

FHA "Redlining"—Inflexible Agency Guidelines Defeat Congressional Intent for the 223(e) "Acceptable Risk" Program

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To eradicate a symptom of poverty, Congress has voiced a national housing goal of "a decent home and a suitable living environment for every American family,"¹ a goal which has been consistently reaffirmed.² Recognizing that deterioration of existing housing has negated progress toward the goal,³ Congress has pledged a greater effort in neighborhoods where deterioration is evident.⁴ Sadly, commitment to this national housing goal has not been matched by attainment.⁵ There are several reasons for this failure.

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1. The Congress declares that the general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, the elimination of substandard and other inadequate housing through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family

42 U.S.C. § 1441 (1970). This section was passed as part of the Housing Act of 1949, ch. 338, 63 Stat. 413 (codified as amended at 42 U.S.C. §§ 1441-1496g (1970 & Supp. V 1975)). Passage of the Act was not without controversy. *See* N. KEITH, *POLITICS AND THE HOUSING CRISIS SINCE 1930*, 88-100 (1973). The housing goal was more than rhetoric to the conservative home financing institutions; it was a threat. It took four years for proponents of the Act to overcome charges of socialism from the National Association of Real Estate Boards, the National Association of Home Builders, and the United States Savings and Loan League, among others. *See id.* at 89, 93, 99. During the House debate on the Act, representative G.A. Dondero of Michigan stated: "If this colossal program is adopted, the first fatal step toward national socialism will have been taken and the first real imitation of the Russian ideology of government will have gained a foothold on the shores of freedom." 95 CONG. REC. 8452 (1949).

2. *See* 12 U.S.C. § 1701t (1976); 42 U.S.C. § 1441a(a) (Supp. V 1975).

3. 42 U.S.C. § 1441a(b) (Supp. V 1975).

4. *Id.* § 1441a(c) provides:

The Congress declares that if the national housing goal is to be achieved, a greater effort must be made to encourage the preservation of existing housing and neighborhoods through such measures as housing preservation, moderate rehabilitation, and improvements in housing management and maintenance, in conjunction with the provision of adequate municipal services. Such an effort should concentrate, to a greater extent than it has in the past, on housing and neighborhoods where deterioration is evident but has not yet become acute.

5. A. LAFRANCE, M. SCHROEDER, R. BENNETT, & W. BOYD, *LAW OF THE POOR* § 201, at 104 (1973); *see* N. KEITH, *supra* note 1, at 100; Rouse & Wehbring, *Housing as a National Priority*, 39 GEO. WASH. L. REV. 674, 674-75 (1970-71).

First, the urban housing problem has proven to be of greater complexity than originally foreseen.⁶ Second, the rising costs of a single family home have rendered the goal unattainable for the unassisted blue collar worker.⁷ Third, Congress has been unwilling to make the political decisions necessary to transform rhetoric into concrete programs.⁸ Moreover, differing perspectives in Congress on strategies to meet housing needs⁹ reflect disparities between economic interests and the need for housing in certain areas.¹⁰ Finally, there are conflicts between the national housing goal and national economic and social policies.¹¹ The housing goal should be more than a congressional promise. The benefits to be derived from the achievement of the goal are substantial and accrue to both society¹² and individual homeowners.¹³ The most convincing advantage of home ownership is the accrued financial benefits to the individual. It has been stated that "home ownership is the dominant method used by low and middle income households to accumulate wealth."¹⁴ A decent home requires financing for construction,

6. See Rouse & Wehbring, *supra* note 5, at 680.

7. See Sternlieb, *Death of the American Dream House*, in 2 HOUSING 1971-1972, 492, 496 (G. Sternlieb & V. Paulus eds. 1974) [hereinafter cited as 2 HOUSING].

8. See Rouse & Wehbring, *supra* note 5, at 685. This congressional inaction presents the most difficult problem. Congress must choose between public or private housing construction, it must decide whether to favor suburban development or inner city revitalization, and it must balance funding for housing with other national goals such as controlling inflation. *Id.* at 685-86. Each of these decisions affects the well-being of the construction industry, labor, and mortgage bankers.

The housing goal is beyond reach without massive federal funding. *Id.*; D. MANDELKER & R. MONTGOMERY, HOUSING IN AMERICA 306 (1973). To meet current housing goals would require an estimated 57 billion dollars, an amount equal to one quarter of the total private investment in housing in the United States. *Id.*

9. Rouse & Wehbring, *supra* note 5, at 685. Congressional choices include whether to concentrate on housing construction or urban development, and whether development should be through the public or private sector. *Id.*

10. *Id.* at 685-86. These conflicts include deciding whether primary responsibility for meeting housing needs should rest with the private home-building industry or the public as well as deciding whether the new homes should be built in the cities or in suburban areas. *Id.*

11. *Id.* at 686. Because of its widespread effect on other sectors of the national economy, housing activity affects wage and price levels. Since housing activity may change the racial composition of a neighborhood, it also has an effect on national integration goals.

12. The real estate industry stresses strong moral incentives: "[T]he way to make a man a good citizen in this country is to make him part owner of it." R. HELPER, RACIAL POLICIES AND PRACTICES OF REAL ESTATE BROKERS 223 (1969) (quoting Robert C. Givens). Maintaining property values becomes a corollary goal. *Id.* "[B]y learning to cherish their individual rights and property, homeowners and their families gain respect for the rights and property of others." Hood & Kushner, *Real Estate Finance: The Discount Point System and its Effect on Federally Insured Home Loans*, 40 U. MO. KAN. CITY L. REV. 1, 1 (1971-72). The industry also stresses the fundamental property rights granted by the Constitution. See Wagner, *Appraisal of Single-Family Homes*, in AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, REAL ESTATE APPRAISAL PRACTICE 63, 63-64 (1958), where the author said: "The amenities of ownership are sensations experienced by possession and are conferred upon us by fundamental property rights granted by the Bill of Rights in the Constitution." *Id.*

A contrary view does not identify land primarily as an opportunity for financial gain. Under this view a "private owner holds land in trust for the public, which can legitimately insist on making the resource benefit all the people in the community." This is known as a "social role for private land." J. STEVENS, IMPACT OF FEDERAL LEGISLATION AND PROGRAMS ON PRIVATE LAND IN URBAN AND METROPOLITAN DEVELOPMENT 154-55 (1973).

13. There are many advantages of home ownership. For example, a home provides privacy, status, savings, and a key to schools and community facilities. HESBURGH, *Foreword to D. BAUM, TOWARD A FREE HOUSING MARKET*, at xi (1971); M. SCHUSSHEIM, *THE MODEST COMMITMENT TO CITIES 2* (1974).

14. J. KAIN & J. QUIGLEY, HOUSING MARKETS AND RACIAL DISCRIMINATION 152 (1975).

renovation, or simple maintenance. However, private lenders are reluctant to participate in home financing in inner city neighborhoods and the continuing viability of these areas is therefore dependent upon mortgage insurance provided by the Federal Housing Administration [FHA].¹⁵ Standards promulgated by the FHA which, as a practical matter, prevent the issuance of mortgage insurance in these areas contribute significantly to urban decay.¹⁶ Denial of mortgage insurance, since it often results in a denial of mortgage credit and, thereby, the ability to buy a home, significantly impedes economic opportunity and frustrates accomplishment of the national housing goal.¹⁷ Whether these FHA mortgage insurance standards are consistent with housing as a national priority is a question which needs to be analyzed thoroughly.

Where reasonable financing can be obtained, the homeowner is usually able to rely on increasing property values to give him a sizable return on his investment. For instance, where Federal Housing Administration [FHA] insurance is obtained, a \$24,000 mortgage might be obtained with a 10% down payment. In 14 years, the value of the property is likely to double. *See M. SCHUSSHEIM, supra* note 13, at 147. *Cf. J. KAIN & J. QUIGLEY, supra* at 322-23 (increase in wealth is a bonus of home ownership).

To encourage home ownership, Congress has, in addition to establishing the national housing goal, granted tax advantages for homeowners. *See Aaron, Federal Housing Subsidies*, in 2 HOUSING, *supra* note 7, at 5-7. For example, the homeowner is able to receive a considerable benefit through tax deductions. All mortgage interest and property taxes are deductible from adjusted gross income. IRC §§ 163, 164(a), 1016(a)(1); *see Aaron, supra*. There is an additional advantage, albeit subtle and indirect, to be found in the tax treatment of the home compared with that of other investments. If a house were treated as other investments, the gross rent—the rent which the homeowner could have obtained had he rented the house—would have to be reported. *Id.* at 6. Maintenance, depreciation, mortgage interest, and property taxes would then be deducted as expenses incurred in earning income, but income on which tax would be payable would result. *See id.* at 6-7. In 1971, the tax savings to homeowners from this treatment was estimated at over \$10 billion, more than 10 times as large a benefit as under the next largest federal housing subsidy. *Id.* at 3, 16. Additionally, tax laws provide the greatest benefits to recipients of larger than average incomes who do not depend upon their homes as a principle means to accumulate wealth. They provide negligible aid to low income households. *Id.* at 5-15. Thus the ability to own a home makes a significant difference in the ability to realize wealth through increase in property values and tax treatment.

15. Duncan, Hood, & Neet, *Redlining Practices, Racial Resegregation, and Urban Decay & Neighborhood Housing Services as a Viable Alternative*, 7 URB. LAW. 518, 518 (1975); *see text & notes 22-30 infra*.

16. *See text & notes 88-94 infra*.

17. However, the national housing goal has been attacked as treating the symptoms of poverty rather than the roots of the problem. *See J. STEVENS, supra* note 12, at 24. Thus, the emphasis on housing may be misplaced. Money is misused because substandard housing will continue to exist in our society as long as poverty exists. *Cf. Breckenfeld, Housing Subsidies are a Grand Delusion*, 85 FORTUNE 164 (Jan.-Mar. 1972) (the real problem is income and class).

It can be argued that home ownership may not be good for all low income people, many of whom are inexperienced housing consumers and often have irregular incomes which are too low to maintain a home. M. SCHUSSHEIM, *supra* note 13, at 104. *But see C. ABRAMS & R. KOLODNY, HOME OWNERSHIP FOR THE POOR* 190-224 (1970). Additionally, it is suggested that a policy of increasing incomes through full employment or income supplement may be a more direct and effective way of achieving adequate housing for all. Conyers, *The Real Problem is Poverty*, THE NATION, Jan. 24, 1976, at 84. This assumes that people would purchase decent housing if they could afford it, and that the reason people live in substandard housing is poverty. *Id.*

Finally, critics suggest that the government itself is incapable of instituting reform which would attack the roots of the problem:

[R]eforms help the few, not the many. For the many nothing short of a complete change in the system—the abolition of both poles [wealth, privilege, and power versus poverty, deprivation, and powerlessness] and the substitution of a society in which wealth and power are shared by all—can transform [the oppressed's] condition.

P. BARAN & P. SWEETZ, *MONOPOLY CAPITAL* 279 (1966).

This Note will examine the administrative implementation of the congressional directive to aid declining urban areas. First, the administrative role of the Federal Housing Administration will be set out. Then, the traditional home evaluation criteria for FHA mortgage insurance—economic soundness—will be discussed in light of its de facto exclusion of declining urban areas. The alternative congressional standard—reasonably viable and acceptable risk—will also be analyzed with regard to its congressional intent and administrative implementation. Finally, the justiciability of the agency's interpretation of the acceptable risk standard will be discussed.

THE ROLE OF THE FEDERAL HOUSING ADMINISTRATION

The Federal Housing Administration [FHA] functions as part of the Department of Housing and Urban Development [HUD] organization.¹⁸ HUD was created in 1965, a time of urban riots and social crisis.¹⁹ It is charged with developing and implementing a comprehensive urban social policy.²⁰ HUD is specifically designed to reach low income people unaffected by other established governmental programs.²¹ Its purpose is to effectuate sound development of the cities through the solution of the problems of housing, urban development, and mass transportation. HUD also has the responsibility to encourage private home building.²² The FHA was created in 1934, also a time of economic crisis, and was designed to stimulate the

18. 24 C.F.R. § 200.2 (1977).

