. In two of these cases the courts relied almost exclusively on determination of whether tax credits were intangible and thus nontaxable under state law. The Court of Appeals of Missouri in *Maryville Properties* reversed a decision allowing tax credits to be included in valuing LIHTC properties. The Court held that tax credits are intangible personal property and thus not subject to real property taxation. In classifying LIHTCs as intangible property, the Maryville Properties Court stated that “LIHTCs are not characteristics of the property. Rather they are assets having direct monetary value. Their restricted transferability does not destroy their essential status as

agreement that it would be improper to find value in tax credits. *Id.; see also* Elliott B. Pollack, Property Tax Win Saves LIHTC Project $30,000 A Year, AFFORDABLE HOUSING FIN., (July 2005), available at http://www.housingfinance.com/ahf/articles/2005/july/042_AHF_12-3.htm.

*Town Square Ltd. P'ship*, 704 N.W.2d at 897, 901.

*Id. at 903.

*Town Square Ltd. P'ship*, 704 N.W.2d at 903.

*Huron Ridge LP*, MTT Docket No. 292811.

*Epping Senior Housing Associates, LP*, Docket No. 19135-01PT/20263-03PT.


*In re Greens of Pine Glen Ltd. Partnership*, 576 S.E.2d at 322.

*In re Ottawa Housing Assoc., L.P.*, 10 P3d 777.

*In a Wisconsin case addressing the valuation of LIHT properties, Metro Holding*, the Wisconsin Supreme Court held that property assessment for low-income housing should be based on actual rents and expenses. A subsequent Wisconsin Court of Appeals case found that “nothing in either the [Metro Holding] court’s holding or the underlying principles of the decision suggest that the federal subsidy given in exchange for the restrictions on rent or income of residents-in this case, in the form of income tax credits-should not be considered in arriving at a fair market value.” The Court went on to conclude that due to subsequent Wisconsin legislation it was unnecessary to address the issue.
intangible property having value primarily to their owner. Objective standards should be used for determining fair market value in the market place. The particular circumstances of the owner are not a proper consideration. The Washington Court of Appeals in the Cascade Court case similarly held that LIHTCs are intangible personal property that could not be considered by assessors when valuing real property.

**B. Are LIHTCs Tangible or Intangible Property?**

Some of these court concluded that LIHTCs were not intangible property, while state law in other jurisdictions allowed for valuation of intangibles. Some courts addressing this issue have concluded that “even if . . . tax credits could be designated as intangible property, a distinction can be made between taxing intangible property and considering such credits as a value increasing feature.” In other words, even if LIHTCs are intangibles and state law prohibits taxation of intangibles, LIHTCs “do have an effect on the valuation of real estate for assessment purposes, and should be a factor in determining the fair market value.”

The conclusion reached by the court in *Deerfield 95 Investor Assocs.* is probably the correct outcome, that is, LIHTCs are intangible however their impact on the value of tangible property can be properly included in valuation. Under all of the standard definitions LIHTCs appear to be intangible property. According to the appraisal literature, intangible are property that “cannot be imputed to any part of the physical property.” According to BLACK’S LAW DICTIONARY (8th ed. 2004) intangible property is any “[p]roperty that lacks a physical existence.” Or as the Supreme Court stated, intangibles are “rights which are not related to physical things . . . relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts. The power of government over them and the protection which it gives them cannot be exerted through control of a physical thing. They can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights.”

Although arguably distinguishable from the typical example of intangible property, good will, LIHTCs fit neatly within the standard definitions.

The second part of the question, whether the impact of intangible property on related tangible property can be valued, appears to be a similarly simple

---

99 *Maryville Props., L.P.*, 83 S.W.3d at 616.
100 *Pine Pointe Housing, L.P.*, 561 S.E.2d at 863.
101 *Town Square Ltd. P’ship*, 704 N.W.2d 99.
102 Id.
104 *DICTIONARY OF REAL ESTATE APPRAISAL* 186 (3d ed. 1993).
question based on prior analogous case law. A number of cases in non-LIHTC contexts have involved disputes as to whether the values of intangible assets were included in an assessment of real property or tangible personal property used in a business. These courts have generally held that intangible values “that cannot be separately taxed as property may be reflected in the valuation of taxable property.”

Thus, in determining the value of property, assessing authorities may take into consideration earnings derived therefrom, which may depend upon the possession of intangible rights and privileges that are not themselves regarded as a separate class of taxable property.

In the most closely analogous situation, the Michigan Supreme Court in Meadowlanes Ltd. Dividend Housing Ass’n v. City of Holland, 473 N.W.2d 636 (1991), held that, in valuing a mortgage-interest subsidy for low-income housing, an assessor should take into account the mortgage interest subsidy paid by the federal government to the mortgage lender. Finding that these types of properties would not exist without the subsidy, the court said that “although the mortgage-interest subsidy is an intangible, and not taxable in and of itself, it is a value-influencing factor.”

Courts have reached similar conclusions in determining whether the value of other intangible government benefits such as licenses, subsidies or contracts could be properly included in an assessment. For example, in Freeport-McMoran Resource Partners v. County of Lake, 12 Cal. App. 4th 634 (1st Dist. 1993), the court held that the assessor’s valuation of two geothermal power plants, made under the income approach by capitalizing the plant owner’s income from long-term, fixed-price contracts for the sale of electricity to a public utility at above-market rates, properly considered the presence of the contracts. In reaching the conclusion the court found that despite being intangible the assessor properly considered the impact of the contracts, because they were integral to the economic viability of the plants.

Thus although specific state laws may require a different outcome, based on a relatively consistent line of analogous cases at least some of the value associated with LIHTCs should be included in property valuation. Presumably, after the initial ten-year LIHTC allocation period the credits would no longer

106 Roehm v. County of Orange, 32 Cal. 2d 280, 285 (Cal. 1948)
107 Id. For a thorough list of such cases see INCLUSION OF INTANGIBLE ASSET VALUES IN TANGIBLE PROPERTY TAX ASSESSMENTS, 90 A.L.R.5th 547 (2005).
110 Utah Code § 59-2-1101(3).
impact the value of the property and thus would no longer be included in the assessment.

Most recently, an Arizona Tax Court focused on a LIHTC project’s restricted income potential when siding with the taxpayer in a tax assessment suit. In Cottonwood Affordable Housing, the Arizona Court stated that a property’s value should be determined from its restricted income potential, without regard to low-income housing tax credits.\(^\text{111}\) The Court further ruled that while LIHTCs do provide an incentive for an investor or developer to invest in and construct these low-income housing projects, they also act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property.\(^\text{112}\) Thus, the Court found that LIHTCs add little, if anything, to the long-term value of the property.

The reasoning in Cottonwood illustrates a factual disagreement between the majority and minority. While Cottonwood found that LIHTCs act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property, the South Dakota Supreme Court in Town Square Ltd. concluded that “tax credits make ownership of the property more desirable . . . because the tax credits can be transferred to purchasers, they enhance the value of the property in the marketplace.”\(^\text{113}\) Thus whether the tax credits and properties are functionally transferable appears to play a significant role in the determination of their inclusion in valuation. Although, properties are occasionally transferred, the rules and risks are so onerous that such transfers are exceedingly rare. For example, according to Wayne Tenenbaum, a property tax attorney with Neill, Terrill & Embree LLC in Overland Park, Kansas “[s]ince the credits run out after ten years, but the restrictions may last for another 20 years beyond that time, a purchaser would, in effect, be buying only the restrictions without getting the benefit of the credits. Not surprisingly . . . there has been no sale of an operating Section 42 LIHTC project.”\(^\text{114}\) In all of the above reported cases, the tax credits were still being distributed. Whether courts would reach the same conclusion in the clear absence of tax credits is entirely unclear. This is likely to renew the issue in some states as more LIHTC properties fully distribute their tax credits and reach the end of their federal compliance period.

**C. Application of Market Rents and Restricted Rents**

Only one court, the Supreme Court of North Carolina, has ruled that valuation should be based on market rents rather than actual rents because a voluntary agreement by a developer to be bound by restricted rents is not a

\(^{111}\) Cottonwood Affordable Housing v. Yavapai, 72 P3d 357 (Ariz TC 2003).

\(^{112}\) Id.

\(^{113}\) Town Square Ltd. P’ship, 704 N.W.2d at 903.

