

CLIENT UPDATE

MUNICIPALITIES FILE FAIR LENDING LAWSUITS

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In the years since the credit crisis, a number of municipalities have filed lawsuits under the Fair Housing Act (“FHA”) seeking to recover for alleged discriminatory lending practices by mortgage originators. In recent months, there has been a surge in such filings, with Los Angeles; Miami; Cook County, Illinois; and Providence all filing federal complaints since December.¹ These suits come on the heels of numerous fair lending settlements with the Department of Justice (“DOJ”), which resolved allegations that lenders engaged in discriminatory lending practices with African-American and Hispanic borrowers.² Suits brought by municipalities cite to the same discriminatory conduct on the part of defendant-lenders, but allege further that, in addition to harming minority borrowers, the discrimination also damaged the municipalities. The resolution of

¹ Complaint, *City of Miami v. JPMorgan Chase & Co.*, No. 1:14-cv-22205, 2014 WL 2709434 (S.D.Fla. June 13, 2014) (“JPMorgan Chase Complaint 1”); Complaint, *City of Los Angeles v. JPMorgan Chase & Co.*, No. 14-4168, 2014 WL2256909 (C.D.Cal. May 30, 2014) (“JPMorgan Chase Complaint 2”); Complaint, *City of Providence v. Santander Bank*, No. 1:14-cv-00244-ML-LDA, 2014 WL 2441639 (D.R.I May 29, 2014) (“Santander Complaint”); Amended Complaint, *County of Cook v. HSBC North America Holdings Inc.*, No. 1:14-cv-2031, 2014 WL 1677060 (N.D.Ill. March 31, 2014) (“HSBC Complaint”); Complaint, *City of Los Angeles v. Bank of America Corp.*, No. 2:13CV09046, 2013 WL 6502834 (C.D.Cal. Dec. 6, 2013) (“Bank of America Complaint”); Complaint, *City of Los Angeles v. Wells Fargo & Co.*, No. 2:13CV09007, 2013 WL 6916826 (C.D.Cal. Dec. 5, 2013) (“Wells Fargo Complaint”); Complaint, *City of Los Angeles v. Citigroup Inc.*, No. 2:13CV09009 (C.D. Cal. Dec. 5, 2013) (“Citigroup Complaint”).

² United States Department of Justice, Recent Accomplishments of the Housing & Civil Enforcement Section, available at <http://www.justice.gov/crt/about/hce/whatnew.php>

these actions will help define the FHA's reach and will implicate how mortgage lenders assess litigation risks intrinsic to the mortgage business.

THE FAIR HOUSING ACT

The FHA prohibits discrimination based on race, color, religion, sex, handicap, familial status or national origin in residential real estate-related transactions, including, but not limited to, the making or purchasing of loans or providing other financial assistance and the selling, brokering or appraising of residential real estate property.³ The act also makes it unlawful to discriminate, based on the aforementioned characteristics, 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 a dwelling.⁴ Under the statute, an "aggrieved person"⁵—defined as "any person who claims to have been injured by a discriminatory housing practice; or believes that such person will be injured by a discriminatory housing practice that is about to occur"⁶—can bring a civil action for redress of harm caused by violations of the act.

THE COMPLAINTS

The plaintiff-municipalities allege that they are entitled to sue as "aggrieved persons" because the defendants' discriminatory lending practices caused them financial harm. According to the complaints, the lenders' discrimination resulted in a veritable explosion of foreclosures in minority communities, which, in turn, led to lower property values and reduced tax revenues.⁷ In addition, the municipalities allege injury based on the increased need to provide costly municipal services in response to public health and safety threats at foreclosed properties that remain vacant.⁸

According to plaintiff-municipalities, the defendant-lenders engaged in two discriminatory tactics that led to the increase in foreclosures: "redlining"⁹ and "reverse redlining."¹⁰ Redlining is the practice of denying credit to particular neighborhoods based

³ 42 U.S.C. § 3604.

⁴ 42 U.S.C. § 3605(b).

⁵ 42 U.S.C. § 3613.

⁶ 42 U.S.C. § 3602(i).

⁷ *E.g.*, JPMorgan Chase Complaint 2 ¶¶ 127-139.

⁸ *E.g.*, JPMorgan Chase Complaint 2 ¶¶ 140-144.

⁹ Santander Complaint ¶ 2.

¹⁰ HSBC Complaint ¶ 44.

on race.¹¹ Reverse redlining is the practice of flooding a minority community with allegedly exploitative loan products,¹² such as high-cost loans, sub-prime loans, interest-only loans, balloon payment loans, loans with pre-payment penalties, negative amortization loans, no documentation loans and /or ARM loans with teaser rates.¹³ In particular, plaintiffs allege that in the run-up to the financial crisis, defendant-lenders engaged in reverse redlining by steering minority borrowers into predatory loans they could not pay back. The complaints further allege that since the crisis, discriminatory practices have continued as the lenders have refused to extend credit to minority borrowers, including by refusing to refinance or to modify the allegedly predatory loans. According to the plaintiffs, both practices contributed to a dramatic increase in the incidence of foreclosures in minority neighborhoods.

IMPLICATIONS

- The recent lawsuits by municipalities have the potential to expand significantly the scope of fair lending liability for mortgage lenders. To date, the lower courts have permitted these cases to survive motions to dismiss, setting unfavorable precedents, at least temporarily.
- The municipalities' theories of causation linking the alleged discrimination to the alleged damages are untested. Mortgage lenders that may face similar claims may need to consider strategies for capturing and marshaling credible data on reasons for default, as well as data on tax assessments for foreclosed REO properties that could be used to demonstrate that any alleged discriminatory lending practices did not cause defaults and that defaults did not have a material impact on tax revenues.
- If these lawsuits continue to proceed, mortgage lenders may need to consider making adjustments to their fair lending monitoring programs to incorporate analyses on the municipal level and analyses of home preservation/foreclosure outcomes.

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Please do not hesitate to contact us with any questions.

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¹¹ Wells Fargo Complaint ¶ 4 n. 2.

¹² Wells Fargo Complaint ¶ 4 n. 3.

¹³ Wells Fargo Complaint ¶ 144.