19. Housing and Urban Development Act of 1965, Pub. L. No. 89-174, § 3, 79 Stat. 667 (codified at 42 U.S.C. § 3532 (1970)). As a result of the demonstrations in the inner cities during the 1960's, massive federal relief for the cities was proposed by the Johnson administration and passed by Congress as part of the Great Society program. As opposed to earlier policies of conservative finance, these programs were primarily FHA housing subsidies for the poor. *HUD Investigation of Low and Moderate Income Housing Programs: Hearing Before the House Committee on Banking and Currency*, 92d Cong., 1st Sess. 4, 104, 235-36 (1971) [hereinafter cited as *HUD Investigations*]. See also Comment, *Exploiting the Home-Buying Poor: A Case Study of Abuse of the National Housing Act*, 17 St. Louis U.L.J. 525, 526-28 (1973). The Housing and Urban Development Act of 1968, passed partly to assist the nation's low income families, set a goal of 26 million homes to be built by 1978, six million of these specifically for low and moderate income families. Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 1601, 82 Stat. 476, 601 (codified as amended at 42 U.S.C. § 1441a(a) (Supp. V 1975)). The Act amended earlier statutes by adding sections 235 and 223(e). Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 101(a), 103(a), 82 Stat. 477-85, 486 (codified as amended at 12 U.S.C. § 1715z, 1715n(e) (1976)); McClaughry, *The Troubled Dream: The Life and Times of Section 235 of the National Housing Act*, 6 Loy. Chi. L.J. 1, 9 & n.29 (1975). The numbers 235 and 223(e) refer to placement of these programs in sections of the National Housing Act of 1934, ch. 847, §§ 1-513, 48 Stat. 1246 (1934) (codified as amended in scattered sections of 12, 42 U.S.C.), which has been amended by subsequent housing acts.

20. Ink, *The Development of Housing and Urban Development—Building a New Federal Department*, in HOUSING 193 (R. Everett & J. Johnson eds 1968).

21. Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 2, 82 Stat. 476, 476 (codified at 12 U.S.C. § 1701t (1976)). In 1967, FHA Director Phillip N. Brownstein pledged the FHA to stimulate rehabilitation of the inner city: "We have got to recognize that stimulating a flow of mortgage funds into the inner city, yes, even the slums for the transfer of houses for rehabilitation, and for new construction, is an FHA mission of the highest priority." McClaughry, *supra* note 19, at 15 (quoting FHA Director Brownstein).

22. 42 U.S.C. §§ 3531-3532a (1970); see Ink, *supra* note 20, at 191.

home building industry.²³ The FHA is charged with the improvement of housing standards and conditions, the provision of adequate home mortgage insurance, and the stabilization of the mortgage market.²⁴ The FHA is basically a self-supporting institution. Its operating expenses are, with one exception,²⁵ not funded by Congress, but are generated by the payment of mortgage insurance premiums.²⁶

Mortgage insurance furnished by the FHA plays a major role in making home ownership available to Americans by creating an incentive for banks to grant home mortgages.²⁷ Under its insurance program the FHA guarantees payment of the balance of a mortgage to the bank if a homeowner should default, thereby encouraging the flow of private money into home

23. As the Great Depression of the thirties deepened and the 1932 presidential election neared, President Hoover established the Reconstruction Finance Corporation [RFC], which gave loans to banks, railroads and insurance companies. N. KEITH, *supra* note 1, at 21; see W. DOUGLAS, *GO EAST YOUNG MAN* 344 (1974). Congress extended the RFC idea to the home industry and created the FHA. N. KEITH, *supra* at 21, 25, a program politically heralded "to unfreeze the home-building industry and thereby stimulate employment and the economy." *Id.* at 13. The depression persisted and President Roosevelt vowed to change the situation in which "one third of a nation" was ill housed, ill clad and ill fed. P. BARAN & P. SWEETZ, *supra* note 17, at 287. In 1933, residential construction had less than 100,000 housing starts, compared with 134,000 in 1932. *Id.* at 25. Nonfarm real estate foreclosures reached a high of 252,400. FEDERAL HOUSING ADMINISTRATION, *THE FHA STORY IN SUMMARY 1934-1959*, at 2. (1959) [hereinafter cited as *FHA STORY*]. The home-building industry was mired in a stagnant cycle: "[H]omeowners [had] lost their sources of income and landlords could not command high rents." M. Stone, *Housing, Mortgages, and the State*, *UPSTART*, Dec. 1971, at 23, reprinted in D. MANDELKER & R. MONTGOMERY, *supra* note 8, at 69, 77 (1973). Property owners needed to withdraw savings to pay mortgages. Banks, deprived of cash, could not grant new mortgages. If a property was foreclosed, banks could not sell it, since there were few buyers. *Id.*

Early in his administration, Roosevelt tried to placate business, and in 1934 he was cheered by the American Bankers Association for advocating the alliance of business, banking, agriculture, labor, and industry. W. DOUGLAS, *supra* at 346. Critics charged that early New Deal policies helped the banks so much that the latter would be weakened and made less efficient because their mistakes would be underwritten by the government. *Id.* at 349. The New Deal was not actually a radical program but a collection of make-shift devices to shore up the existing economic system. *Id.* at 363.

At its inception in 1934, the FHA was oriented toward the interest of the home finance industry. D. MANDELKER & R. MONTGOMERY, *supra* at 78-79. The principal mortgage insurance program guaranteed payment of FHA approved mortgages. See B. BOYER, *CITIES DESTROYED FOR CASH* 21, 23 (1973); N. KEITH, *supra* at 25. Lenders could accept lower interest rates and longer repayment periods since approved mortgages carried no risk of loss upon default. One half of one percent of the purchase price was charged to the home buyer to cover the bank's insurance premium and FHA operating expenses. Thus, the FHA became "self supporting." The program was imminently successful, construction doubled, and FHA insured 40% of new mortgages within one year of its creation. See *FHA STORY*, *supra* at 9; Comment, *Mortgage Discrimination: Eliminating Racial Discrimination in Home Financing Through the Fair Housing Act of 1968*, 20 ST. LOUIS U.L.J. 139, 141 (1975).

As the FHA developed as a major force in the housing and home finance industry, it closely aligned itself with the interests of the industry. The industry's home appraisal standards, employing the assumption that racial integration caused a decline in property values, were adopted wholesale by the FHA. Comment, *supra* at 141. Indeed, the basic text used for real estate appraisers was written by Frederic M. Babcock who also wrote the FHA Underwriting Manual. P. WENDT, *REAL ESTATE APPRAISAL REVIEW AND OUTLOOK* 3 (1974); see F. BABCOCK, *VALUATION OF REAL ESTATE* (1932). Babcock's personal ideas of home valuation are reflected in the original FHA underwriting manual. One of the factors which increased a home's value was protection from adverse influences which included the use of restrictive covenants to keep the neighborhood racially homogeneous. See R. HELPER, *supra* note 12, at 202.

24. 24 C.F.R. § 200.3 (1977). See 12 U.S.C. § 1702 (1976); 42 U.S.C. § 3534 (1970).

25. See 12 U.S.C. § 1708 (1976), which, in 1934, allocated 10 million dollars to the Mutual Mortgage Insurance Fund.

26. See *FHA STORY*, *supra* note 23, at 2.

27. See Duncan, Hood, & Neet, *supra* note 15.

finance.²⁸ Theoretically, since the risk of loss to the banks is diminished, the cost of financing for the home buyer is greatly reduced. Lenders need not charge large down-payments and high interest rates; financing becomes available to more people.²⁹ In this venture, the FHA and the mortgage lenders are intended to have a "creative symbiotic relationship with bank expertise, management capacities, servicing capacities, government strategy and inducement."³⁰ In reality, the mortgage lenders often use loan insurance to increase their profits without returning the expected advantages to the home buyer and society.³¹

The specific programs which FHA administers cover a broad range of needs for mortgage insurance. In addition to the general home mortgage insurance programs,³² there are special programs for war housing,³³ urban renewal,³⁴ housing for the elderly,³⁵ and condominiums.³⁶ Although there are a variety of mortgage insurance programs, the most popular is the traditional mutual mortgage insurance and insured home improvement loan program known as the section 203 program.³⁷ Under this provision, the FHA is authorized to insure mortgages on private residential property.³⁸ To qualify for such insurance, the mortgagor, mortgagee, and the property must

28. See *FHA STORY*, *supra* note 23, at 5-10.

29. *Id.* See also S. REP. NO. 94-187, 94th Cong., 1st Sess. 11, 12 (1975) [hereinafter cited as S. REP. NO. 94-187] (FHA mortgage insurance should increase the availability of private home financing).

30. S. REP. NO. 94-187, *supra* note 29, at 12.

31. *Id.* Thus public monies used to fund FHA programs are channeled into profits for private investors without improving the quality of housing. See Hood & Kushner, *supra* note 12, at 1, 23. Although lender cooperation is implied in the notion of FHA insurance as an incentive to provide home loans for more people, lenders have abused the system. A prime example is the discount point system. For those mortgages which are FHA insured, banks are precluded from exceeding an interest rate specified by the Secretary of HUD, under the authority of Congress. *Id.* at 3 & n.7; see 12 U.S.C. § 1709-1 (1976); 24 C.F.R. § 203.20 (1977). However, the lenders invented a discount point system whereby the seller of a home to be insured by the FHA was charged a percentage of the purchase price. This percentage was simply deducted from the amount, secured by the buyer's mortgage, which the bank gave to the seller. Hood & Kushner, *supra* at 5-6. In this fashion, the banks exceeded the restricted profits afforded by the interest limit. Since a seller would be less willing to sell when he had to pay interest points, he would either sell to someone who does not need FHA insurance or simply raise the price of the house to cover his added expenses of sale. *Id.* at 8.

Additionally, banks often treat FHA activity as a signal that a neighborhood is changing racially and therefore becoming economically unsound. See S. REP. NO. 94-187, *supra* note 29, at 11-12. They then deny loans to applicants in those areas. *Id.*; Duncan, Hood, & Neet, *supra* note 15, at 518-21. With non-FHA home loans, banks sometimes grant extensions in payment time to avoid default because they are reluctant to become homeowners. C. ABRAMS & R. KOLODNY, *supra* note 17, at 99. However, with FHA insurance this reluctance disappears and there is an incentive for banks to foreclose since the FHA takes over the property upon default of FHA insured mortgages. See generally 24 C.F.R. §§ 200.153-.156 (1977).

32. 12 U.S.C. §§ 1709-1712, 1715 (1976).

33. *Id.* §§ 1736-1746a (1976); 24 C.F.R. §§ 209.251-.300 (1977).

34. 12 U.S.C. § 1715k (1976); 24 C.F.R. §§ 220.1-.850 (1977).

35. 12 U.S.C. § 1715v (1976); 24 C.F.R. §§ 231.1-.251 (1977).

36. 12 U.S.C. § 1715y (1976); 24 C.F.R. §§ 234.1-.571 (1977).

37. Section 203 gets its title from the National Housing Act, Act of June 27, 1934, ch. 847, § 203, 48 Stat. 1246, 1248 (current version at 12 U.S.C. § 1709 (1976)). See generally Cason v. United States, 381 F. Supp. 1362, 1364 (W.D. Mo. 1974), *aff'd sub nom.* Summers v. United States, 510 F.2d 123 (8th Cir. 1975). For a discussion of the entire National Housing Act, see HOUSE COMMITTEE ON BANKING CURRENCY AND HOUSING, BASIC LAWS AND AUTHORITIES ON HOUSING AND COMMUNITY DEVELOPMENT, 94th Cong., 1st Sess. 119 (1975).