“government restriction” requiring consideration of the lower rents. In the Matter of Appeal of The Greens of Pine Glen Ltd. Partnership, the court reasoned that “unlike a governmental restriction such as zoning, [LIHTC] restrictions do not diminish the property’s value, but instead balance tax credits allowed to the developer against rent restrictions imposed on the developer,” and “because [LIHTC] restrictions are freely entered contractual covenants, not governmental regulations,” the “taxpayer may not artificially alter the value of [the] property below fair market value.”\footnote{576 S.E.2d 316, 322 (NC 2003).}

A minority of courts examining other subsidy programs have also concluded that market rents rather than actual rents should be used when a HUD projects has actual rents “far below fair market value.”\footnote{John P. Burke Apartments, Inc. v. Swan, 137 A.D.2d 321, 326 (N.Y. App. Div. 1988); Canton Towers, Ltd. v. Board of Revision, 3 Ohio St. 3d 4 (Ohio 1983); but see Kankakee County Bd. of Review v. Property Tax Appeal Bd., 131 Ill. 2d 1, 19 (Ill. 1989).} However, “a clear majority of courts have ruled that the restricted rents must be taken into account when assessing LIHTC property.”\footnote{Town Square Ltd. P’ship, 704 N.W.2d at 900.}

### D. Other Affordable Housing Subsidies

The conclusion reached by the majority of courts, as to valuation of LIHTCs, appears consistent with treatment by other courts determining the appropriate considerations for valuation of properties impacted by federal housing subsidy programs. In the majority of court decision addressing whether government subsidy impacts the value of low-income properties and therefore should be included when determining the fair market value for property tax, courts have concluded that subsidy may be considered.\footnote{See In re Ottawa Hous. Assoc., 27 Kan. App. 2d 1008; but see Alliance Towers, Ltd. v. Stark County Bd. Of Revision, 37 Ohio St. 3d 16, 523 N.E.2d 826 (Ohio 1988), appeal after remand, 50 Ohio St. 3d 42, 552 N.E.2d 632 (1990)(artificial effects of the federal housing assistance program not indicative of the value of the real estate).} “These cases apply the general theory that a low-income housing contract is an investment tool for maximizing an investment in real estate.”\footnote{In re Ottawa Hous. Assoc., 27 Kan. App. 2d at 1013 (citing Penns Grove Gardens, 18 N.J. Tax at 261-62; Parkside Townhomes, 511 A.2d at 611).} Consequently, “buyers and sellers of real estate consider these tools in determining the market value of real estate.”\footnote{In re Ottawa Hous. Assoc., 27 Kan. App. 2d at 1013 (citing Pedcor Investments, 715 N.E.2d at 437; Rebelwood, Ltd., 544 So. 2d at 1364).}

In determining valuation of properties financed with various HUD programs courts in California,\footnote{Maples v. Kern County Assessment Appeals Bd., 96 Cal. App. 4th 1007, 1010 (Cal. Ct. App. 2002) (assessor may consider a subsidize 1% interest rate paid by taxpayer to develop 42 U.S.C. § 1485 low-income apartment complex in valuation of property).} New Jersey,\footnote{Penns Grove Gardens v. Penns Grove, 18 N.J. Tax 253, 264-65 (1999) (holding that the governmental contract rent and the actual management fee should be used in determining valuation).} Louisiana,\footnote{Pedcor Investments, 715 N.E.2d at 437; Rebelwood, Ltd., 544 So. 2d at 1364.} Mississippi,\footnote{Penns Grove Gardens v. Penns Grove, 18 N.J. Tax 253, 264-65 (1999) (holding that the governmental contract rent and the actual management fee should be used in determining valuation).} Michigan,
Illinois, Maine, and Maryland have all concluded that the value of the subsidy should be included in assessment of the property for tax purposes. These cases either involved inclusion of mortgage-interest subsidy or inclusion of rent subsidies based on above market contract rents in the valuation process.

E. Calculating Capitalization Rates

As noted earlier, capitalization rates play a significant, and somewhat complicated, role in the income valuation approach. “Small changes in capitalization rate can make large differences in ultimate indicated value.” Such rates are typically developed either from examination of actual sales and income data or from methods such as the band-of-investment approach. Generally, the capitalization rate is intended to “reflect what investors generally are expecting from an investment in a particular type of property.”

Recent cases have tried to determine the proper approach for determining the capitalization rate of LIHTC and other federally subsidized properties. For example a Connecticut trial court, Saranor Apts. Ltd. P’ship v. City of Milford, 2005 Conn. Super. LEXIS 911 (2005), determined that the correct capitalization rate for an LIHTC property should rely on a comparison of market value apartments. The Saranor Court relied heavily on the Oregon Tax Court’s decision in Wilsonville Heights Assoc., LTD. v. Dep’t of Revenue, 17 OTR 139 (2003), which reached a similar conclusion in a case examining the proper

---

123 New Walnut Square; Ltd. Partnership v. Louisiana Tax Com’n, 626 So. 2d 430 (La. Ct. App. 4th Cir. 1993) (holding appropriate to consider as “income” the subsidized low-interest mortgage used to finance complex for property tax purposes);
124 Rebelwood, Ltd. v. Hinds County, 544 So. 2d 1356, 1364 (Miss. 1989) (holding that because the benefits of participating in a federal low-income housing program affect the value of the property in the open market, they must sensibly be considered in assessing value).
125 Meadowlanes Ltd. Dividend Housing Ass’n v. Holland, 437 Mich. 473, 500 (Mich. 1991) (holding “Section 236 properties are subject to unique restrictions and advantages. All of them, including the subsidized interest feature, must be at least considered in the assessment process”).
126 Kankakee County Bd. of Review v. Property Tax Appeal Bd., 544 N.E.2d 762 (Ill. 1989) (federal rent subsidy must be considered in assessing the value of housing project).
127 Glenridge Development Co. v. City of Augusta, 662 A.2d 928 (Me. 1995) (holding assessor properly considered both the interest subsidy payments made by federal government, as well as the rent ceiling in his income approach valuation).
capitalization rate of an apartment complex constructed with financing obtained under 42 USC § 1485 (1990).\textsuperscript{131}

Both courts held that capitalization rates should reflect the value that hypothetical “market participants would expect as a debt return and an equity return, again as of the date of assessment.”\textsuperscript{132} On the other hand, both courts rejected a capitalization rate which fails to reference any “market but only reference the facts of the particular project at issue, at the time of original construction of the project.”\textsuperscript{133} Such a limited approach, rather than capturing the true market value, incorrectly “prevents any fluctuation in value based on shifting expectations of the capital markets over time.”\textsuperscript{134}

\subsection*{F. Valuation of LIHTCs Outside of the Property Tax Context}

There are different techniques of valuing an LIHTC property, depending on the purpose of the appraisal, i.e., mortgage financing, insurance, or \textit{ad valorem} taxation. Although never cited by reviewing courts, there are executive guidelines at the federal levels and among the appraisal literature describing how to value LIHTC properties for not tax purposes. For example guidelines issued jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, Federal Reserve Board, and the Office of the Thrift Supervision state generally that appraisals of projects which are constructed with low income housing tax credits should consider the market value impact of these credits. According to the joint release:

An institution that extends credit for development of an affordable housing project should consider the financial assistance that frequently accompanies these projects, such as low-income housing tax credits (LIHTC), subsidies, and grants. Such financial assistance creates an incentive for developers and investors to undertake the project. . . . When a regulated financial institution obtains an appraisal for an affordable housing project, the appraisal should contain a market value estimate that reflects the real estate collateral and typical interests in the real estate on a cash or cash equivalent basis. The agencies’ appraisal regulations permit the appraiser to include in the

\begin{footnotesize}
\textsuperscript{132} \textit{Wilsonville Heights Assoc.}, 17 OTR 155.
\textsuperscript{133} \textit{Id.}
\textsuperscript{134} \textit{Id.}
\end{footnotesize}
market value estimate any significant financial assistance that would survive sale or foreclosure, such as the value of LIHTC, subsidies, and grants.\(^{135}\)

The impact of these guidelines is that the value associated with the tax credits can be added to the value of the property.

There is thus an inherent tension between this initial valuation for financing and tax credit purposes and later property tax assessments. In the initial stage of valuation, developers will wish to include the value of tax credits in valuation because capital sources need them to show high values, lenders must justify loans and investors must show equity above debt.\(^{136}\) On the other hand, all the analysis used to support the financing is equally good evidence to support a high *ad valorem* assessment.\(^{137}\)

### G. Conclusion

Appellate courts are almost evenly split as to whether tax credits should be included in the valuation of LIHTC properties. To a large extent this split appears to depend on three issues, first, whether LIHTCs are tangible or intangible, second whether LIHTCs if intangible can be valued to the extent that they impact the value of the associated tangible property, and third whether LIHTC properties can be transferred so as to provide incentive for a new buyer to purchase the property.

Based on standard definitions and analogous case law, it seems clear that LIHTCs are intangible property. However, impact of the LIHTCs, on the related tangible property is properly included in a property assessment because it is so integral to the economic viability of the project. The third issue is a much more difficult factual question. While The Arizona Tax Court found in *Cottonwood* that LIHTCs act as a disincentive for a current owner to sell, and provide little or no incentive for a new buyer to purchase the property, the South Dakota Supreme Court in *Town Square* concluded that “tax credits make ownership of the property more desirable” to a purchaser.\(^ {138}\) The true value is probably located somewhere between. That is, the *Town Square* court failed to consider the significant limits on illiquidity, while the *Cottonwood* court failed to consider the transferability of the credits at the entity level. Although from a purely legal position the *Cottonwood* court is probably closer to being correct, this issue is probably best

---

137 *Id.*
138 *Town Square Ltd. P’ship*, 704 N.W.2d at 903.
decided by the legislature, which is better able to assess the relative illiquidity and transferability of projects generally and determine an intermediate valuation.

III. Legislative Valuation of Low-Income Housing Tax Credit Properties

It is hard to predict how a court will rule on an issue as complicated as the valuation of LIHTC properties. Conflicting court decisions prove problematic for both the LIHTC property owner and assessors. Courts are placed in a difficult position, in most cases recognizing that “federal tax credits significantly enhance the value of subsidized housing. . . .” In light of this, the question becomes whether “there may be some valuable policy reason underlying” a decision not to include LIHTCs in property valuation. As the dissent in Bayridge stated, “[t]he legislature knows how to provide property tax relief to owners of low-income housing. . . . Had the legislature intended owners of property that qualified under IRC § 42 to be entitled to property tax relief on that basis, it surely would have provided for an explicit exemption or reduction.”

Courts in the majority have consistently cited statutory authority in other jurisdictions indicating that despite arguments by “taxpayers and amici” urging consideration of “policy implications of the inclusion of the Tax Credits in valuation. . . . The legislature is the appropriate body to determine public policy on this issue.” Since shortly after the first decisions requiring inclusion of the value of LIHTCs, legislatures have, begun to enact various forms of clarifying legislation.

Twenty-two states have passed legislation addressing the valuation of LIHTC properties. All of these states’ statutes provide valuation guidance beneficial to both LIHTC property owners and assessors. A majority of these states require that LIHTC properties be assessed under the income approach and that assessors exclude tax credits from the assessment process. The impetus for enactment appears to be to “help insure that their valuation for property taxation does not result in taxes so high that rent levels must be raised to cover this project expense, which can cause excess vacancies, project loan defaults, and eventual loss of rental housing facilities for those most in need of them. . . .” In almost all cases these statues passed unanimously.

---

139 Bayridge Assocs. Ltd. Partnership, 892 P.2d at 1012 (Van Hoomissen, J., dissenting).
141 These states are Alaska, California, Colorado, Florida, Georgia, Illinois, Indiana, Iowa, Maryland, Minnesota, Mississippi, Montana, Nebraska, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Vermont, and Wisconsin.
142 Wis. Stat. § 70.32; Utah Code § 59-2-1101 and § 59-2-102 (Intangible); 72 P.S. § 5020-402; R.R.S. Neb. § 77-1333; Md. Tax-Property Code Ann. § 8-105; Iowa Code § 441.21; Ind. Code § 6-1.1-4-40 and ; O.C.G.A. § 48-5-2; Fla. Stat. § 193.017; Cal Rev & Tax Code § 402.95; 35 ILCS § 200/10-235; NY CLS RPTL § 581-a.
143 35 ILCS § 200/10-235.
Some academics have argued for a broad property tax exemption for LIHTC properties.\textsuperscript{144} Currently, only one statute requires tax exemption for LIHTC properties owned and operated by nonprofit entities,\textsuperscript{145} although some other states allow exemption under narrow circumstance,\textsuperscript{146} and others allow for bargaining between LIHTC property owners and governments which could result in tax exemption.\textsuperscript{147} LIHTC project owners have been generally unsuccessful in obtaining property tax exempt status under other statutes which provide exemption for affordable housing properties generally.\textsuperscript{148}

There is some concern that exempting properties may lead to increased hostility between local taxing authorities and property owners.\textsuperscript{149} Such concerns “at the local level may be exacerbated by numerous factors which obscure the perception of the public benefit . . . the imposition of the exemption scheme by state government; a high concentration of exempt property in a given municipality disproportionate to local benefits; and beliefs of local citizens and assessors about equitable distribution of the property tax burden.”\textsuperscript{150} This would tend to diminish some of the significant strengths of the LIHTC program, namely the well developed multilevel partnership between private parties and government entities at the local, state and federal level. Because of the unique structure of the LIHTC program, LIHTC properties “have less of a stigma than public housing ‘projects’ that are sure to inspire NIMBY-ism in almost any neighborhood.”\textsuperscript{151}

\textsuperscript{144} See Jonathan Penna, supra note 52; Lance S. Bocarsly & Steven C. Koppel, \textit{Real Property Tax Exemptions in Affordable Housing Transactions}, 2 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 12, 19 (1993).


\textsuperscript{146} See e.g. Tex. Tax Code § 11.182 (2005).

\textsuperscript{147} See e.g. R.I. Gen. Laws § 44-5-13.11.


\textsuperscript{149} This can be seen in the statements made by Gary Superman who voted against lowered valuation for LIHTCs in the Alaskan Borough of Kenai, who said “the clincher for him at this point was the fact the borough already was required to assess two apartment complexes at the lower rate by virtue of their being qualified prior to Jan. 1, 2001, and that the state is not reimbursing us one cent for that cost. Until the state comes to grips with that, he said, he would not be supporting additional low-assessment properties.” Hal Spence, No tax break for low-income housing Kenai Peninsula Online, September 23, 2004, http://peninsulaclarion.com/stories/092304/news_923new003.shtml; This is discussed in greater detail in the land conservation context in Kirk G. Siegel, Comment, \textit{Weighing the Costs and Benefits of Property tax Exemption: Nonprofit Organization Land Conservation}, 49 ME. L. REV. 399, 434 (1997) (The lack of recourse in some municipalities makes exempt property a likely target of broad-based animosity).

\textsuperscript{150} Id. at 411.

exempting LIHTC properties from taxation ignores the fact that “[d]evelopers and owners of affordable housing want to pay their fair share in local taxes.”

Thus, rather than focusing on exemption, this paper argues for enactment of statutes which would increase the uniformity and predictability of LIHTC property valuation. In particular it identifies four criteria desirable in LIHTC valuation legislation: 1) predictability for preconstruction project viability, 2) consistency of application over the life of the project, 3) uniformity of application to similar projects, and 4) fostering of ongoing amicable relationships between LIHTC project managers and local governments.

A. Typical LIHTC Valuation Statutes

The most recently enacted legislation is a good representative of the standard LIHTC valuation statute. In October 2005, the New York Legislature amended the New York Real Property Tax Law by adding Section 581-a, which requires property assessors to value affordable housing projects “using the income approach as applied to the actual net operating income . . . and shall not include federal . . . income tax credits.”

Legislatures in California, Florida, Georgia, Indiana, Iowa, Illinois, Maryland, Nebraska, Pennsylvania, and Wisconsin have all enacted statutes substantially similar to the New York legislation. For example, Section 402.95 of California’s Revenue and Taxation Code states, “in valuing property under the income method of appraisal, the assessor shall exclude from income the benefit from federal and state low-income housing tax credits.” Maryland’s statute provides assessors one of the clearest guidance. Maryland’s Tax Code § 8-105 states that:

In determining the value of commercial real property developed under Sec. 42…the [assessor]:
(i) shall consider the impact of applicable rent restrictions…required by Sec. 42;
(ii) may not consider income tax credits under Sec. 42…as income attributable to the real property; and
(iii) may consider the replacement cost approach only if the value produced by the replacement cost approach is less than the value produced by the income approach….

Other states, like Georgia and Wisconsin, address the LIHTC valuation issue in broader terms. For instance, Georgia Revenue and Taxation Code § 48-5-
2 states that when determining the fair market value of property, “the tax assessor shall not consider any income tax credits with respect to real property.”

Alaska Statute 29.45.110(d)(1) takes a unique approach to valuing LIHTC properties. Under 29.45.110(d)(1), the assessor is required to value low-income housing tax credit projects existing prior to the effective date of the legislation, January 2001, based on the actual income derived from the property. Alaska Statute 29.45.110(d)(2) also requires the governing body of localities to determine by ordinance whether projects qualified for LIHTCs after January 2001, be assessed based on income derived in the same way as preenactment properties. If the assembly does not exempt newly qualified parcels from the income method, it may determine on a parcel-by-parcel basis whether the property be assessed based on the restricted rent income approach or at full and true value.\(^{153}\)

Although Alaska’s opt-out state is unique other state legislatures have exempted large cities or counties from their LIHTC valuation statute. For example, the recent New York statute “was not intended to include New York City properties. Although the Legislation does not exclude such properties, it is expected that the law will be amended in the next session of the New York State Legislature to exclude properties in New York City.”\(^{154}\) The Illinois statute similarly, exempts “counties with a population of more than 200,000” from the state statutory limitations.

**B. Discount Valuation Statutes**

Under Illinois statute, 35 ILCS § 200/10-235, “low-income housing projects . . . that qualify for the low-income housing tax credit . . . shall be valued at 33 and one-third percent of the fair market value of their economic productivity to the owners of the projects . . . .” This approach is taken with the stated purpose “to help insure that their valuation for property taxation does not result in taxes so high that rent levels must be raised to cover this project expense, which can cause

\(^{153}\) Of those Alaskan boroughs with LIHTC properties in the Municipality of Anchorage despite a failed ordinance in 2001 all LIHTC projects are assessed at their full and true value; no ordinance is in place Matanuska-Susitna Borough, however the “restricted rent valuation is provided to those projects that qualify, apply timely and provide all requested financial information;” six projects receive assessments based on restricted rents in the Borough of Juneau, and the Borough is currently drafting an ordinance; one property in the Ketchikan Borough benefits from a reduced assessment as by local Ordinance 45.11.055 (b). Memorandum from Shane Horan Director of Assessing for the Kenai Peninsula Borough to Members of the Kenai Peninsula Borough Assembly, Valuation of Low-Income Housing Tax Credit (LIHTC) (Oct. 16, 2003), available at http://www.borough.kenai.ak.us/assemblyclerk/Assembly/Ordinances/2003/O2003-43memo.htm. The Kenai Peninsula Borough failed to pass an ordinance and values post enactment properties at their full and true value. Hal Spence, supra note 149.

excess vacancies, project loan defaults, and eventual loss of rental housing facilities for those most in need of them, low-income families and the elderly."\footnote{35 ILCS § 200/10-235.}

Rhode Island General Law § 44-5-13.11 takes a similar valuation approach, although explicitly allowing municipalities to value at a lower percentage. Illinois takes a substantially similar approach to Rhode Island. Minnesota Statute, § 273.128 also discounts LIHTC properties although it does so by providing for a decreased tax rate for LIHTC properties rather than a decreased income based valuation. Under the Rhode Island and Illinois statutes, which compute value based on income, a developer may not have to worry as much about prohibitive property taxes. Generally, although these statutes presumably decrease the likelihood of default, they do not appear to increase consistency of application or predictability.