38. 12 U.S.C. § 1709(a) (1976).

meet eligibility requirements specified by statute and FHA regulations.³⁹ The mortgage may not exceed the appraised value of the property,⁴⁰ and the structures must conform to standards promulgated by the FHA commissioner.⁴¹ Congress has also enacted section 221(d),⁴² a program intended to encourage private industry to provide housing for low and moderate income families and displaced persons. Like the section 203 program, section 221(d) contains mortgage limitations⁴³ and eligibility requirements.⁴⁴ The buildings must meet certain property standards and comply with local health and safety regulations.⁴⁵

The Housing and Urban Development Act of 1968⁴⁶ expanded the government's role for low income and inner city residents with the section 235, section 236, and section 223(e) programs. The section 235 program subsidizes, in part, home ownership for low income families.⁴⁷ Once the low income home buyer has contributed twenty percent of his income toward the purchase of the home, the FHA will pay all interest over five percent on the home loan.⁴⁸ The section 236 program provides rent supplements to lower income families.⁴⁹ Finally, the section 223(e) program is designed to assist declining urban areas⁵⁰ by increasing the degree of risk which the FHA may take on mortgage insurance.⁵¹ There are miscellaneous provisions of housing law which are intended to meet additional special needs of low income people in inner city areas. These include counseling for people who are considered bad credit risks,⁵² provisions for encouraging urban homesteading,⁵³ and programs for purchasing or demolishing abandoned property.⁵⁴

39. *Id.* § 1709(b) (1976); see 24 C.F.R. §§ 203.1-9, 203.32-43b (1977). See generally *Cason v. United States*, 381 F. Supp. 1362, 1364 (W.D. Mo. 1974), *aff'd sub nom.* *Summers v. United States*, 510 F.2d 123 (8th Cir. 1975).

40. 12 U.S.C. § 1709(b)(2) (1976); see 24 C.F.R. § 203.18 (1977).

41. 24 C.F.R. § 203.39 (1977). See text & note 146 *infra*.

42. National Housing Act of 1954, Pub. L. No. 560, § 221(d)(2), 68 Stat. 590, 600 (current version at 12 U.S.C. § 1715l(d)(2) (1976)); see 24 C.F.R. §§ 221.1-55 (1977); Comment, *supra* note 19, at 527. See generally *Cason v. United States*, 381 F. Supp. 1362, 1364 (W.D. Mo. 1974), *aff'd sub nom.* *Summers v. United States*, 510 F.2d 123 (8th Cir. 1975); see also [1977] 1 URB. AFF. REP. (CCH) ¶ 2894.

43. 12 U.S.C. § 1715l(d)(2) (1976); 24 C.F.R. §§ 221.10-11, 221.20-21 (1977).

44. 12 U.S.C. § 1715l(d)(2) (1976); 24 C.F.R. §§ 221.1-55 (1977).

45. 12 U.S.C. § 1715l(d)(2) (1976); see *Cason v. United States*, 381 F. Supp. 1362, 1365 (W.D. Mo. 1974), *aff'd sub nom.* *Summers v. United States*, 510 F.2d 123 (8th Cir. 1975).

46. Pub. L. No. 90-448, 82 Stat. 476 (codified as amended in scattered sections of 5, 12, 15, 18, 20, 31, 38, 40, 42, & 49 U.S.C.).

47. 12 U.S.C. § 1715z (1976); 24 C.F.R. §§ 235.1-499 (1977); [1977] 1 URB. AFF. REP. (CCH) ¶¶ 2861-66.

48. 12 U.S.C. §§ 1715z(c), 1715z(e) (1976); 24 C.F.R. § 235.335(a)(2)(ii) (1977).

49. 12 U.S.C. § 1715z-1 (1976); 24 C.F.R. §§ 236.1-760 (1977).

50. 12 U.S.C. § 1715n(e) (1976). See [1978] 1 URB. AFF. REP. (CCH) ¶ 2926. See text accompanying notes 79-94 *infra*.

51. Rather than requiring a project to be "economically sound," see 12 U.S.C. § 1709(c) (1976), an area may be "reasonably viable" and the property an "acceptable risk." See 12 U.S.C. § 1715n(e) (1976). See text & notes 95-120 *infra*.

52. See 12 U.S.C. §§ 1715z-2(d), 1715z-2(e) (1976).

53. See *id.* § 1706(e) (1976).

54. See *id.* § 1701z-4 (1976).

FHA procedures for all of its programs are basically the same. There are four administrative steps: applications for insurance; commitments for insurance; insurance endorsements; and claims for losses.⁵⁵ Upon initial application by a financial institution, the eligibility of the bank mortgagee, the home-buyer mortgagor, and the property are evaluated.⁵⁶ The nature of the commitment for insurance will depend upon whether the identity of the mortgagor is known at the time of the application. If his identity is known and he meets the eligibility standards, the commitment will be firm; if not known, the commitment will be conditional.⁵⁷ Under a conditional commitment, the property must be sold to a home buyer who is "satisfactory to the FHA as a borrower."⁵⁸ Once all the conditions have been met, the mortgage is endorsed, and the mortgagee is entitled to insurance.⁵⁹

The multitude of housing finance programs for urban areas illustrates that the approach to the problem of urban housing is extremely complex. Each program is designed to meet a special aspect of the problem of urban decay. The housing code requirements and income limitations⁶⁰ reveal a choice to stimulate only selected aspects of the housing market. The role of the FHA is therefore a dynamic one. FHA insurance is used as an incentive to satisfy the needs for housing in specific areas of the housing market. As an awareness of new needs develops, new programs are implemented.

While the FHA began as an example of free enterprise economics, it has become a tool for social engineering. This conflict between maintaining a sound economic basis and meeting unprofitable human service needs has not been totally resolved.

FHA RISK CRITERIA

Economic Soundness

Congress has delegated authority to the FHA to promulgate specific regulations for the types of risks it will undertake.⁶¹ However, for most FHA programs there is a congressionally imposed requirement that the projects for which mortgage insurance is granted be economically sound.⁶² The test

55. 24 C.F.R. § 200.141 (1977); see *Cason v. United States*, 381 F. Supp. 1362, 1365 (W.D. Mo. 1974), *aff'd sub nom. Summers v. United States*, 510 F.2d 123 (8th Cir. 1975).

56. 24 C.F.R. § 200.143 (1977).

57. *Id.* § 200.148.

58. *Id.*

59. *Id.* §§ 200.152, 203.257.

60. See text & notes 125-127 *infra*.

61. 12 U.S.C. § 1709 (1976).

62. 12 U.S.C. § 1709(c) (1976); 24 C.F.R. § 203.28 (1977). The HUD regulations contain four exceptions to the economic soundness test: homes for low and moderate income families in basically small communities, as defined in *id.* § 203.18(d), where the standard is relaxed to that of an "acceptable risk," *id.* § 203.28(a); homes of disaster victims, as defined in *id.* §§ 203.18(e), 203.28(b); houses in older, declining urban areas, which may be of acceptable risk if they are in a reasonably viable area, as defined in *id.* §§ 203.43(a), 203.28(c); and homes of seasonal occupancy, as defined in *id.* §§ 203.43(b), 203.28(d). In both the National Housing Act of 1934, ch. 847, § 203(c), 48 Stat. 1246 (current version at 12 U.S.C. § 1709(c) (1976)) and the National Housing Act Amendments of 1938, ch. 13, § 207(c), 52 Stat. 8, 18 (current version at 12

is part of the mortgage application procedure and is considered after there has been an appraisal of the home and a risk analysis performed which compares the overall value of the property to the amount of the loan.⁶³ Thus a deteriorated house would be deemed a high risk for a large mortgage. The economic soundness requirement for FHA home mortgage insurance is based upon traditional banking assumptions concerning sound investment practice. The rationale underlying the economic soundness criterion is the need for the FHA to maintain its insurance fund against the risk of mortgage foreclosure.⁶⁴ In the finance industry, sound lending practices necessitate that the bank mortgagee retain a posture adverse to that of the mortgagor. To preclude the risk of loss upon foreclosure, the insured property must maintain a higher fair market value than the outstanding principal on the loan throughout the entire loan period.⁶⁵ In the FHA context, the need for actuarially sound lending practices becomes even more acute in light of the operation of its general insurance fund.⁶⁶ Contributions to this fund consist of the one-half of one percent fee which the FHA charges mortgage lenders.⁶⁷ Loan practices which are lax thereby serve to deplete the fund and threaten the foundation of FHA programs. Reliance on this fund has caused the FHA to develop fiscally restrictive standards, similar to those of the mortgage lenders, in order to ensure the continued survival of the agency.

The economic soundness test is implemented through the FHA valuation process. The decision to grant insurance is based upon an assessment of both the particular property to be mortgaged and the neighborhood in which it is located. The property assessment is initially computed by estimating the value of the property.⁶⁸ This estimated value is not the same as market price.

U.S.C. § 1713(c) (1976)), Congress required application of the economic soundness test for FHA financing decisions. Neighborhoods had to exhibit market acceptability in terms of future viability and stability. McClaghry, *supra* note 19, at 14. For a discussion of the historical treatment of home mortgage insurance risks in federal legislation, see H.R. REP. NO. 92-1152, 92d Cong., 2d Sess. 51 (1972).

63. See U.S. DEP'T OF HOUSING & URBAN DEV., A HUD HANDBOOK: VALUATION ANALYSIS FOR HOME MORTGAGE INSURANCE (No. 4150.1) ¶ 1-1 (1976) [hereinafter cited as HUD HANDBOOK (No. 4150.1)]. See text & notes 68-85 *infra*.

64. See INTERIM REPORT ON HUD INVESTIGATION OF LOW AND MODERATE INCOME HOUSING PROGRAMS, HEARINGS BEFORE THE HOUSE COMM. ON BANKING AND CURRENCY, 92d Cong., 1st Sess. 106, 107 (1971).

65. FHA insurance removes all risk for the mortgage lender since it assures that payments are made by either the purchaser or the FHA. 24 C.F.R. §§ 203.400-.411 (1977). See W. BEATON, REAL ESTATE FINANCE 103 (1973); B. BOYER, *supra* note 23, at 23. Moreover, if the lender does foreclose, the FHA has the burden of trying to sell the house to recover its equity. Banks are reluctant to become owners of slum property. C. ABRAMS & B. KOLODNY, *supra* note 17, at 99. The risk of the loss is transferred to the FHA and along with it is the duty to protect the loan. With the risk of financial loss removed, the mortgage lender has little incentive to scrutinize the feasibility of its loans.

66. See 12 U.S.C. §§ 1708, 1711-1712, 1735 (1976); FHA STORY, *supra* note 23, at 5.

67. "[T]he mortgagor does not pay the insurance premium; it is paid by the mortgagee." *Cason v. United States*, 381 F. Supp. 1362, 1367 (W.D. Mo. 1974), *aff'd sub nom. Summers v. United States*, 510 F.2d 123 (8th Cir. 1975). The Secretary of HUD is authorized by Congress to fix the insurance fee between one-fourth and one percent. 12 U.S.C. § 1709(c) (1976). The amount presently selected is one-half of one percent. 24 C.F.R. §§ 203.265, 221.254 (1977).

68. For appraisal purposes, value is defined as "the price which typical buyers would be warranted in paying for the property for long term use or investment, if they were well

Market price refers to the amount that buyers actually pay; estimated value is the price that should be paid for property in view of its long-term productiveness.⁶⁹ In addition to a property assessment, a location analysis is performed.⁷⁰ If a neighborhood fails to qualify at this stage, mortgage insurance will be denied.⁷¹

The implementation of the economic soundness standard results in redlining, the exclusion of many homes in urban centers from FHA financing, simply because the neighborhood property values of those areas are perceived as declining.⁷² Although an inner city home may be structurally sound, there is often a general lack of confidence in the neighborhood's

informed, acted intelligently, voluntarily and without necessity." HUD HANDBOOK (No. 4150.1), *supra* note 63, at ¶ 1-4. The valuation process estimates the future use of the property, calculates the projected future returns, and then converts these future prices into a present price—an estimate of value. *Id.* at ¶ 1-14. There are three basic approaches to computing value; capitalization of income, replacement value, and market price. The capitalization of income approach assumes that all present value is derived from the prospect of future returns. *Id.* at ¶ 1-20. Replacement value is the highest possible measure of value and serves as an upper limit of value by estimating the cost of assembling a replacement of the property. *Id.* at ¶ 1-21. Market price reflects the replacement value by calculating in effect the present cost of purchasing a completed substitute home. *Id.* at ¶ 1-27. Each of these is computed separately and then a final value based on a combination of the three is figured. This is the figure used in determining whether FHA loans are granted or denied. W. BEATON, *supra* note 65, at 148.