C. Limitations

Notably, only one state provides explicit guidance as to calculation of tax credits, valuation method, and capitalization rate. Nebraska’s LIHTC valuation statute requires county assessors to “perform an income-approach calculation,” in which “low-income housing tax credits . . . shall not be considered income for purposes of the calculation . . . .” However, the statute explicitly allows the low-income housing tax credits to “be considered in determining the capitalization rate to be used when capitalizing the income stream.” As to determination of capitalization rate, the Nebraska statute appears to place discretion with the assessor. Although this results in a clear legal standard, it also allows for unpredictable and inconsistent application.

Only two other state statutes address capitalization rates at all. Mississippi Code Ann. § 27-35-50 mandates that “appraisal shall be made according to actual net operating income” and “capitalized at a market value capitalization rate.” Texas Tax Code § 11.1825 requires that the assessor “use the same capitalization rate that the chief appraiser uses to appraise other rent-restricted properties.” Notably, neither the Mississippi statute nor the Texas statute explicitly addresses the valuation of LIHTCs. Although the statutory language in the Mississippi Code “according to actual net operating income” might be interpreted to prohibit inclusion of LIHTCs language excluding valuation of LIHTCs was removed from a prior version of the Bill. The Texas statute is similarly ambiguous.

D. Conclusion

Where enacted, statutes do not as yet provide a clear and complete answer to the question of LIHTC valuation. As outlined above, statutes either address only some of the major valuation issues or fail to provide clear guidance. This paper recommends that in order to best support a fair distribution of affordable
housing development statutes should be drafted with the goals of 1) predictability for preconstruction project viability, 2) consistent application over the life of the project, 3) uniformity of application to similar projects, and, 4) fostering amicable relationships between LIHTC project managers and local governments; statutes should provide clear language addressing valuation of credits, assessment methodology (i.e. income capitalization method using actual rents), and applicable capitalization rate.

Examining these goals in comparison to current statutes demonstrates the inadequacies of those statutes. The bulk of statutes do not address all three of the major factors impacting assessed value: inclusion of LIHTCs, use of market or restricted rents, and proper calculation of capitalization rates. These statutes are especially lacking in their failure to define the proper capitalization rate for LIHTC properties.

State courts have clearly demonstrated a preference that legislatures address this issue. Further, courts have demonstrated confusion over the factual workings of the LIHTC program, especially with regard to transfer and sale of LIHTC properties. The difficulties experienced by courts in determining the proper valuation of LIHTC properties is likely to increase as properties continue to operate after the ten-year credit allocation period.

IV. Conclusion

Property taxes are one of the largest single line items in project operating costs. High tax burdens threaten the stability of a multimillion public investment. “State allocating agencies, knowing the local assessments will be higher, could be forced to choose between not supporting projects in certain areas or only approving projects that serve higher income tenants (thus resulting in higher rents) in that community because only those projects are feasible.”156 In the end, much-needed affordable housing is lost and those who require this housing the most have the least access to it.”157 Consequently, considerations must be made about the extent to which housing funded with public monies should be taxed.

Generally, state courts are divided. Although a clear majority of state courts hold that actual rents rather than market rents must be used for tax assessment, courts are quite divided as to whether value of tax credits should be included in the property value. This difference of opinion is based on three major factors, classification of LIHTCs as tangible or intangible property, valuation of the impact of intangible property on tangible property, and the liquidity of LIHTCs. Based on standard definitions and analogous case law, it seems clear that LIHTCs are intangible property; however, the impact of intangible LIHTCs on related tangible property is properly included in an assessment. The third issue is a much closer question. Thus, although from a factual perspective LIHTCs are

156 National Association of Home Builders, supra note 152.
157 Id.
extremely illiquid, this issue is probably best resolved by the legislature, which is better able to assess the relative illiquidity and transferability of projects generally and settle upon an intermediate valuation.

State courts have only just begun to address whether capitalization rates should be adjusted or based solely on market rate comparables. Further, state courts appear disinclined to address these issues in favor of property owners in the absence of statute, believing that the legislature is the most capable institution to provide protection to the interest of LIHTC property owners.

Similarly, statutes, where enacted, do not provide a clear answer. However, looking at the individual elements of current LIHTC valuation statutes, one can see both significant progress being made by states towards uniformity and predictability of LIHTC property valuation and also the future possibility of clear complete valuation statutes. Finally, as legislatures are in a better position to properly analyze the workings of the LIHTC program, this paper recommends that legislatures take a proactive position on this issue and clearly describe proper valuation methods for both the initial period in which credits are being distributed and all years after credits have been expended.
Behavioral Economics in the Mortgage Lending and Mortgage Foreclosure Contexts

By Kelli Dudley

Copyright © Kelli Dudley 2006
Behavioral Economics in the Mortgage Lending and Mortgage Foreclosure Contexts

By Kelli Dudley

I. Introduction

Barry and Beth Borrower call seeking an appointment at your law office. Beth relates to your intake coordinator that the couple is in foreclosure, has two other mortgages on their home, and is at least three months behind on every mortgage. Beth provides a suburban address, in a nearby town that consists of both new development and older homes where most residents have owned their homes a long time. She shares with your sympathetic staff person that she has two children enrolled in elementary school, although your staff person does not gather her precise age. Your staff person forgets to ask about income, but as he is setting the appointment time, he gathers that both Barry and Beth are employed. Beth also shares with him that the default was caused by a brief bout of unemployment on Barry’s part.

A. The Intake

Reading the intake sheet, you tell your assistant you are happy to meet with Barry and Beth. “This looks like a case of predatory lending,” you say, “I doubt they can afford to hire me, but I can explain their rights to them and provide them with the telephone numbers of some Clinics. Maybe someone at the John

---

* Kelli Dudley is an attorney practicing in Illinois and teaches Real Estate and Civil Litigation at MacCormac College in Chicago. Kelli is a guest lecturer at the John Marshall Law School in Chicago, where she addresses mortgage foreclosure, fraud, and predatory lending. Kelli teaches business law at MacCormac College, contract law at Brown-Mackie College, and a series of community education classes on financial literacy at Rock Valley Community College. As needed, Kelli offers workshops and seminars to attorneys and the public in cooperation legal services, religious groups, and community organizations. In her legal practice, Kelli takes many different types of cases, but most of her work involves helping people threatened with mortgage foreclosure or who are victims of predatory lending or real estate fraud.

Kelli is the former supervisor of the Chancery Advice Desk located in the Daley Center courthouse in Chicago. The Advice Desk was founded as a collaboration between the Court, legal services agencies, and attorneys to help people with problems like mortgage foreclosure understand their rights. Kelli also worked as an attorney and as a law student to assist people with limited income as an attorney with the Chicago Legal Clinic. This enabled her to win judgments or settlements in cases involving civil rights, fair debt collection practices, fair housing, tenant’s rights, fraud, and similar issues.
Marshall Law School can help.¹ You ask your assistant to prepare the conference table with a brochure explaining to clients the types of problems that can lead to foreclosure and advising them to get help if they believe they are victims of predatory lending, a list of causes of action arising from home repair fraud, a checklist of disclosures and documents required at a real estate closing, a timetable explaining redemption and reinstatement rights, and your bulging referral list.

B. The First Impression

You are shocked when Barry and Beth arrive for their appointment. You see them pull into the parking lot in a brand-new Ford F-150 vehicle replete with carrying cases in the bed for various tools. The side of the truck is emblazoned with a logo for “B & B Home Repair.” The two people who exit the truck are in their late 30’s. Barry is wearing work clothes, but Beth has on a designer suit of recent vintage. You are well aware of the cost of the suit, because you have tried it on several times and, ultimately, decided against spending the large sum. Beth reaches behind her and extracts two children from the extended cab—a boy and a girl, each clad in designer clothing. Both children carry small electronic games that seem to absorb all of their attention.²

C. The Problem

Predatory lending has received well-deserved attention from lawyers and academia alike. Although predatory lending has not been precisely defined, it is a subset of sub-prime lending. Sub-prime loans carry higher interest rates and less favorable loan terms, but are believed by some to provide access to credit to people who could not afford prime loans. The loans classified as predatory include features designed to prevent the homeowner from ever building any equity in the home, or to strip any equity the homeowner has at the time he or she

¹ While enough compliments cannot be heaped upon the Fair Housing Clinic at the John Marshall Law School and other legal service organizations, a referral does not ensure representation. Each organization is overburdened, has income and eligibility guidelines it must follow, and faces funding cuts when funding is most needed. Even clients who can afford private representation may decline to pay or may be unable to find a competent attorney who is willing to accept the complex mortgage foreclosure defense at any price. Referrals sometimes result in declinations and further referral, adding to the mortgage foreclosure defendant’s confusion and raising the time investment (from an economic perspective, a cost) required on the part of the defendant to assert his or her rights.
² Barry and Beth Borrower, who appear throughout this paper, are not typical borrowers. They represent one species of borrower. Typically, this does not include low-income, minority, elderly, or non-English speaking borrowers. This type of borrower is also usually distinct from those borrowers who have experienced redlining or reverse-redlining. Although the challenges faced by these other borrowers are many, and interesting, they are beyond the very narrow scope of this paper. This paper does not do anything more than open a dialogue about behavioral economics as applied to the challenges presented by mortgage foreclosure.
applies for the loan. These features include high upfront costs like broker’s commissions or “bogus” charges listed on the HUD-1, high interest rate, negative amortization, high prepayment penalties, balloon payments—often undisclosed to the borrower, and similar terms unfavorable to the borrower.