69. HUD HANDBOOK (No. 4150.1), *supra* note 63, at ¶ 1-7.

70. "The purpose of location analysis is to identify the characteristics of location which affect the value and economic life of a specific property." *Id.* at ¶ 2-1. Location analysis involves an evaluation of economic trends (employment, mortgage interest rates, population change), land uses (zoning, protective covenants), physical and social attractiveness (heavy traffic, airports, risk of floods), unattractiveness of neighborhood buildings, and availability of civic and social centers (shopping centers, schools), transportation, and utilities. *Id.* at ¶¶ 2-5 to 2-15. Any older community which does not meet minimum standards used in the location analysis is eligible for section 223(e) consideration. *Id.* at ¶ 2-16. See text & notes 70-83 *infra*.

71. HUD HANDBOOK (No. 4150.1), *supra* note 63, at ¶ 2-14.

72. Redlining is a mortgage lending practice which systematically refuses loans or loan insurance in neighborhoods which are old or occupied by people of minority racial groups. See S. REP. NO. 94-187, *supra* note 29, at 1. The term redlining is derived from a time-worn practice of mortgage lenders whereby a red line, drawn on a map around a neighborhood, signifies that no loans are to be given in that area. See Renne, *Eliminating Redlining by Judicial Action: Are Erasers Available?*, 29 VAND. L. REV. 987, 989 n.12, 990-93 (1976); Note, *Urban Housing Finance and the Redlining Controversy*, 25 CLEV. ST. L. REV. 110, 110 n.1 (1976).

The FHA previously was found to have entered into a tacit agreement with lending institutions to "redline" areas in central cities where property values were likely to decline and where there was an unfavorable economic future. UNITED STATES NAT'L COMM'N ON URBAN PROBLEMS, BUILDING THE AMERICAN CITY, H.R. DOC. NO. 91-34, 91st Cong., 1st Sess. 100-01 (1968) [hereinafter cited as BUILDING THE AMERICAN CITY]; Werner, Frei, & Madway, *Redlining and Disinvestment: Causes, Consequences, and Proposed Remedies*, 10 CLEARINGHOUSE REV. 501, 508-09 (1976-77).

One writer has suggested both local underwriting of high risk loans and revision of the FHA screening process as a method for attacking redlining. K. Baptiste, *Attacking the Urban Redlining Problem*, reprinted in PRACTICING L. INST., REINVESTMENT IN URBAN COMMUNITIES 694-97 (1977). It is also important to note that many inner city homes are sold either on contract, forcing the buyer to build up equity in a home before he receives title, or by purchase money mortgage, allowing the previous owner to hold the mortgage. Benston, *The Persistent Myth of Redlining*, 97 FORTUNE 66, 68 (March 13, 1978). This leads to the possibility of highly inflated sales prices and abuse of FHA programs. *Id.* Intermittently, newspaper accounts have surfaced relating that the FHA has been systematically refusing to insure loans in older urban neighborhoods. See, e.g., Ariz. Daily Star, May 23, 1976, § D, at 1, col. 4; Ariz. Daily Star, May 19, 1976, § A, at 1, col. 2; Kansas City Star, Dec. 3, 1974, § A, at 4, cited in Duncan, Hood & Neet, *supra* note 15, at 519 n.42. Administrators of the FHA, however, have officially denied that they engage in such practices. Ariz. Daily Star, June 15, 1976, § 4, at 1, col. 1. In one instance, redlining was admitted but the statement was subsequently retracted. *Id.*

continuing financial value on the part of the mortgage lenders.⁷³ Since FHA insurance is often required by lenders to overcome their reluctance to risk loans in these areas, a general denial of FHA insurance can result in urban decay.⁷⁴ As potential buyers are unable to get home financing, demand for homes drops, defaults increase,⁷⁵ owner occupancy decreases,⁷⁶ and the neighborhood deteriorates to the point where urban renewal may be required.⁷⁷ Although the economic soundness test may be based on sound lending practices and may be necessary for the continuing operation of the FHA and its insurance fund, the consequences of this policy are that some sections of urban areas are denied any opportunity for development.

The Reasonably Viable and Acceptable Risk Alternative

To lessen the harsh effects of the economic soundness test, Congress has lowered the degree of risk allowed in older urban areas.⁷⁸ Since 1968 a two pronged test of "reasonably viable" and "acceptable risk" has been applied to structures in these neighborhoods under section 223(e):⁷⁹

Notwithstanding any of the provisions of this chapter . . .
the Secretary is authorized, upon application by the mortgagee, to

73. See S. REP. NO. 94-187, *supra* note 29, at 6-8, 20; Daniel, *Redlining Reaches Congress*, 32 J. HOUSING 441, 442 (1975); Duncan, Hood, & Neet, *supra* note 15, at 513-14; Searing, *Discrimination in Home Finance*, 48 NOTRE DAME LAW. 1113, 1115-16 (1973); Note, *Redlining—The Fight Against Discrimination in Mortgage Lending*, 6 LOY. CHI. L.J. 71, 72-73 (1975).

The FHA also has been accused of encouraging the flight of homeowners from redlined areas. Werner, Frei, & Madway, *supra* note 72, at 508.

74. Urban decay caused by redlining practices and FHA policies are deeply intertwined. Werner, Frei, & Madway, *supra* note 72, at 508-09.

75. In an area of declining property values, the fair market value of a home eventually drops below the outstanding principal due on the mortgage. In this case a homeowner owes more on his home than it is worth, and it is in his best interest to default. Nourse & Phares, *The Impact of FHA Insurance Practices on Urban Housing Markets in Transition—The St. Louis Case*, 9 URB. L. 111, 114 (1975). Denial of further FHA financing perpetuates the decline in property values. "[H]igh rates of foreclosure and abandonment have been observed in neighborhoods with heavy concentrations of FHA mortgages." Werner, Frei, & Madway, *supra* note 72, at 509.

76. See S. REP. NO. 94-187, *supra* note 29, at 3. Those homeowners who cannot sell their homes may leave the neighborhoods and become absentee landlords. Because of a lack of personal involvement in maintenance of the home, the landlord often lets the home deteriorate. Thus, absentee landlords often share the blame for the poor conditions in a deteriorating neighborhood. "The supply of housing for the low income urban family has been so small that landlords could make good profits without repairing the buildings . . ." Teaford, *Homeownership for Low-Income Families: The Condominium*, in HOUSING 1970-1971, 457, 458 (G. Sternlieb & L. Sagalyn eds. 1972). *Contra*, M. STEGMAN, HOUSING INVESTMENT IN THE INNER CITY: THE DYNAMICS OF DECLINE 27-29 (1972). See generally R. HELPER, *supra* note 12, at 25.

77. Urban renewal is a process whereby deteriorated housing in urban centers is replaced by housing or civic centers. This is done on a neighborhood scale to allow comprehensive planning. However, where renewal occurs, demolition of old buildings often outstrips the construction of new housing. In the state of New York between 1968 and 1971, 40,000 low rent dwelling units were lost through decay and demolition, but only 20,000 built in their place. P. BLAKE, OUR HOUSING MESS 15 (1974). As the supply of low income housing is reduced, the cost of remaining units increases. P. BARAN & P. SWEEZY, *supra* note 17, at 293; D. MANDELKER & R. MONTGOMERY, *supra* note 8, at 67. The cost of urban renewal programs has been exceedingly high: "Since 1937 the federal government has invested about 11 billion in direct housing subsidies and such related programs as urban renewal." Breckenfield, *Housing Subsidies are a Grand Delusion*, 85 FORTUNE 136, 137 (Jan.-Mar. 1972).

78. See McClaghry, *supra* note 19, at 14-15.

79. Housing and Urban Development Act of 1968, PUB. L. NO. 90-448, § 103(a), 82 Stat. 476, 486 (current version at 12 U.S.C. § 1715n(e) (1976)).

insure . . . a mortgage executed in connection with the repair, rehabilitation, construction, or purchase of property located in an older, declining urban area in which the conditions are such that one or more of the eligibility requirements . . . could not be met if the Secretary finds that (1) the area is reasonably viable, giving consideration to the need for providing adequate housing . . . for families of low and moderate income in such area, and (2) the property is an acceptable risk in view of such consideration. The insurance of a mortgage pursuant to this subsection shall be the obligation of the Special Risk Insurance Fund.⁸⁰

The purpose of section 223(e) is to permit the use of FHA mortgage insurance for the repair, rehabilitation, construction and purchase of property located in older declining areas.⁸¹ The FHA is authorized by this statute to insure mortgages in areas where normal requirements cannot be met. A special risk insurance fund is established in recognition of the high underwriting risk involved.⁸²

Although there is no absolute meaning to the terms reasonably viable and acceptable risk, a functional meaning can be found in the administrative implementation of the program.⁸³ The section 223(e) administrative guidelines carefully outline procedures for denial of mortgage insurance. As required by statute, the neighborhood area is required to be "reasonably viable" and the specific property must be an "acceptable risk."⁸⁴ The only definition given to the term reasonably viable by the administrative guidelines is the suggestion that viability means "ability to live."⁸⁵ Acceptable risk is defined not in terms of economic life as in other FHA programs, but rather by the anticipated physical life of the property.⁸⁶ The primary determination involved here is to ascertain environmental elements or locational features which so adversely affect the property that the area is judged nonviable. Three general factors are considered in making this determination: economic risk, livability, and marketability.⁸⁷ Criteria for each factor are found throughout the HUD administrative guidelines. First, the location or structural features affecting the property must not endanger the health and

80. 12 U.S.C. § 1715n(e) (1976). The Special Risk Insurance Fund is authorized by 12 U.S.C. § 1715z-3 (1976). The Secretary of HUD is authorized to advance up to \$20,000,000 from the General Insurance Fund, *see* 12 U.S.C. § 1735c (1976), to the Special Risk Insurance Fund to cover high risk programs such as the 223(e) program. 12 U.S.C. § 1715z-3(b) (1976).

81. U.S. DEP'T OF HOUSING AND URBAN DEV., A HUD HANDBOOK: MISCELLANEOUS TYPE HOME MORTGAGE INSURANCE-SECTION 223(a), (e), and (d) (No. 4260.1) (Nov. 1972) [hereinafter cited as HUD HANDBOOK (No. 4260.1)].

82. 12 U.S.C. § 1715z-3 (1976). McClaghry, *supra* note 19, at 20. The special risk provision compensates for environmental factors that diminish economic life. *Id.* at ¶ 4-8.

83. HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-8.

84. 12 U.S.C. § 1715n(e) (1976); 24 C.F.R. §§ 203.43a(b)(1), (2), (3), 203.43a(c) (1977); *see* B. BOYER, *supra* note 23, at 23.

85. HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-7.

86. *Id.*

87. *Id.* at ¶ 4-8.

safety of its occupants.⁸⁸ In addition, the property must be free of hazards, noxious odors, grossly offensive sights, and excessive noises.⁸⁹ These environmental conditions are not subject to waiver. Examples of unacceptable environmental conditions as given in the HUD Handbook include:

Hazards. This includes an expansive range of physical conditions such as unsafe construction, flooding, unstable soils, air or vehicular traffic hazards, danger from fire or explosion, inadequate water or sewage facilities, inadequate police and fire protection in high crime locations, and even radiation hazards.⁹⁰

Noxious Odors. Homes are excluded from mortgage insurance because of smoke, chemical fumes, stagnant ponds and marshes, to the extent that the health of occupants may be deemed affected.⁹¹

Grossly Offensive Sights. These include junk yards, truck warehouses, industrial plants, sewage disposal plants, or dilapidated abandoned properties.⁹²

Excessive Noise. Noises which the FHA considers dangerous to the health and peace of mind of the occupants are heavy industrial activity, all night cafes, bars, gas stations, truck terminals, airport activity, kennels, and the like.⁹³

Marketability. Marketability considers the need for housing "in light of the alternative housing available to the typical occupant of the area despite the presence of the limiting location influences."⁹⁴ In determining marketability, each house must be evaluated on an individual basis.⁹⁵

The reasonably viable-acceptable risk criteria significantly reduce the eligibility requirements for FHA mortgage insurance. These standards reject an analysis of the long-term economic life of a property in favor of an evaluation of physical life. For those homes which do not meet these administrative tests, however, no mortgage insurance may be granted. In reality many people do live near gas stations, all night cafes, and industrial

88. *Id.* at ¶ 4-6.