However, not all mortgage defaults are caused solely by predatory behavior by the lender. Indeed, some people who become mortgage foreclosure defendants are sophisticated, enjoy moderate or high incomes, and—outwardly—enjoy all the trappings of economic success. Models that assume defaults are strictly due to unfavorable mortgage terms or lack of income do not account for the defaults on the part of Barry and Beth, the mortgage foreclosure defendants in the hypothetical above. Barry and Beth are not representatives of all mortgage foreclosure defendants. Although some of their circumstances may be common to many defendants, Barry and Beth are a conflation of several mortgage foreclosure defendants, created for illustrative purposes. Typically, the borrowers discussed in this paper are not low-income, minority, elderly, or non-English speaking borrowers. They also are not representative of people who are victims of redlining or reverse-redlining. In Barry and Beth’s case, unlike most cases, the borrowers share some fault with the lender for the loan terms leading to default and foreclosure.

The reasons for default are complex and vary greatly among individuals. More study is needed to equip practitioners to recognize the sorts of behavior on the part of the borrower that may make the borrower more likely to experience default. While this may be distasteful to some practitioners as “blaming” the client, the demand for services in the defense of mortgage foreclosure is high. It is in the interest of clients, the courts, and practitioners to use resources wisely by understanding and recognizing the factors that may make one client more prone than another to particular kinds of imprudent financial behavior. Likewise, lenders may know about and exploit human frailties like those belonging to Barry and Beth, and some of this lender behavior could be unrecognized, as yet, as predatory lending. Lenders hoping to make a positive impact, and avoid the expense and inconvenience that mortgage foreclosure proceedings cause ethical lenders, must be equipped to recognize people who engage in fraud. Some of the motivation to engage in behavior such as falsification of loan applications may be explained, or even predicted by, behavioral economics.

D. The Interview

“I am glad you came in,” you tell Barry and Beth as they spoon sugar and cream into their coffee cups at your conference table. “This mortgage foreclosure complaint appears to have only been filed three weeks ago. It looks like you sought legal help right away, and that can be one of the most important things to enable us to help you.”
Beth sobs. “But that isn’t the only one. We saw the Sheriff coming up the lane as we left today. We think we are getting two more, because we are behind on all our mortgages.”

You take a minute to scan the complaint. “That just can’t be. This complaint asks for over $300,000. You mean you have additional mortgages not included in that?”

Beth sniffs. “Yes, we are behind on both of our other mortgages. They are both from investors we met through our business. We couldn’t qualify for any more loans from a bank, and we needed another $150,000 to close.”

You quickly do the math. Barry and Beth seem to owe about $450,000. “So you bought your house a little over a year ago for about $450,000?”

“No, it was $475,000. We wiped out our savings to do this,” Barry adds. “We thought we would pay it all back with money from the business, but I got hurt and missed two weeks.”

You ask the couple how much they make. They toss around figures. Finally, you place your pen firmly on a lined pad. “Barry, your job selling truck parts?”

“$40,000, plus commission.”

“How much is the commission?”

“Well the last two years, only $5,000 a year, but—”

“Fine, and the business—how much do you clear each year?”

“Well, the accountant kinda took our papers to do our taxes and took off.”

“Ok, but how much did you pay yourselves out of the business?”

“Well, we didn’t really clear anything.”

“Now, Beth, how about your job as a secretary?”

“$30,000, but I’ve been hoping for a raise. I missed some days when Barry got hurt, so I think that’s why I didn’t get my raise. But I think it will come through any day now, and I was hoping to bring the mortgages current with that.”

You look at the figures in dismay. Barry and Beth earn $75,000 per year. You quickly calculate that they could easily afford a mortgage of $225,000—maybe even $250,000. But, instead, you have just discovered they purchased a $475,000 house and owe $450,000.

E. Conclusion

The Barry and Beth scenario above is an extreme example. As the truth comes out about Barry and Beth, they have never been current on all their mortgages at once, and they have experienced far more than the one default they attribute to Barry’s short illness. They reluctantly admit that they may have made some “mistakes” in the figures they presented to the bank and investors when they applied for their loans. A last-ditch Chapter 13 bankruptcy fails to save the house because Barry and Beth have credit card balances and other unsecured debts that make it impossible for them to make the monthly payments required as part of a Chapter 13 bankruptcy plan. They fail to accurately describe their financial
situation to a well-respected, diligent bankruptcy attorney. In the end, Barry, Beth, and their two children lose their home and experience difficulty finding an apartment to rent because of their poor credit rating.

If Barry and Beth were hypothetical clients, their virtual homelessness would not be so troubling. Unfortunately, their story is an amalgamation of several actual mortgage foreclosure cases in which I have been involved. If lawyers are going to be able to help people like Barry and Beth, then it will be necessary to understand their financial behavior pattern to avoid time wasted treating their cases like any predatory lending case, and, ultimately, to become able to counsel such clients to avoid a cycle of repeated mistakes.

Although cases come into law offices one at a time and most evidence about clients whose primary legal problems arise from their improvident use of money or debt is anecdotal, it may be possible to define some common characteristics for the purpose of study. The following is intended to begin the discussion. More study is needed, and this article is intended only to open a discussion that may prove helpful to practitioners.

Clients whose legal problems arise primarily from their behavior concerning money are people with:

- Income above the median for their geographical location
- Some savings or home equity, or who have had savings or home equity in the past
- Employment
- Multiple debts that have become a problem (collections, foreclosures, judgments, etc.)
- Debts that are so high relative to income the client cannot reasonably expect to repay the debts

As the list above reflects, clients in this category have income that is above the median, employment, and some savings or home equity. However, these factors, which seem to be positive, may work against the client because he or she is more likely to qualify for loans—leading to problems with multiple debts and a total indebtedness so high that the client cannot reasonably expect to ever repay the debts.

II. A New Paradigm for Evaluating the Relationship Between Economic Choices and Legal Outcomes

Fortunately, the question of whether people behave rationally with regard to money is not a new one. Anecdotal evidence tells us that they do not, but, as

---

3 The client may insist that she is repaying the debt, will repay the debt, or even has repaid the debt. The relevant question is whether a reasonable person in the client’s circumstance would reasonably expect to repay the debt.
discussed above, has little or no predictive value. The relatively new field of behavioral economics may provide a basis for understanding debtors like Barry and Beth. Behavioral economics has value for lawyers because it may enable the legal community to have a discussion that is not tied to the legal relevance of the facts of a particular case for purposes of preparing a pleading. This discussion may lead to an increase in some attorneys’ abilities to recognize new forms of predatory lending or to counsel clients to avoid the consequences of improvident financial behavior. These consequences often include home loss.

While understanding the behavioral factors that contribute to the accumulation of debts that cannot reasonably be repaid may not lead to the immediate collection of a legal fee, it may serve an important policy goal of preventing the distress associated with loss of a home to mortgage foreclosure. Such an understanding may also help lawyers serve clients more efficiently, an achievement that would particularly benefit attorneys practicing in the legal services area or in small neighborhood law offices where few clients have the money to fully pay the attorney for time spent on complex mortgage foreclosure defense work.

A. Behavioral Economics

Behavioral economics describes and attempts to explain areas where human behavior does not comport with economic predictions. For example, economists have traditionally based their models on assumptions that market actors are “rational.” In the area of finance, this might mean that an investor who receives new information about the market will update his or her beliefs, and will make market choices that are normatively acceptable, or another investor will make normatively acceptable choices and profit for doing so. Behavioral economics explores instances where market actors do not appear rational.

Traditional economics placed great faith in the ability of the market to correct itself. In other words, a stock might be underpriced because “noise,” or misinformed, traders suddenly dumped many shares of that stock onto the

---


5 “Normatively acceptable” means that the choices made by the investor will make choices that maximize profits. This is an overgeneralization, and description of complex economic theories is beyond the scope of this paper. For more information see Richard H. Thaler. (2005). Preface, in Advances in Behavioral Finance: Volume II. Princeton: Princeton University Press, xii.


This “mistake” would be corrected because “arbitrageurs,” rational traders, would quickly buy up the stock. The demand created by the arbitrageurs would correct the price of the stock, bringing it to the higher cost it enjoyed before it was spurned by the noise traders.

Behavioral economists recognize that not all mistakes can be corrected. One reason that mistakes, or irrationality, persist in some markets is that there is no corrective mechanism like that described above. The absence of a corrective mechanism is described by behavioral economists as a “limit to arbitrage.” This is eloquently explained by Richard Thaler, who uses a quaint example and brings this complex subject much closer to the realm of consumer-level decision making:

It has long been known by researchers in behavioral economics that the importance of less than fully rational behavior depends on the extent to which rational actors can profit from the sub optimal choices of others, especially if in the act of profiting, rational individuals push the quasi-rational agents to behave more rationally [citation omitted]. In many important economic choices (e.g., career choice, marriage, saving for retirement), if one agent makes a poor choice (picks the wrong career or spouse, saves too little) no profit opportunity is created. You may think that my wife will soon realize what a mistake she has made in marrying me, but (as far as I know) there is no way for you to sell my marriage prospects short, and even if you could, it might not alter the behavior of me or my unlucky wife. Missing markets prevent arbitrage, thus allowing irrationality to persist.

The absence of arbitrage should be no surprise to lawyers, simply a new term. Poor decision-making by clients is the basis, in many cases, for the need for an attorney’s advice. This is indicated in the statistics concerning foreclosure and bankruptcy. Foreclosure has increased precipitously in Cook County, Illinois, alone. In this large, urban county, home to the largest unified court system in the United States, the number of foreclosures increased from under 6,000 in 1993 to

---

9 Id.
10 Id.
12 Limitations can arise from factors such as lack of incentive to take advantage of profitable opportunities or unavailability of a profit margin for arbiters. See Id., 81-99 and Richard H. Thaler, Preface, in Advances in Behavioral Finance: Volume II. Princeton: Princeton University Press, xii.
more than 12,000 in 2001.\textsuperscript{15} Approximately 20,000 foreclosures were filed in 2002.\textsuperscript{16} Similarly, the number of people who filed for bankruptcy protection has increased greatly, with some scholars placing the increase as high as 600 percent during the past decade.\textsuperscript{17} While attorneys do not always know for certain whether clients have previously experienced financial problems, lawmakers are certainly convinced. The Illinois Mortgage Foreclosure law provides for only one reinstatement\textsuperscript{18} every five years.\textsuperscript{19} Similarly, the recently-enacted bankruptcy provisions set limits on the number of petitions for bankruptcy protection that may be filed by an individual in a given time.\textsuperscript{20} The presence of such provisions suggests that there is a public policy concern that some people repeatedly fail to meet their financial obligations.