89. *Id.* at ¶ 4-5.

90. *Id.* at ¶ 4-5(a)(1).

91. *Id.* at ¶ 4-5(a)(2).

92. *Id.* at ¶ 4-5(a)(3).

93. *Id.* at ¶ 4-5(a)(4).

94. *Id.* at ¶ 4-7.

95. Any decision to reject a property affected by any specified environmental condition, or any other conditions, must be made on a case by case basis. *Id.* at ¶ 4-9. The instructions further state that "care must be exercised to limit rejection only to the actual properties affected." *Id.* This specifically forbids any arbitrary delineation of reject areas. The instructions also require documentation of adverse factors causing a property to be ineligible for mortgage insurance. This includes a "description of the extent of the adverse factors and photos of the adverse environmental factors." *Id.* at ¶ 4-9.

Prior to final rejection by HUD-FHA, local authorities in the affected area must be presented with a description of the problem encountered. *Id.* at ¶ 4-9(c). The instructions require identification of only those "specific environmental factors which present a serious hazard to prospective occupants." *Id.* at ¶ 4-9. Final application rejection must be withheld for a reasonable period of time enabling local authorities to take steps to correct the problem. *Id.* at ¶ 4-4.

plants. For these people, FHA funding is foreclosed. Although on their face the FHA criteria appear reasonably designed to fulfill an agency concern for health and safety, some of the FHA's factors may be inconsistent with congressional policy. It therefore becomes necessary to seek the congressional intent behind creation of the reasonably viable-acceptable risk criteria.

STATUTORY CONSTRUCTION OF ACCEPTABLE RISK

The phrases "reasonably viable" and "acceptable risk" are vague. They offer no express guideline for the FHA to follow. Therefore, on the face of the statute, it is difficult to discover the standards which these terms are meant to embody and, thereby, to judge whether administrative implementation of section 223(e) follows congressional intent. This determination can be accomplished, however, by analyzing analogous legislative action and social history.

Although the phrase "reasonably viable" cannot be found in other statutes administered by the FHA,⁹⁶ the phrase "acceptable risk" is used extensively. There are several programs within the present federal housing laws which lower the standard of risk for FHA mortgage insurance from "economic soundness" to "acceptable risk."⁹⁷ An examination of the context in which these laws were passed indicates the level of risk which is to be accepted in a section 223(e) insured loan.⁹⁸

The earliest example of the acceptable risk criterion is the Alaska Housing Act of 1949.⁹⁹ The insurance projects covered by the Act were to be of acceptable risk "giving consideration to the acute housing shortage in Alaska."¹⁰⁰ The standard expressed a congressional desire to increase and upgrade the severely substandard housing in the Territory of Alaska.¹⁰¹

96. See 12 U.S.C. §§ 1701-1750(g) (1976).

97. See text & notes 86-106.

98. The wording in one statute may be used to construe similar wording in another statute since statutes which pertain to the same subject matter are considered to be *in pari materia*. This can occur when the statutes "relate to the same person or thing, or to the same class of persons or things or have the same purpose or object." C. SANDS, 2A SUTHERLAND STATUTORY CONSTRUCTION § 51.03, at 298 (4th ed. 1973). As "acceptable risk" is a term of art used in statutes, its intended meaning in one statute can be used to interpret other statutes which contain the term. The rationale behind this method of interpretation is that the legislature is presumed to have intended a uniform meaning. *Id.* at 299. This may be applied to acts passed at prior and subsequent legislative sessions, even though there is no explicit reference to the other acts. *Id.* at 299-300. *In pari materia* does not apply if statutes are enacted for different purposes even though the subject matter is the same. *Id.* at 298.

99. Ch. 89, § 2(a), 63 Stat. 57 (current version at 12 U.S.C. § 1715d (1976)). The program now includes Guam and Hawaii. 12 U.S.C. § 1715d (1976).

100. 12 U.S.C. § 1715d (1976).

101. S. REP. NO. 129, 81st Cong., 1st Sess. 1-2, reprinted in [1949] U.S. CODE CONG. & AD. NEWS 1221.

By any standard, present housing conditions in Alaska are deplorable. The Territorial department of health has estimated that 50 percent of all housing in Alaska is substandard. A common dwelling, even in the more populated areas, is a tar-paper shack without running water or sanitary facilities. Just as unsatisfactory for adequate living are the many tents, shacks, and wannigans (huts on skids) in which many inhabitants of the Territory are forced to live. It is estimated that even if no substan-

People were living in tar-paper shacks, tents, and sod huts, and many lived without running water. There was congressional concern that existing housing conditions were resulting in tuberculosis.¹⁰² These conditions were primarily the result of a total lack of financial resources in the Territory.¹⁰³ Congress found it necessary to apply the flexible standard of acceptable risk to these areas in order to upgrade living conditions. Mortgage insurance operations under this statutory structure were required to meet the needs of the Territory.¹⁰⁴

The acceptable risk standard was used again in the Housing Act of 1950.¹⁰⁵ The standard was to be applied giving consideration to the need for providing adequate housing for families of low and moderate income, particularly in suburban and outlying nonfarm and rural areas.¹⁰⁶ It was to be sufficiently flexible so as to maintain sound standards of construction and yet avoid the traditional mortgage insurance requirements concerning location, neighborhood, and community facilities. These traditionally required conditions simply did not exist in the rural areas.¹⁰⁷ The new acceptable risk standard provided as much flexibility as was needed and in a manner appropriate to such rural localities.¹⁰⁸

The best explanation of the rationale of Congress in using the acceptable risk standard is found in the legislative history of the Housing Act of 1964.¹⁰⁹ Previously, the acceptable risk standard had been used to benefit low and moderate income families in the purchase of suburban homes.¹¹⁰

dard housing is replaced, more than 6,000 units would have to be added to the present supply to meet the minimum demand resulting from forced overcrowding in existing structures.

Your committee was also impressed by the special housing needs of the Eskimos. Living generally in damp sod huts, they have proved to be highly susceptible to tuberculosis brought in by civilization, and their death rate from this disease is nine times that of the population of the United States as a whole. Experiments have demonstrated that wood floors and roofs can be installed cheaply in their dwellings, which will protect them to the extent of greatly diminishing occurrence of the disease. Testimony was presented to your committee that in one Eskimo village where wood floors and roofs were installed, the incidence of tuberculosis was reduced by 80 percent.

Id. at 2, [1949] U.S. CODE CONG. & AD. NEWS at 1222.

102. *See id.*

103. *Id.* "There is almost no financing available on reasonable terms to home builders in the Territory." *Id.*

104. *Id.* at 3-4, [1949] U.S. CODE CONG. & AD. NEWS at 1224.

105. Ch. 94, § 8(b)(2), 64 Stat. 48 (current version at 12 U.S.C. § 1706c(b)(2) (1976)).

Additionally, in the Housing Act of 1954, ch. 649, § 220, 68 Stat. 590, 596-99 (current version at 12 U.S.C. § 1715k (1976)), there was a substitution of replacement cost for value in appraising insured properties and a substitution of acceptable risk for economic soundness. *Id.* § 1715k(d)(3); *see* McClaughry, *supra* note 19, at 15.

106. S. REP. NO. 1286, 81st Cong., 2d Sess. 910, *reprinted in* [1950] U.S. CODE CONG. & AD. NEWS 2021, 2030-31.

107. *Id.*

108. *Id.*

109. Pub. L. No. 88-560, § 103(1), 78 Stat. 769 (codified at 12 U.S.C. § 1709k (1976)); *see* text & notes 109-15 *infra*.

110. "The Housing Act of 1961 established an FHA insurance program for home improvement loans for homes outside urban renewal areas under section 203k of the National Housing Act." H.R. REP. NO. 1703, 88th Cong., 2d Sess. 7, *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 3416, 3422.

The 1964 provision extended the eligibility requirements to home improvement loans.¹¹¹ Under this program, projects of rehabilitation were to be insured upon a showing of acceptable risk, giving consideration to the need for providing adequate housing for families of low and moderate income, particularly in suburban or outlying areas or small communities.¹¹² The legislative history describes the harsh effects of the economic soundness standard.¹¹³ The traditional standard resulted in loans being used to enlarge homes in good residential neighborhoods. The older neighborhoods, where some blighting influences had begun to appear, were unable to get home improvement loan insurance. The alternative of acceptable risk was therefore adopted to produce certain changes. First, the FHA was to look to current property values rather than probable future value of mortgaged property.¹¹⁴ Second, the program applied to the "grey areas" where there was some obsolescence, decay, and other blighting influences.¹¹⁵ Third, the program implemented one of the FHA objectives, the prevention of housing deterioration.¹¹⁶ Thus a neighborhood was an acceptable risk even though blight had begun to appear.

The considerations for which acceptable risk is applicable extend beyond the need to help low income home buyers in undeveloped areas. For example, the standard is found in the Housing and Urban Development Act of 1968¹¹⁷ which applies the acceptable risk standard with respect to the economic potential of an area and the contribution which housing will make toward improving the area.¹¹⁸ The acceptable risk standard has also been

111. Housing Act of 1964, Pub. L. No. 88-560, § 110, 78 Stat. 769 (codified at 12 U.S.C. § 1709(i) (1976)).

112. 12 U.S.C. § 1709k (1976).

113. H.R. REP. NO. 1703, 88th Cong., 2d Sess. 7-8, *reprinted in* [1964] U.S. CODE CONG. & AD. NEWS 3416, 3422.

114. *Id.*, [1964] U.S. CODE CONG. & AD. NEWS at 3422-23.

115. *Id.*

116. *Id.* Federal housing policy regarding the inner city is based on eradicating what is perceived by many to be the cause of urban decay. However there are other theories about the causes of urban decay. One view is that disinvestment, the withdrawal of lending institution monies, follows neighborhood decline, which is in turn a product of age. Thus, urban decay is viewed as a natural process, a product of the move to suburbia. It is argued that this social trend has not been produced by the banks, but by many factors, including a growing middle class, use of the automobile, and fear of city crime. Since these "social" factors—as opposed to economic causes—are not well understood, any remedial action directed to them should be cautiously undertaken. S. REP. NO. 94-187, *supra* note 29, at 13, 19, 31. Interview with G. Romney, Secretary, Department of Housing and Urban Development (December 1, 1972), *reprinted in* B. BOYER, *supra* note 23, at 237.

A contrary view holds that the causes of urban decay are the "policies of the real estate and mortgage industries, compounded by FHA programs." *Id.* at 19-20. This latter view is preferable for it recognizes rather than minimizes the influences which financial institutions have on federal housing problems and policies. S. REP. NO. 94-187, *supra* at 3-4; *see* B. BOYER, *supra* at 19-20; D. MANDELKER & R. MONTGOMERY, *supra* note 8, at 83; Kuttner, *Ethnic Renewal*, N.Y. Times, May 9, 1976 (Magazine), at 18. These financial influences have a dramatic effect in the housing sector. These decisions are often not made on the basis of human needs, but are primarily concerned with flow of investment capital into housing, and opportunities for profit. Stone, *supra* note 23.

117. Pub. L. No. 90-448, § 318, 82 Stat. 476 (codified at 12 U.S.C. § 1715n(e) (1976)).

118. 12 U.S.C. § 1709i (1976). *See generally* H.R. REP. NO. 1585, 90th Cong., 2d Sess. 41-42, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 2873, 2915.

used in consideration of the housing shortage for veterans.¹¹⁹ Additionally, the Housing and Urban Development Act of 1970¹²⁰ uses the acceptable risk standard in providing mortgage insurance for civilian employees of the military. The risk involved is that of the Secretary of Defense transferring employees out of the area shortly after mortgage insurance is granted. If the Secretary of Defense certifies a need for housing in the area and HUD finds the house is not of acceptable risk, then HUD may require the Secretary of Defense to guarantee the general insurance fund from loss.¹²¹

The degree of risk which is acceptable is therefore dependent, in part, upon the extent of need which exists in the area designated by Congress to be considered. Presumably, this degree of risk will vary depending upon whether one gives consideration to the need for employment or to the need for rural housing. Arguably, the standard should also be flexible enough to reflect changes of circumstances in different localities or in the same localities at different times. Thus, the term "acceptable risk" must have a variable meaning. In summary, the use of the acceptable risk standard in various statutes has shown it to be a standard designed to relax the stringent economic soundness criteria whenever the adverse effects of that standard are inconsistent with congressional goals. Acceptable risk is a flexible standard, applied to a variety of situations, including urban and rural housing, seasonal and permanent housing, and housing of military and civilian employees. The predominate concept is the need to view acceptable risk in consideration of a particular problem. The degree of risk which is acceptable depends ultimately on the seriousness of a particular social problem. This was the intended effect of Congress in the statutes discussed above and should be applied to the section 223(e) program as well.

The reasonably viable and acceptable risk requirements of section 223(e) insurance are to be applied "giving consideration to the need for providing adequate housing . . . for families of low and moderate income in such area[s]."¹²² To understand the congressional intent behind 223(e) it is necessary to inquire into its statutory predecessors. Also, an assessment of the congressionally perceived immediate need for housing must be undertaken. This assessment can be found in governmental studies, most notably the Kerner Commission report.¹²³ Finally, the language of section 223(e)

119. See 12 U.S.C. § 1738c (1976). There is an additional program which also mentions acceptable risk but does not contribute to an understanding of its meaning. 12 U.S.C. § 1735(e) (1976) provides that acceptance of materials as suitable for construction will not affect the acceptable risk status. This is a reference to other acceptable risk programs and does not require separate consideration.

120. Pub. L. No. 91-609, § 112, 84 Stat. 1770 (codified at 12 U.S.C. § 1748h-1(b) (1976)).

121. *Id.*

122. 12 U.S.C. § 1715n(e) (1976).

123. REPORT OF THE NAT'L ADVISORY COMM'N ON CIVIL DISORDERS (1968) [hereinafter cited as KERNER REPORT]; see BUILDING THE AMERICAN CITY, *supra* note 72, at 66-76.

can be analyzed in light of the judicial articulation of the federal government's role in urban areas.

The 223(e) program was substantially revised as part of the Housing and Urban Development Act of 1968.¹²⁴ Unfortunately, the legislative history does not elaborate on the application of the standard of acceptable risk.¹²⁵ However, the 223(e) program replaces a 1966 program designed to insure mortgages for one-to-four family properties located in an area where rioting or other disorders had occurred or were threatened,¹²⁶ and which used the acceptable risk standard where the economic soundness test would not be satisfied. This 1966 provision was part of new and imaginative proposals to rebuild and revitalize large slums and blighted areas.¹²⁷ As the 1966 program applied only to specific types of housing insurance in riot areas, its effectiveness was limited to specific geographical areas. On the other hand, the 223(e) program permits the FHA to expand the use of federal financing schemes and allows the acceptable risk test to apply in all older declining urban areas, without regard to the occurrence of riots or civil disorders.¹²⁸ Arguably, the statutory history of 223(e) indicates that the degree of risk which is acceptable at the very least embraces financing of riot areas or areas where riots are threatened. The congressional intent therefore is to lower the standard to embrace these riot prone slum areas.

Since the acceptable risk standard is stated to depend on the need for low income housing, it is necessary to determine the extent of that need. The need for low and moderate income housing in the United States is well documented in the Kerner Commission report.¹²⁹ The report concluded that poor housing was a direct cause of urban disorders.¹³⁰ The causes of

124. Pub. L. No. 90-448, § 103(a), 82 Stat. 476 (current version at 12 U.S.C. § 1715n(e) (1976)).

125. See H.R. REP. NO. 1585, 90th Cong., 2d Sess. 12-13, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 2873, 2884-85. The acceptable risk program was proposed by a Senate subcommittee. McClaughry, *supra* note 19, at 15.

126. The old provision, § 203(l) of the National Housing Act, was passed in the Demonstration Cities and Metropolitan Development Act of 1966, Pub. L. No. 89-754, § 302(1), 80 Stat. 1255, 1266 (repealed 1968). Section 103 of the Housing and Urban Development Act of 1968, which created the Section 223(e) program, repealed the earlier provisions. Housing and Urban Development Act of 1968, § 103, Pub. L. No. 90-448, 82 Stat. 476, 486 (current version at 12 U.S.C. § 1715n(e) (1976)).

127. See Demonstration Cities and Metropolitan Development Act of 1966, Pub. L. No. 89-754, § 101, 80 Stat. 1255 (current version at 42 U.S.C. § 3301 (1970)).

128. *Id.* § 302(1)(1), 80 Stat. 1255 (repealed 1968); H.R. REP. NO. 1585, 90th Cong., 2d Sess. 13, *reprinted in* [1968] U.S. CODE CONG. & AD. NEWS 2873, 2885.

129. See KERNER REPORT, *supra* note 123, at 467-73; BUILDING THE AMERICAN CITY, *supra* note 72, at 66-76; PRESIDENT'S COMM'N ON URBAN HOUSING, A DECENT HOME 96-98 (1968). The Kerner Commission was formed pursuant to Exec. Order No. 11,365, 2 C.F.R. § 310 (1967) *reprinted in* [1967] U.S. CODE CONG. & AD. NEWS 3510-11, after widespread rioting in many large American cities during the summer of 1967. See KERNER REPORT, *supra* at 534.

130. See KERNER REPORT, *supra* note 123, at 472-73. The Kerner Commission found that 56% of the country's nonwhite families lived in the poorest, central areas of the cities, and that two-thirds of these families lived in inadequate housing. *Id.* at 467. The Commission also found that blacks generally had to pay higher rent than whites for similar accommodations. *Id.* at 470. This increased the cost of urban housing. Thus, a higher proportion of a family's income went to housing and left less money for other expenses. This resulted in widespread discontent among inner-city blacks. *Id.* at 472-73; see *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 496 (S.D. Ohio 1976).

substandard housing, in turn, lie in poverty, discrimination, and federal programs which centralize the poor in deteriorating central city neighborhoods.¹³¹ The Commission recommended a change in federal priorities, away from the federal programs which aid upper and middle income housing and toward adequate financing of low income housing projects.¹³² Additionally, the Commission called for a reduction of requirements and limitations on federal programs in the inner cities where needed to revitalize those areas.¹³³ The Kerner Commission report of substandard housing and urban blight provided the background for the congressional directive in 223(e) that the FHA lower its standards in relation to the desperate need for low income housing.¹³⁴ Moreover, the concerns expressed in the Kerner Commission report have also been used in construing housing goals contained in other legislation passed at the same time as section 223(e). In interpretation of the Fair Housing provisions of the Civil Rights Act of 1968,¹³⁵ the Kerner Commission report has been used as grounds for applying the housing discrimination sanctions to redlining by private mortgage lenders.¹³⁶ The rationale in preventing redlining is that a refusal to grant loans to inner city neighborhoods directly contributes to urban decay.¹³⁷ In a similar manner the section 223(e) program should be interpreted in conjunction with an awareness of the desperate need for housing as expressed in the Kerner report. This interpretation of congressional intent can be used to evaluate the FHA's interpretation of the acceptable risk standard as evidenced by its administrative regulations.

AN ANALYSIS OF THE ADMINISTRATIVE IMPLEMENTATION OF SECTION 223(e)

The administrative implementation of section 223(e) can be strongly criticized in light of the underlying congressional intent. Although the economic soundness requirement is waived,¹³⁸ other eligibility factors continue to present serious obstacles to getting mortgage insurance in older

131. The report noted that the incidence of substandard housing was increasing despite federal urban renewal programs. KERNER REPORT, *supra* note 123, at 467. Since 1934, there had been an overall production of 800,000 federally subsidized housing units, with a recent rate of 50,000 units per year. The Commission noted that the FHA had provided insurance for 10 million middle and upper income units during a period only 3 years longer. *Id.* at 474. The report also noted that recent federal programs compounded the conditions of failure and hopelessness which leads to crime, civil disorder, and social disorganization. *Id.*

132. Commission recommendations followed two strategies: expanding the suitable housing supply for low income families; and opening up areas outside of ghetto neighborhoods to racial minorities. Specifically, the report called for massive increased low and middle income housing construction, subsidizing a below-market interest rate, rent and ownership supplements, aid to private builders, expanded public housing, urban renewal, model cities programs, and reform of antiquated local building codes. *Id.* at 475-81.

133. *Id.* at 474.

134. See *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 497 (S.D. Ohio 1976).

135. 42 U.S.C. §§ 3601-3619 (1970 & Supp. V 1975); see Comment, *supra* note 23, at 144-47.

136. See 408 F. Supp. at 496.

137. *Id.* at 496-97.

138. 12 U.S.C. § 1715n(e) (1976); HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-4.

urban areas.¹³⁹ The property must be free from environmental conditions which, in the view of the FHA, are offensive.¹⁴⁰ If a property has been disqualified because of such an impermissible neighborhood condition, no flexibility in the evaluation process is authorized.¹⁴¹ Additionally, the home must comply with housing codes and must show enough future economic life to justify a long-term mortgage.¹⁴²

In addition to imposing requirements such as the environmental factors, the FHA fails to provide for sufficient evaluation of housing need as is required by statute. Congressional intent for the program shows it is meant to be flexible in view of the variety of situations in which the acceptable risk standard has been applied.¹⁴³ Although the statute mandates explicit consideration of the need for housing in a given area,¹⁴⁴ no such individual assessment in each locality is considered.¹⁴⁵ Nor do the requirements change from city to city. The present method of implementation of 223(e) remains one of a fixed standard.

A second basis for criticism of the FHA administrative implementation of the 223(e) program is the possible exclusion from financing of the very neighborhoods the statute was enacted to serve. Arguably, the FHA-imposed conditions which render a property unacceptable are rational health and safety requirements;¹⁴⁶ the government does not want to encourage people to live where there is a high crime rate, dilapidated or abandoned properties, or all night cafes.¹⁴⁷ The government further provides for the public safety by requiring that houses be maintained pursuant to established minimum standards.¹⁴⁸ Yet these policies exclude those areas where the

139. The factors to be considered in approving properties under 223(e) are: (1) submission of the mortgage by the mortgagee usually under sections 203(b) or 221(d)(2); (2) freedom from hazards, noxious odors, grossly offensive sights, or excessive noises; (3) compliance with housing codes; (4) possession by the property of sufficient future economic life to warrant a long-term mortgage. HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-5. The environmental factors are not subject to waiver. *Id.* at ¶ 4-6(b).

140. *See id.*

141. *See id.* at ¶ 4-9. *See* text & notes 88-94.

142. *See* HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-5.

143. *Id.* at ¶¶ 4-1 to 4-20.

144. *See* 12 U.S.C. § 1715n(e) (1976).

145. The present HUD guidelines do require an assessment of other housing in the locality. *See* HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-7. A location analysis considers "alternative housing available" in the area. However, this analysis does not necessarily consider the need for housing in the community as required by the acceptable risk standard. *See* text & note 93 *supra*.

146. *See id.* at ¶ 4-5.