\textbf{B. Irrational Borrower Behavior}

“You could sell the house,” you advise Barry and Beth after reviewing their paperwork. “You don’t have any equity, but you could move and get a fresh start without doing any more harm to your credit record.”

“We can’t sell!” Beth wails. “The kids really like the house. I have it all decorated.”

“Well, then, for the meantime, you will have to refinance the loan that is in default,” you begin—doubtful your clients will ever find a lender willing to loan such a large amount on Barry and Beth’s income, which is small relative to the size of the indebtedness.

“We’ll never refinance,” says Barry. “They’ve smeared us with all the credit bureaus. This is all over our credit reports,” he snorts.

You begin to see there is little that can be done for Barry and Beth. You quickly explain the rights of reinstatement, redemption, and so on to them—each time hearing why each option will never work for them due to one creditor-driven vendetta or another. Finally, you explain that some of the loans may have been improvidently made, giving rise to possible defenses, and you offer to enter your appearance in the lawsuit. However, Barry and Beth assert they have no money to pay. You watch them leave the office with the materials you have provided, saddened by the realization that, despite their relatively good income, they are

\textsuperscript{15} Cook County Clerk of Court at www.cookcountyclerkofcourt.org.

\textsuperscript{16} \textit{Id.}


\textsuperscript{18} Reinstatement is the process by which a borrower brings a mortgage loan current, including costs associated with collection, and is able to resume making his or her regular mortgage payment.

\textsuperscript{19} 735 ILCS Section 5/15-1602.

\textsuperscript{20} For example, debtors are limited to using Chapter 7 bankruptcy once every eight years. 11 U.S.C. Section 727.
likely to experience the same outcome as your severely economically-disadvantaged clients—the loss of their home.\textsuperscript{21}

The following are some of the behavioral phenomena observed by behavioral economists that may explain some of the irrational behavioral observed among debtors, particularly those in mortgage foreclosure. This is in no way an exhaustive discussion, and other behavioral factors may better explain some of the problems experienced by debtors. The following is an opening discussion based on a brief literature review.

\textbf{1. Endowment Effect, Status Quo Bias, or Loss Aversion}

In the scenario above, the lawyer offers Barry and Beth Borrower the chance to sell the home and pay off the mortgage. Even though they have no equity to speak of, Beth stridently insists this is “her” home. The evidence in the hypothetical suggests that Beth is not relying upon having clear title as the indicia of ownership; in fact, there has never been a time that all the mortgages were current. She verbally offers the following as reasons why it is “her” home: the kids like the house, and she has decorated it. The borrower’s definition of ownership seems to be based upon possession, improvement, and comfort. These factors mean very little in the legal context, where a lawyer or judge would examine deeds and other documents to determine ownership.

Debtors like Beth and Barry are stuck in the gap that separates the vernacular and legal definitions of ownership. The result is that their emotional attachment to the home is greater than their economic stake in it. This is a phenomenon similar to that described by behavioral economists as endowment effect, status quo bias, or loss aversion.\textsuperscript{22} There are differences in how each phenomenon is described,\textsuperscript{23} but, in general, each refers to the attachment to a

\textsuperscript{21}Barry and Beth are among the few fortunate borrowers who have the opportunity to consult with competent counsel. Legal services that are free or based on a sliding-scale fee are rare compared to the overwhelming demand for the services. Many such services would not accept clients with Barry and Beth’s income. Even for clients who can pay and who are eager to pay, there is a lack of competent professionals willing to accept the cases. An effective defense, asserting affirmative defenses and counterclaims, can be so time-consuming that many private lawyers do not even consider accepting the cases. In my law office, only about three in ten telephone calls culminates in an offer of representation from me; of these three offers, at most one results in a signed contract.


\textsuperscript{23}Thaler sets forth a hypothetical in which a wine-loving investor both refuses to buy more of a wine in his collection at the going price, yet simultaneously refuses to sell the bottles he owns of the same wine at any price. He explains the concepts of endowment effect, loss aversion, and status quo bias as follows: “This pattern—the fact that people often demand much more to give up an object that they would be willing to pay to acquire it is called the endowment effect . . . . The example also illustrates . . . a status quo bias, a preference for the current state that biases the [investor] against both buying and selling his wine. These anomalies are a manifestation of an
good that causes one to be reluctant to give up that good—more reluctant that one objectively should be given the value of the good. For example, one may demand more to sell the object than one would be willing to pay to have acquired it.

In Barry and Beth’s case, they are unwilling to part with their house even though they cannot possibly pay for it, or, in this case, prevent its loss. In the absence of some action on the part of Beth and Barry, mere legal formalities lie between them and eviction from their home. They are unwilling to sell, presumably at a price that would at least be sufficient to relieve them of their legal problems, yet they claim to be incapable of paying anything—even a legal fee—to keep the right to stay in the home. The quandary created when a borrower is unable to pay, unwilling or unable to invest anything to retain the property, and unwilling to sell is a sinkhole for the legal practitioner and for the borrower. The legal practitioner will urge some sort of solution sanctioned by the legal system—paying the debt, refinancing, selling, or pleading appropriate defenses. All of these require some monetary or emotional investment on the part of the borrower. If the borrower has decided that he “owns” the house even if he cannot pay for it, the practitioner will be left confronting irrationality with reason, often to no avail.

a. Endowment Effect

Endowment effect is described as the phenomenon that may be observed when people demand more to give up an object than they would be willing to pay to acquire it. As discussed above, borrowers are loathe to sell a property at any price, even when they have no equity and are unwilling or unable to invest any money in saving it. Studies conducted by behavioral economists suggest that this behavior is motivated by the pain of giving up the good one owns more than by the benefit one derives from owning the good.

b. Status Quo Bias

Status quo bias is the tendency of individual to remain at the status quo, because the disadvantages of other options seem more compelling than the advantages. As set forth above, one who refuses to move out of the discomfort of mortgage foreclosure by selling his or her home or investing money to in some way move past the economic challenges of owning a home one cannot afford,

asymmetry of value [called] loss aversion—the disutility of giving up an object is greater than the utility associated with acquiring it.” *Id.*

24 Selling requires giving up the emotional commitment to the idea that the house is the borrower’s regardless of the legal status, and even pro bono legal services require time commitment and acceptance of legal advice by the borrower.


26 *Id.* at 68.
may be motivated in part by the idea that the house is “mine” regardless of the legal definition of ownership. At the same time, staying in the home, even with the attendant discomfort of an impending foreclosure, maintains the status quo. Resolving the foreclosure will mean change—resumed mortgage payments if one stays in the home, relocation if one moves. The second scenario, relocation, brings with it many other changes that may increase the preference for the status quo. For example, school-aged children may have to attend new schools, the commute to work may be longer, and friends from the neighborhood may be lost.

Status quo preference may contribute to financial hardship in ways other than failing to resolve a mortgage foreclosure. For example, a person in a disadvantageous loan may become aware that her payments are too high. She may come to regret taking out the loan, even discovering that she has grounds to rescind the loan.\footnote{For example, laws like the Truth in Lending Act have provisions that allow homeowners to rescind a loan transaction if certain violations have taken place, such as if the creditor failed to make certain required disclosure. \textit{See} 15 U.S.C. Section 1635.} Despite the discomfort generated by making the monthly mortgage payment required by the disadvantageous loan, the borrower may be loathe to visit a lawyer to exercise her rights or approach another lender about receiving a loan that is more fair. Each of these options will require an extra effort, and bears the risk that the borrower is wrong about her rights or mistaken in believing that another lender might offer better terms—in other words, it might be better to stick with the devil (or, in this case, banker) one knows rather than risk rejection by another lender or otherwise invest effort to no avail.

Lawrence M. Ausubel describes the effort required to find a better loan as the “search/switch” cost.\footnote{Lawrence M. Ausubel. (1993). The Failure of Competition in the Credit Card Market, in \textit{Advances in Behavioral Finance}. New York: Russell Sage Foundation, 557-560.} Ausubel explores the possibility that consumers who continue to use credit cards with high interest rates or fees may do so because of the costs of finding and obtaining a different credit card.\footnote{\textit{Id.}} According to Ausubel, these costs include:

\begin{quote}
\text{… (a) the information cost of discovering which banks are offering lower interest rates; (b) the cost in time, effort, and emotional energy in filling out an application for a new card (and possibly getting rejected); (c) the fact that the card is usually billed on an annual basis, so that if one switches bands at the wrong time, one foregoes some money; (d) the perception that one acquires a better credit rating or higher credit limit by holding the same bank’s card for a long time; and (e) the time lag between applying for a card and receiving one.}\footnote{\textit{Id.} at 558.}
\end{quote}
Although Ausubel is not convinced that search/switch costs fully explain the failure of credit card rates to decline with competition, search/switch costs such as those set forth above would certainly await any borrower seeking to refinance a mortgage loan. This may explain why borrowers remain in disadvantageous loans, even when they realize that better loans may be available.