147. *See id.*

148. The minimum property standards have been published in three volumes: U.S. DEP'T OF HOUSING AND URBAN DEV., HOUSING AND URBAN DEVELOPMENT MINIMUM PROPERTY STANDARDS: ONE AND TWO FAMILY DWELLINGS (No. 4900.1) (1973); U.S. DEP'T OF HOUSING AND URBAN DEV., HOUSING AND URBAN DEVELOPMENT MINIMUM PROPERTY STANDARDS: MULTIFAMILY HOUSING (No. 4910.1) (1973); U.S. DEP'T OF HOUSING AND URBAN DEV., HOUSING AND URBAN DEVELOPMENT MINIMUM PROPERTY STANDARDS: CARE-TYPE HOUSING (No. 4920.1) (1973); *see* 24 C.F.R. §§ 200.925-933 (1977). These standards specify materials requirements for masonry, carpentry, plumbing, and electrical work. *See id.* app. § 200.933. These minimum property standards are complained to be construction industry designed, and full of loopholes for builders. *See* Nader, *Falling-Apart Houses*, 166 NEW REPUBLIC, May 27, 1972, at 11. Initial

Kerner Commission report found the greatest need to develop home ownership to alleviate social unrest. This report has been read as supplying the motivation behind congressional intent to aid blighted areas.¹⁴⁹ Furthermore, section 223(e) is an expansion of a program specifically designed to aid slum and riot areas.¹⁵⁰ Those FHA criteria which exclude blighted areas from mortgage insurance contravene congressional intent and also frustrate the national housing goal.

Thus there are two public policies in conflict. One policy seeks to encourage government funding of only those homes which meet health and safety standards. The other policy seeks to promote the use of government funding even for neighborhoods which do not meet such standards in order to alleviate some of the causes of urban unrest. In spite of the grave urgency reflected in the Kerner report, the FHA guidelines do not adequately respond to the need to provide mortgage insurance to inner city neighborhoods.

In addition to the failure of the FHA to follow congressional intent in the formulation of administrative regulations, problems are created by the application of those administrative regulations. Property evaluation criteria and the process of value appraisal result in a severe prejudice against the inner city.¹⁵¹ In every large city, there are train terminals, highways, and airports, often in the central part of town. Under the FHA regulations, homes in these areas will be excluded from mortgage insurance.¹⁵² Denial of FHA insurance to any neighborhood makes obtaining home loans difficult if not impossible.¹⁵³ Thus, it may be said that the official FHA guidelines result in de facto redlining¹⁵⁴ which violates both civil rights laws¹⁵⁵ and

support for the FHA came from these building materials and equipment industries. N. KEITH, *supra* note 1, at 25. Significant problems arise when these standards are applied to older homes built with outmoded techniques and materials.

149. See *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 496 (S.D. Ohio 1976).

150. See text & notes 123-27 *supra*.

151. Improper implementation can also occur. It stems from the subjective nature of the valuation process which gives appraisers great discretion. Many appraisers who work for FHA retain the bias of the real estate and mortgage lending industries, both of which have traditionally considered older integrated urban neighborhoods to be poor risks. See Comment, *supra* note 23, at 141-42, 149-50. The real estate industry believes that integration has an adverse effect on property values. R. HELPER, *supra* note 12, at 216-17. Where blacks attempt to purchase property in a white neighborhood, many white owners put their property on the market, causing an oversupply. *Id.* at 89. Mortgage lenders, seeing that the property values are declining, are apt to cut off all mortgages to the area. See Duncan, Hood, & Neet, *supra* note 15, at 516-17. There is also a practice known as a windshield survey which consists of conducting a superficial appraisal merely driving through a neighborhood. B. BOYER, *supra* note 23, at 81-82. Charges of improper appraisals by the FHA often occur. See generally HUD INVESTIGATIONS, *supra* note 19, at 57-58, 106-08; Comment, *supra* note 19, at 530.

152. These facilities would be considered impermissible environmental factors. See HUD HANDBOOK (No. 4260.1), *supra* note 81, at ¶ 4-5.

153. See Duncan, Hood, & Neet, *supra* note 15, at 518-20.

154. See discussion note 72 *supra*.

155. See 42 U.S.C. §§ 2000(d), 3604-3605 (1970); *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 501 (S.D. Ohio 1976).

Overt housing discrimination is a deeply rooted civil rights problem in America. U.S. COMM'N ON CIVIL RIGHTS, EQUAL OPPORTUNITY IN SUBURBIA 37-38 (1974) [hereinafter cited as SUBURBIA]; R. HELPER, *supra* note 12, at 301. The practices of the real estate industry are

congressional housing policy.¹⁵⁶ To remedy this situation it is necessary to examine the possibility of judicial relief.

JUSTICIABILITY OF INADEQUATE ADMINISTRATIVE IMPLEMENTATION

The conflict between the congressional intent behind section 223(e) and its application by the FHA raises the question of the justiciability of a challenge to the administrative implementation of the program. Since there is no specific statute concerning judicial review of HUD action, those who are denied mortgage insurance under the HUD guidelines must seek relief under the Administrative Procedure Act [APA],¹⁵⁷ which provides for judi-

partially responsible for discrimination which results in segregation of minorities in older neighborhoods. These practices have been thoroughly documented by Rose Helper's studies of the real estate profession conducted in 1958 and 1964 at the University of Chicago. *Id.* at xii. Wealthy blacks are not shown houses in white areas by real estate brokers, *id.* at 4, since it is against the realtor's ethics to do anything which might lower property values, *id.* at 196. Brokers, like appraisers, tend to act on the assumption that values decline when blacks enter a neighborhood. Homogeneity is perceived to be desirable among residents. Since blacks are considered different, those neighborhoods which are integrated are considered less desirable. As desirability declines, so do property values. Residents begin to move, low income people move in and neighborhoods decline further. *Id.* at 202. This belief is shared by both brokers and appraisers, so that homes are likely to be valued at less in an integrated neighborhood regardless of the attitudes of the residents. *Id.* at 197.

In financing, discrimination by mortgage lenders against potential mortgagors of minority groups takes two forms. The discrimination may be an overt refusal of financing on the basis of race or religion, or it may be a covert denial based on assumptions about the instability of income among group members or the effect of an integrated neighborhood upon property values. This latter form of discrimination may cause lenders to impose more stringent loan conditions. See J. KAIN & J. QUIGLEY, *supra* note 14, at 298.

Finally, the federal government in the past fostered a policy of discrimination. Until 1947, both the FHA and Federal Home Bank Board, which provides assistance to mortgage finance institutions, were active exponents of racial discrimination and racial segregation in housing. From 1950 to 1962, the policies of the federal government were officially neutral, but had a discriminatory impact. *SUBURBIA*, *supra* at 37; *ABA Annual Meeting*, 45 U.S.L.W. 2091, 2102 (Aug. 24, 1976). Starting in 1962, many laws, regulations, and orders were promulgated prohibiting discrimination in housing. The Civil Rights Act of 1968, Pub. L. No. 90-284, §§ 801-819, 82 Stat. 73 (current version at 42 U.S.C. §§ 3601-3619 (1970 & Supp. V 1975)) was applied to housing discrimination in *Hills v. Gautreaux*, 425 U.S. 284, 296 (1976). See Civil Rights Act of 1964, Pub. L. No. 88-352, §§ 601-605, 78 Stat. 241 (current version at 42 U.S.C. §§ 2000d-2000d-2 (1970)); 24 C.F.R. §§ 100.1-115.12 (1977); Exec. Order No. 11063, 27 Fed. Reg. 11527 (1962). However, the zeal with which federal officials carried out policies of racial discrimination in the early days of federal involvement was not matched by similar enthusiasm for implementing equal housing opportunity. *SUBURBIA*, *supra* at 38. For a discussion of legal remedies available for discrimination in housing under present federal law, see Duncan, Hood, & Neet, *supra* note 15, at 522-33.

It is evident that overt racial discrimination still exists in the housing market, including home financing. See Comment, *supra* note 19, at 139. A major legislative act against housing discrimination was the Fair Housing Act of 1968, known as Title VIII, Act of Apr. 11, 1968, Pub. L. No. 90-284, §§ 801-819, 82 Stat. 81-89 (current version at 42 U.S.C. §§ 3601-3619 (1970 & Supp. V 1975)). The Act makes it illegal for a bank or building and loan association to discriminate in finance. *Id.* § 805, 82 Stat. 83-84 (codified at 42 U.S.C. § 3605 (1970 & Supp. V 1975)). For a more thorough discussion of Title VIII and its application to prevent redlining, see Duncan, Hood, & Neet, *supra* at 527-33; Comment, *supra* at 145-52.

In *Jones v. Alfred H. Mayer Co.*, 392 U.S. 409 (1968), the Supreme Court extended the protection of the Civil Rights Act of 1866 to prevent all racial discrimination, private or public, in the sale or rental of real property. *Id.* at 417-44. The success of *Jones* in preventing a dual housing market has been mixed. See *Clark v. Universal Builders, Inc.*, 501 F.2d 324, 333-34 (7th Cir.), *cert. denied*, 419 U.S. 1070 (1974); *Love v. DeCarlo Homes, Inc.*, 482 F.2d 613, 616 (5th Cir. 1973). See generally Note, *Discriminatory Housing Markets, Racial Unconscionability, and Section 1988: The Contract Buyers League Case*, 80 YALE L.J. 516 (1971).

156. See *Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 494-97 (S.D. Ohio 1976).

157. 5 U.S.C. §§ 701-706 (1976). HUD is an agency within the terms of the Act since it is an authority of the United States Government. *Id.* § 701(b)(1) (1976). Challenges to FHA procedures are treated under the APA. *Davis v. Romney*, 490 F.2d 1360, 1364 n.2 (3d Cir. 1974).

cial review of federal agency action. The scope of judicial review authorized by the APA includes a determination as to whether particular agency action constitutes "an abuse of discretion."¹⁵⁸ In *Citizens to Preserve Overton Park, Inc. v. Volpe*,¹⁵⁹ the Supreme Court articulated standards governing judicial review of agency discretion. A federal court must consider first, whether the agency decision is based on a consideration of all relevant legislative factors, and second, whether the agency has committed a clear error in judgment.¹⁶⁰

The APA is not applicable, however, where the statutes governing a particular agency preclude judicial review¹⁶¹ or where agency action is "committed to agency discretion by law."¹⁶² This latter provision is in apparent conflict with the provision providing review for agency abuse of discretion.¹⁶³ The conflict raises the issue "whether action that may have been committed to agency discretion by law should still remain reviewable for abuse of discretion."¹⁶⁴

The APA exclusion of judicial review for agency action "committed to agency discretion by law" has been construed as a very narrow exception.¹⁶⁵ It has been held that Congress intended it to be "applicable in those rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.'" ¹⁶⁶ Thus, courts and commentators contend that although agency action may be committed to agency discretion, it may nevertheless remain reviewable for abuse of discretion.¹⁶⁷ However, the commentators are hardly in agreement as to the proper construction of the review provisions of the APA. Professor Davis argues that a decision which is committed to agency discretion by law cannot be reviewed, even for abuse of discretion.¹⁶⁸ Professor Jaffe finds that limited review is permissi-

158. *Id.* § 706(2)(A).

159. 401 U.S. 402 (1971).

160. *Id.* at 416.

161. 5 U.S.C. § 701(a)(1) (1976).

162. *Id.* § 701(a)(2).

163. See 4 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 28.16, at 80 (1958 & Supp. 1965); B. SCHWARTZ, ADMINISTRATIVE LAW § 152, at 451 (1976).

164. *Ness Inv. Corp. v. United States Dep't of Agriculture*, 512 F.2d 706, 712-13 (9th Cir. 1975); see 4 K. DAVIS, *supra* note 163; B. SCHWARTZ, *supra* note 163 at 452.

165. *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971).

166. *Id.* at 410 (quoting S. REP. NO. 752, 79th Cong., 1st Sess. 26 (1945)).

167. See, e.g., *Littell v. Morton*, 445 F.2d 1207, 1211 (4th Cir. 1971); *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715, 718 (2nd Cir. 1966); *Ozbirman v. Regional Manpower Adm'r*, 335 F. Supp. 467, 470-71 (S.D.N.Y. 1971); L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION 372-76 (1965); Berger, *Administrative Arbitrariness: A Synthesis*, 78 YALE L.J. 965, 999 (1969); text & notes 163-65 *supra*.