Finally, status quo bias is evident at virtually every real estate closing. As lawyers review documents including surveys, disclosures, contracts, mortgages, and notes with their clients, it is rare for a buyer or seller to fail to consummate the purchase or sale of property due to defects discovered at the closing table. In fact, the escrow agent for the mortgage company is the only party likely to “kill” a deal. Borrowers often receive the note and mortgage for the first time at the real estate closing. Careful review with the attorney may disclose terms different from those understood by the borrower, often greatly to the disadvantage of the borrower. However, sound legal advice at the closing table competes with countervailing forces—the agreement to close on a particular day, with possible costs for failing to do so, eagerness to acquire the home, and the fact that the position of the mortgage broker represents a sort of status quo. The borrower may feel it is hardly fair to require the mortgage broker to “change” terms at the last minute—even when it is the broker who has already changed the terms previously negotiated. Were the homebuyer to reject the mortgage offered, all of the search/switch costs discussed above would apply. Finally, mortgages and notes are contracts of adhesion—the borrower typically has little negotiating power, and feels happy to be able to borrow the money needed to buy something as important as a home. Borrowers rarely, if ever, actively negotiate mortgage terms. Perhaps this is the ultimate status quo.

c. Loss Aversion

Loss aversion is similar to status quo bias and endowment effect insofar as it explains the tendency of people not to make a change, even for the better, when it comes to financial decisions. Loss aversion, according to behavioral economists, is the phenomenon whereby the pain of losing something surpasses the pleasure of receiving it. This may explain the tendency, as set forth above, for mortgage foreclosure litigants to remain steadfastly attached to their property, even when there is no equity in the home.

---

31 This section is written from the perspective of a lawyer practicing in Illinois, where lawyers routinely review documents alongside buyers and sellers. If anything, the status quo bias discussed here might be even stronger where no lawyers were present to review documents and explain rights to a new mortgage borrower.

32 This may vary with economic status and educational status. Although it is beyond the scope of this paper, most people are unaware of their true credit worthiness, and most believe their credit is worse than it is. Therefore, they are likely to regard the offer of mortgage financing as a privilege, rather than as an optional product that they might decide to buy from another vendor.
Thaler and other behavioral economists recognize “enhanced loss aversion” that occurs when highly-charged emotional issues are involved in decision making. For example, a focus group is asked what price decrease in the cost of insecticide would justify a very small increase in the risks of injury associated with the product. A control group is asked how much more they would be willing to pay in addition to the current price for insecticide with a very small increase in safety. Although consumers indicate they are willing to pay a few dollars to increase safety, they refuse to take a corresponding decrease in safety for any price.

Similarly, mortgage foreclosure issues often involve a sense of injustice. Consumers are not willing, in some cases, to pay any amount of money to better their financial position, even to the point of saving their home from foreclosure. This may reflect an enhanced loss aversion tied to the outrage felt by many homeowners when a lender attempts to “take” property they feel is theirs. Similarly, consumers may be unwilling to pay for legal services or invest their own time to disengage from a predatory loan because of a sense that they should not be required to do so. While legally unfounded, this position prevents the consumer from opening a productive dialogue with the current lender, who might voluntarily offer more advantageous terms as the result of negotiations, or with prospective lenders who might offer a new loan with competitive terms.

Similar to a sense of injustice, shame is another emotion that may reinforce loss aversion. Home ownership, particularly if the home is large or located in a desirable neighborhood, is a source of pride. Homeowners may resist selling because it amounts to an announcement to the world that they no longer own the status-enhancing home. They may also avoid discussion with professionals such as attorneys or lenders because they are afraid of admitting they are not in control of their finances.

Popular financial advisor Suze Orman offers an illustration of the taboo associated with admitting loss of financial control:

In our culture it’s okay to talk about therapy we’ve been through, marital problems we’ve had, our deepest intimate secrets—but telling the truth about money, confessing our worries to our children, our parents, our friends, just isn’t done. Money is our secret both in private in public. Imagine going to a dinner party and telling a group of close acquaintances, “I just don’t know what to do. My credit card debt has gone up to $17,000, and I don’t know how I’ll ever get out of it.” The room would fall into

---

embarrassed silence. (Most silent of all would be the others in the room weighed down by the secret of their own credit card debt.)

Loss of social status enhances the aversion one would already experience on contemplating losing one’s home, paying for the services of a professional to resolve the mortgage foreclosure problem, or investing time and money into applying for and receiving a new mortgage.

2. Mental Accounting

In the scenario above, Barry and Beth own an expensive vehicle. The entire family is well-heeled, and the children play electronic games. The vehicle, clothes, and games were acquired, presumably, at some cost to the family. The hypothetical makes it clear that the truck and clothes are of recent vintage. Since Barry and Beth have never been current on all three mortgages at once, they have purchased these items while defaulting on a mortgage.

One theory set forth by behavioral economists may be particularly helpful in explaining the phenomenon whereby people experiencing foreclosure, or other serious debt-related problems, spend money to pay unsecured debts or for luxury items rather than applying the money toward resolving the foreclosure.

While traditional economic—and legal—theories treat money as fungible, this is not consistent with how most individuals treat money. Instead, people categorize money by how it was received (i.e., money from gifts) and how they intend to use it (i.e., vacation money). Lest any law student or attorney scoff at the idea of “mental accounting” as an ill of those who do not understand money, consider the following:

1. You are a solo practitioner operating a sole proprietorship. You are buying a new fax machine. Are you willing to spend more money if you purchase the machine from your law office checking account than your personal checking account?

2. You are a student at the John Marshall Law School. You purchased all of your books for this semester from the library, but you were $15.00 short of the money for Professor Caruso’s Fair Housing book. You stop by Subway and enjoy a sandwich while you call your parents on your cell phone to ask for a loan, explaining you spent all the money you had saved from birthday and holiday gifts on books. You are too tired to wait for the classmate who offered you a ride home, so you hop aboard the Metra. You are anxious to get back to your apartment to watch your favorite show on cable.

As the above examples show, people do not always treat money like money. A sole proprietor likely has nothing to gain from treating money from her business checking differently than money from her personal checking account. At the end of the year, sole proprietors report their earnings and their expenses to the IRS for tax purposes, with no distinction made between whether the business or the individual received the money or spent the money.

The JMLS student above would have about broken even if he had foregone the meal at Subway, saved the cellular telephone minutes, waited on his friend for a ride home instead of buying a Metra ticket, and purchased the book. Simply canceling cable television for the duration of law school would save enough money to more than pay for all required textbooks.

The examples above do not involve expenditures most people would consider extravagant or reckless. All of the expenditures, with the exception of cable television, meet some basic business or human need—office supplies, transportation, food, and utilities. Therefore, these examples show how easily “mental accounting” can create problems, even for people who are not in financial distress.

It is likely that some mortgage defaults result from poor mental accounting. A failure to cancel the cable bill when financial trouble looms would be an easy mistake to make, yet skipping cable bills for two months might ease the financial strain of reimbursing a lawyer for appearance fees. An attorney friend of mine who has a reputable bankruptcy practice confided that he has never filed a bankruptcy that did not include a cable bill. This illustrates a complete failure on the part of debtors to adjust spending during times of financial distress. Nothing could be less necessary than television, yet some debtors choose to stay tuned in, even when their housing is threatened.

Larger financial mistakes, such as continuing to make a large vehicle payment while a foreclosure is pending, are likely far more common. If people running law offices and attending law school can fall victim to mental accounting, then it is reasonable that people with less formal education who are facing the severe emotional strain of foreclosure would make mistakes of greater magnitude.

Businesses that advance unsecured funds, such as installment loans or increases in credit card limits, to those who are in foreclosure do so at their peril. A borrower who loses his or her home nears “judgment proof” status—there is no possibility of placing a lien on the real estate to collect unpaid funds, even if the creditor receives a judgment in its favor. If the creditor tries other collection avenues, it will likely find itself in a lengthy line of creditors pursuing the same remedies.

These mistakes likely contribute both to default rates and to the unavailability of funds to hire attorneys, pay filing fees, and to exercise the rights of redemption and reinstatement.

3. Over-confidence
Behavioral economists have found that most people are over-confident about their abilities and their budgeting prowess. While Barry and Beth may be crying in the hypothetical, the problem tells us that they inflate the income earned from their business until pressed, Beth has already spent a raise she believes she will receive, and the couple took out three mortgages—based, in part, on untruthful statements to investors.

Belsky and Gilovich describe over-confidence not as the product of arrogance, but say that “. . . most people—those with healthy egos and those in the basement of self-esteem—consistently overrate their abilities, knowledge, and skill, at whatever level they place them.”

Over-confidence has been documented, according to Belsky and Gilovich, as affecting personal finances:

Because people are over-confident, they’re likely to think they are in better financial shape than they are. Consider the results of a 1996 survey of American parents by the International Association of Financial Planning. Some 83 percent of respondents with children under the age of [18] said that they have a financial plan, while three-quarters of them expressed confidence about their long-term financial well-being. Yet less than half of the respondents said they were saving for their children’s education, and less than 10 percent described their financial plan as addressing basic issues such as investments, budgeting, insurance, savings, wills, and estates.

If people are over-confident about saving and planning, it seems likely they are even less realistic about the state of their mortgage and other debts. Savings and planning are tasks that are powered by the consumer. Note that the study above did not explore whether people were getting the best possible value on savings and investments—simply whether they were engaging in these types of activities. Even using the very low threshold that would have recognized a passbook account at a local bank as savings, consumers were over-confident about their savings and planning. The result might have been more dismal had the quality of savings vehicles, for example, among those who chose to save been analyzed.

Unlike savings, a mortgage cannot be had simply by the actions of an individual consumer. In contrast, a person who decides to take out a mortgage must select among brokers, loan products, interest rates, and the like. Making good decisions about a mortgage means understanding the above terms and their

36 Id. at 158-159.
consequences. Most consumers seem to have an undying belief that they can pay off higher and higher mortgages over longer and longer terms. Yet, the high default and foreclosure rate may indicate that this belief is not realistic.

Ausubel suggests that not all credit-card borrowers intend to borrow on their accounts. These customers find themselves borrowing in response to unforeseen expenses. Like Barry and Beth, these customers do not plan on paying finance charges. The hypothetical reveals that Barry and Beth believed they would pay off their heavy mortgage debt with pay raises, business profits, and bonuses that did not materialize. Like Ausubel’s unintentional borrowers, homeowners like Barry and Beth are less inclined to diligently compare interest rates and loan terms because they do not believe they will be servicing the debt for a long term. I suggest that unrealistic expectations about debt repayment may be a form of over-confidence.

Understanding the phenomenon of over-confidence may help attorneys and advocates understand the mental processes of mortgage foreclosure defendants or buyers seeking to enter into a mortgage. It is likely that a person stating, for example, that he or she understands the cost of a high-interest loan over 30 years is over-confident about his or her information and understanding of the implications of that information. Likewise, a mortgage foreclosure defendant eager to sign a forbearance agreement with a lender may declare that he or she is aware of every jot of the agreement. Good advocacy requires sensitivity to the likelihood that the client believes he or she understands the agreement, and that he or she accurately estimates his or her ability to repay. Taking care not to unduly insult the client, the advocate must take care to explain documents before they are signed and to help the client understand the importance of not signing documents prior to review by an attorney.

III. Thaler’s Rapidly-Expanding Household: Effects, From the Consumer Perspective, of the Absence of Arbitrage in the Mortgage Market

As set forth above, Richard Thaler, a leading behavioral economist, explains the absence of arbitrage in his hypothetical wherein his wife makes a poor choice in her selection of a husband. Because there is no one who will profit from Mrs. Thaler’s mistake, the market will not adjust if the Thaler household

---

37 Some banks in California have introduced 50-year mortgages, giving consumers little or no ability to build up equity in a home during the early years of a loan. If life expectancies are for one to live into one’s 70’s, one cannot expect to pay off a 50-year mortgage in one’s lifetime if one is past one’s mid-20’s at the time the loan is originated. The 50-year mortgage is discussed at http://mortgagenewsdaily.com/5162006_50_Year_Mortgage.asp, last accessed July 18, 2006.
fails to experience domestic bliss. Because of this market failure, or limitation on arbitrage, irrationality (such as poor marriage choices) can continue to exist.\(^{39}\)

Like choices in marriage partners, consumer choices about home buying and financing may be irrational. However, there is no arbitrage in the form of stock market correction. People who become over-mortgaged by taking out predatory loans or simply by over-estimating their ability to repay cannot repeat their experience in the short-term as traders in the stock market can. In the hypothetical, Barry and Beth’s mortgages continue to exist, regardless of whether their decision was good or bad. The mortgage company is not “punished”—it continues to extract late fees, interest, and costs of collection. If Barry and Beth bring their mortgage current by refinancing, all of these expenses must be paid. The expenses must likewise be paid if Barry and Beth sell their property and pay off the mortgage in full. If a foreclosure is completed, the principal and expenses will be paid following a forced sale of the property. Therefore, there is no arbitrage to cause the lender not to make another such loan.

In fact, the lender may profit from offering a loan that could not be repaid by collecting expenses and fees in addition to the principal and interest agreed upon at the inception of the loan. It may also profit by offering Barry and Beth new financing at terms even more profitable than the first loan. The lender could purchase the property at a forced sale, and then sell it at fair market value. In other words, there is virtually no risk to encourage mortgage lenders to adjust their practices—in fact, bad practices such as charging exorbitant interest rates simply cause the mortgage companies to earn more money.

The above article has set forth explanations for borrower behavior that may be found if behavioral economics is applied to the area of debtor behavior. As set forth above, a great deal of consumer behavior with respect to mortgages is irrational. One could argue that arbitrage could come through consumers who would learn from their experiences after selecting bad mortgage products or otherwise failing to pay, resulting in default or foreclosure. This would lead to consumers refusing to sign unfair loan documents or assume levels of debt they could not handle.

This possibility fails because the mortgage market is so vast that one “learner” cannot change the market. Unlike publicly-traded companies that issue limited shares of stock, allowing individual sales and purchases of stock to exert price pressure, mortgage companies market their products to a virtually unlimited universe of consumers. Each year, new potential customers enter the market as new homebuyers come of age, renters decide to buy, homeowners decide to refinance or to move, and the like.

The argument for consumer-driven arbitrage would also fail because, as mentioned above, the mortgage and note are the ultimate contracts of adhesion. The consumer needs the mortgage and note to buy or keep housing and, in the

case of home purchases, to fill her obligations under a real estate contract. The mortgage and note are rarely presented before the scheduled closing date. Therefore, the consumer has no real opportunity to negotiate the costs and terms associated with the mortgage and note.

Like the hypothetical Thaler marriage discussed above, the irrationality in choice of mortgage products persists because there is no arbitrage. However, in this case, there is not only lack of arbitrage, but profits inherent in the irrational choices. This creates a situation in which people consume new mortgage products as quickly as they are offered, even when the mortgages are predatory. Applied to the Thaler hypothetical, the result is not only a long-suffering wife, but a line of women making the same irrational choice and begging admission to the unhappy household.

IV. Practical Application

Attorneys who seek to help those in mortgage foreclosure will do well to learn not to expect rational behavior from the client. Such an expectation will interfere with the attorney-client relationship. The attorney will be dismayed to hear cable television playing loudly in the background during a telephone call. The client may be half-listening to the attorney, paying the cable company while pleading inability to pay even a modest legal fee.

Some attorneys attempt to protect clients from economic mistakes by requiring the client to escrow an amount equal to the client’s monthly mortgage amount with the attorney to be held in the attorney’s client trust fund account. Since mortgage companies typically do not accept payment from borrowers who are in foreclosure, the payment amount will otherwise remain in the household, subject to being spent on items not related to housing. Once escrowed with the attorney, the money, by agreement between the attorney and client and subject to laws regarding attorney trust funds, may only be spent on funds to pay to bring the mortgage current or for expenses related to defending the mortgage foreclosure. The trust fund account makes good use of “mental accounting”; it defeats the fungible nature of money. In this case, it does this to the good by reserving funds for the all-important expense of housing.

Other safeguards might include a clearly-written contract, drafted to inform the client of various options. The contract must inform the client of his or her rights and obligations. For example, mortgage foreclosure defendants, like any other client, are prone to disappear on elaborate vacations or to change their telephone numbers at important junctures in the case. A contract can place a clear requirement on the client to remain available, thus helping the attorney avoid a malpractice charge as a result of not timely solving the case of the vanishing client.
Written communication with clients is invaluable. The mortgage foreclosure client is immersed in a world of “redemption,” “reinstatement,” “workouts,” and other terms. Written communication prevents the practitioner from claims that terms were not explained or that options were not offered. Clearly written communication lets the client know that he or she may attempt to shift blame for developments in the case any way he or she wishes, but the client will not succeed in embroiling the attorney in a malpractice claim.

An understanding of borrower behavior is a worthwhile endeavor for ongoing research and may lead to models that will help predict default, indicate outcomes likely to benefit each mortgage foreclosure defendant, and serve as a guide for borrower education to prevent default.

V. Conclusion

Consumers of mortgage products do not always make rational decisions. This is especially true of the narrow set of borrowers described in this paper, those who are not particularly vulnerable to predatory lending but who overextend themselves financially or make other borrowing mistakes. As a result, they may end up with debt they cannot repay and ultimately default on the loan. The loan may end up in foreclosure.

Because of irrationality, with specific behavioral factors that are explored above, consumers are sometimes unable to cope with their debt or make good decisions even when facing the loss of their home. Awareness of these behavior factors may help attorneys and advocates better assist mortgage foreclosure defendants or those considering entering into a loan to make better decisions. Greater study is needed to understand the applications of behavioral economics to decision-making related to mortgages.

Economists describe a market correction that often occurs when rational actors profit from the choices of irrational actors as “arbitrage.” Arbitrage rewards the rational actors such that stock prices that decline due to bad decisions by a few irrational actors rebound as rational investors buy the stock and return the demand, and price, for it to equilibrium. In contrast, arbitrage does not work in the mortgage market because mortgage companies profit from irrationality. Irrational decisions result in higher interest rates, late fees, and other gains for mortgage companies. Mortgage companies are guaranteed to recoup their investment and costs, along with most or all of their anticipated profit, through forced sales of real estate. Therefore, mortgage companies have no incentive to exert market pressure toward rationality. Consumers are unable to exert enough market pressure to be arbiters because there is a virtually limitless pool of consumers who make irrational decisions because of bad information, bad

---

40 Paying off the entire loan, ending the foreclosure.
41 Bringing the loan current, leading to the dismissal of the foreclosure case.
42 Voluntary settlement arrangements with lenders designed to end the foreclosure; as in any settlement, terms are limited only by the willingness of the parties to discuss options.
decision-making, or lack of choice. Consumers are doubly unable to exert market pressure because mortgages and notes are typically contracts of adhesion—they are necessary for the consumer to procure or keep housing and are rarely offered to the consumer for review before they are signed. Because of this, irrationality not only persists, but also expands. Instead of market correction, the mortgage market becomes increasingly fraught with irrationality.