On the other hand, some commentators and courts have stated that action committed to agency discretion is wholly unreviewable, even where an abuse of discretion may have been alleged. See, e.g., *Sierra Club v. Hickel*, 467 F.2d 1048, 1049, 1051 (6th Cir. 1972), *cert. denied sub nom. Sierra Club v. Morton*, 411 U.S. 920 (1973); *Ferry v. Udall*, 336 F.2d 706, 711-14 (9th Cir. 1964), *cert. denied*, 381 U.S. 904 (1965); Saferstein, *Nonreviewability, A Functional Analysis of "Committed to Agency Discretion"*, 82 HARV. L. REV. 367, 376 (1968). See generally Davis, *Administrative Arbitrariness Not Always Reviewable*, 51 MINN. L. REV. 643 (1967); Davis, *Administrative Arbitrariness—A Postscript*, 114 U. PA. L. REV. 823 (1966).

168. 4 K. DAVIS, *supra* note 163; see *Littell v. Morton*, 445 F.2d 1207, 1211 (4th Cir. 1971). This view was followed in *Ferry v. Udall*, 336 F.2d 706, 712 (9th Cir. 1964), *cert. denied*, 381

ble to determine whether the agency's discretion has been exercised within permissible limits.¹⁶⁹ The Jaffe view is followed in at least three circuit courts of appeal.¹⁷⁰ Professor Schwartz criticizes the Davis approach that agency discretion can be immune from judicial review.¹⁷¹ He contends that if discretionary power is not subject to review, then the ability of a federal court to reverse for abuse of discretion is nonsense.¹⁷² Under the Schwartz interpretation, the agency discretion exception to reviewability adds little or nothing to the statutory preclusion of judicial review.¹⁷³ Under this view, any agency action is reviewable unless Congress manifests a positive intention to eliminate review.¹⁷⁴

There is strong support for the Schwartz view that the phrase "committed to agency discretion by law" does not bar review of arbitrary action.¹⁷⁵ The Court of Appeals for the Ninth Circuit, in *Ness Investment Corp. v. United States Department of Agriculture*,¹⁷⁶ held that review for abuse of discretion may be based on a violation of legislative intent, even though the action taken under a statute has been committed to agency discretion.¹⁷⁷ Review can thereby be based upon a violation of either constitutional, statutory, regulatory, or other legal mandates.¹⁷⁸

Nonetheless, there are agency decisions with which the courts will not interfere. For example, an informed judgment by the agency can be the basis for an alleged abuse of discretion.¹⁷⁹ In *Strickland v. Morton*,¹⁸⁰ review was denied by the Ninth Circuit because the subject matter for decision was held

U.S. 904 (1965). However, the Ninth Circuit apparently has now rejected *Ferry* for a more liberal view. See *Ness Inv. Corp. v. United States Dep't of Agriculture*, 512 F.2d 706, 714 (9th Cir. 1975).

169. L. JAFFE, *supra* note 167, at 359. Professor Jaffe makes an exception to this rule when judicial review is explicitly excluded or an agency's charter implies exclusion. *Id.* at 360; see *Littell v. Morton*, 445 F.2d 1207, 1211 (4th Cir. 1971).

170. *Littell v. Morton*, 445 F.2d 1207, 1211 (4th Cir. 1971); see *Scanwell Laboratories, Inc. v. Shaffer*, 424 F.2d 859, 874 (D.C. Cir. 1970); *Wong Wing Hang v. Immigration & Naturalization Serv.*, 360 F.2d 715, 718 (2d Cir. 1966).

171. B. SCHWARTZ, *supra* note 163, at 452.

172. *Id.* (citing *Littell v. Morton*, 445 F.2d 1207, 1210-11 (4th Cir. 1971)).

173. See B. SCHWARTZ, *supra* note 163, at 452.

174. *Id.* at 454.

175. See *Save the Bay, Inc. v. Administrator of E.P.A.*, 556 F.2d 1282, 1295-96 (5th Cir. 1977); *Strickland v. Morton*, 519 F.2d 467, 471 (9th Cir. 1975); *Scanwell Laboratories, Inc. v. Shaffer*, 424 F.2d 859, 875 (D.C. Cir. 1970). See generally *Krueger v. Morton*, 539 F.2d 235, 239 (D.C. Cir. 1976).

176. 512 F.2d 706 (9th Cir. 1975).

177. 512 F.2d at 714-15. The court stated:

Where consideration of the language, purpose and history of a statute indicate that action taken thereunder has been committed to agency discretion: (1) a federal court has jurisdiction to review agency action for abuse of discretion when the alleged abuse of discretion involves violation by the agency of constitutional, statutory, regulatory or other legal mandates or restrictions; (2) but a federal court does not have jurisdiction to review agency action for abuse of discretion when the alleged abuse of discretion consists only of the making of an informed judgment by the agency.

Id. at 715.

178. *Id.*

179. *Id.* "[The] circuit has not been quick to approve review of allegations that an agency abused its discretion merely by deciding an issue, involving agency expertise, adversely to a complaining plaintiff." *Id.* at 714.

180. 519 F.2d 467 (9th Cir. 1975).

to be committed to agency discretion.¹⁸¹ Since the agency action could not be adequately reviewed by reference to statutory standards or legislative intent,¹⁸² the court refused review.

Applying scope-of-review analysis to the FHA administration of the 223(e) program yields mixed results. The only limitations provided by the wording of section 223(e) are those of "reasonably viable" and "acceptable risk."¹⁸³ These terms are vague and might well fall within the narrow exception to review in the APA, on the theory that there is no law to apply.¹⁸⁴ If general terminology is employed in a statute, then the agency implementing the statute is given broad discretionary power to weigh the many factors which fall within the broad wording.¹⁸⁵ Specifically, it has been found that the companion to the acceptable risk standard, the standard of economic soundness, is such a broad regulatory criterion¹⁸⁶ that a court would be incapable of contributing intelligently to such decisions.¹⁸⁷ Thus, judging by the face of the statute, agency implementation of section 223(e) would not be reviewable. "Reasonably viable" and "acceptable risk" would be found too broad for judicial review. Moreover, courts are reluctant to review public assistance programs once it is determined that they are rationally based and free from invidious discrimination.¹⁸⁸ The courts are ill equipped to make decisions involving economics and administration.¹⁸⁹ Yet some courts are willing to make these economic decisions in the areas of urban renewal demolition¹⁹⁰ and of costs and rents of federal housing.¹⁹¹

181. *Id.* at 471.

182. *See id.* at 468-70. In *Curran v. Laird*, 420 F.2d 122 (D.C. Cir. 1969), the Court of Appeals for the District of Columbia held that the decision not to use government owned reserve ships was "not subject to judicial surveillance and correction for error in the exercise of discretion." *Id.* at 128. The reason for nonreviewability was that agency action was wholly committed to agency discretion by law. *Id.* Since the agency decision concerned national defense and the national interest, the court saw a need for flexibility in the decision-making process of the agency. *Id.* at 128-29. *See Schonbrun v. Commanding Officer, Armed Forces*, 403 F.2d 371, 375 (2d Cir. 1968), *cert. denied*, 394 U.S. 929 (1969).

183. 12 U.S.C. § 1715n(e) (1976); *see text & notes 95-120 supra*.

184. *See Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 410 (1971).

185. *Hahn v. Gottlieb*, 430 F.2d 1243, 1249 (1st Cir. 1970); *see Matson Navigation Co. v. Connor*, 258 F. Supp. 144, 149 (N.D. Cal. 1966) (the meaning of "unfair competition" is for the agency to determine).

186. *Hahn v. Gottlieb*, 430 F.2d 1243, 1249 (1st Cir. 1970).

187. *Id.*; *see Dew v. McLendon Garden Assocs.*, 394 F. Supp. 1223, 1233-34 (N.D. Ga. 1975).

188. *See Dandridge v. Williams*, 397 U.S. 471, 487 (1970); *Snell v. Wyman*, 281 F. Supp. 853, 863, 865 (S.D.N.Y. 1968), *aff'd*, 393 U.S. 323 (1969).

189. *See, e.g., Hahn v. Gottlieb*, 430 F.2d 1243, 1251 (1st Cir. 1970); *Matson Navigation Co. v. Connor*, 258 F. Supp. 144, 148 (N.D. Cal. 1966); *Dew v. McLendon Garden Assocs.*, 394 F. Supp. 1223, 1233-34 (N.D. Ga. 1975).

190. *See, e.g., Norwalk CORE v. Norwalk Redevelopment Agency*, 395 F.2d 920, 928-29 (2d Cir. 1968); *Western Addition Community Org. v. Weaver*, 294 F. Supp. 433, 441 (N.D. Cal. 1969); *Powelton Civil Homeowner Ass'n v. Department of Housing & Urban Dev.*, 284 F. Supp. 809, 825 (E.D. Pa. 1968). *But see Green Street Ass'n v. Daley*, 373 F.2d 1, 7 (7th Cir. 1967).

191. *Langevin v. Chenango Court, Inc.*, 447 F.2d 296, 302 (2d Cir. 1971). The *Langevin*

The congressional intent of the 223(e) program contains more substance than the wording of the statute.¹⁹² Arguably, a denial of loan insurance because of environmental factors which invariably would exclude riot torn neighborhoods should be reviewable. Broad agency discretion in classifying public lands has been held to be reviewable when the agency action conflicts with legislative history.¹⁹³ In a similar manner an agency action excluding homes and neighborhoods from home loan insurance should be reviewable when it frustrates congressional intent. Thus, in spite of the broad statutory language of section 223(e), a court has jurisdiction to review agency implementation for a violation of legislative intent.

In summary, the FHA interpretation of the 223(e) program embodied in the HUD Handbook should be subject to review for abuse of authority. However, if the factors the FHA delineates do not violate congressional intent, the application of these factors in the sound and informed judgment of the FHA is not reviewable unless impermissible factors enter into the agency determination. In that event, *Citizens to Preserve Overton Park* should require the administrator to articulate his reasons, subject to judicial review for clear error. Nonetheless, it is possible that FHA implementation of the 223(e) program will be held to be nonreviewable by the courts. Only Congress can then provide the proper administrative and judicial remedy.¹⁹⁴

CONCLUSION

Over ten years have passed since the violence and the riots in the summer of 1967. The Kerner Commission attributed a good part of the anger and frustration of the urban residents which led to the urban riots of the sixties to urban slum housing conditions and to government programs which reinforced those conditions. The practices of the FHA specifically were singled out as a major contributor to the conditions leading to urban decay. Accordingly, Congress has extended the "acceptable risk" standard to riot torn areas and to declining urban centers generally in the 223(e) program. Present FHA implementation of the 223(e) program includes inflexible environmental requirements which eliminate from mortgage insurance many of the areas the program was intended to cover. This violation of congressional intent should be justiciable. Although a specific decision to

court rejected the argument that the area of inquiry was inappropriate for judicial consideration. *Id.* at 303. The court found that judging the reasonableness of a rent increase did not substantially differ from many other decisions the court must make. However, the court went on to find that congressional intent precluded review. *Id.*

192. See text & notes 123-27 *supra*.

193. See *Broker v. Morton*, 473 F.2d 790, 794-95 (9th Cir. 1973).

194. Congress can design a statute vesting jurisdiction in the federal courts to review determinations by the FHA. Such a statute can be patterned after review statutes applicable to the Federal Source Commission, Interstate Commerce Commission, or the Civil Aeronautics Board. See 16 U.S.C. § 8251 (1976) (FPC); 15 U.S.C. § 21(c) (1976) (ICC); 49 U.S.C. § 1486 (1970) (CAB).

deny mortgage insurance cannot be reviewed de novo, the FHA can be required to articulate its reasons for rejection of any loan insurance, which can be reviewed for clear error. Absent judicial review, further congressional supervision is necessary for the continued feasibility of the national housing goal.

