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## Incentivizing Fair Housing

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## INCENTIVIZING FAIR HOUSING

STEWART E. STERK\*

### ABSTRACT

*Restrictive land use regulation has thwarted the upward mobility of many Americans, particularly Americans of color. Local restrictions imposed by affluent municipalities have limited access to safe neighborhoods, better housing, and good schools. Racism and economic self-interest have both played a role in exclusionary practices which have contributed to high housing costs that place a strain on the entire economy.*

*Fair Housing Act litigation has been one weapon in the fight against these practices. Despite the Supreme Court's decision in *Texas Department of Housing & Community Affairs v. Inclusive Communities Project, Inc.*, disparate impact litigation faces significant obstacles that limit its value as a tool to fight exclusionary zoning. First, because restrictive zoning ordinances have such widespread economic effect, it will generally be difficult to prove that their impact on members of protected classes is disparate. Second, municipalities are likely to have successful defenses against disparate impact claims arising from restrictive zoning—including the “business necessity” defense that zoning restrictions are necessary to minimize the tax burden on local residents. Third, litigation sets up an adversarial dynamic that leads municipalities to resist housing initiatives rather than embracing them.*

*By contrast, incentives are better calculated to induce local cooperation in the development of fair housing. The Department of Housing and Urban Development made some use of incentives during the Obama Administration, but those efforts were not ideally designed to promote buy-in by recalcitrant municipalities and were abandoned during the Trump Administration. States, however, are well positioned to use the real property tax system to create substantial incentives for municipalities to abandon exclusionary practices. Using tax incentives rather than mandates would enlist municipal self-interest as a weapon against exclusion.*

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## INTRODUCTION

Restrictive land use regulation has been a major force in limiting the upward mobility of many Americans, particularly Americans of color. Sometimes, regulation directly excludes subsidized housing projects likely to include residents of color.<sup>1</sup> Far more often, restrictive zoning that permits only single-family homes on large lots contributes to the high cost of housing, putting improved housing, safer neighborhoods, and better schools out of the reach of many who would otherwise be able to afford them.<sup>2</sup> Restrictive zoning's impact on housing prices has been most pronounced in "blue" states on the East and West coasts.<sup>3</sup> High housing costs have contributed to economic and racial segregation,<sup>4</sup> and they have also made it difficult for outsiders to move into areas where they might be most productive—resulting in a drain on the national economy.<sup>5</sup>

Suburban municipalities have played the principal role in zoning that makes housing inaccessible to people of color and others with modest means. Exclusionary policies in suburbs are critical because more than half of the Black

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<sup>1</sup> See discussion *infra* Section II.C.4.

<sup>2</sup> See *id.*

<sup>3</sup> See RYAN AVENT, *THE GATED CITY* ch. 6 (2011) (ebook) (noting that land use limits lead to higher housing costs, and that community opposition may operate to restrict supply even without expressly enacted land use regulations); Edward Glaeser & Joseph Gyourko, *The Economic Implications of Housing Supply*, 32 J. ECON. PERSPS. 3, 8 (2018) (finding local land use regulation reduces the elasticity of housing supply, resulting in smaller stock of housing and higher housing prices); Joseph Gyourko, Albert Saiz & Anita Summers, *A New Measure of the Local Regulatory Environment for Housing Markets: The Wharton Residential Land Use Regulatory Index*, 45 URB. STUD. 693, 695-96, 710 (2008) (noting that "median house value in highly regulated places is nearly double that in lightly regulated places," with the most highly regulated areas in the Northeast and West Coast and least in the South and Midwest). The disparity between housing prices on the coasts and housing prices elsewhere in the country became persistent after 1970. William A. Fischel, *The Evolution of Homeownership*, 77 U. CHI. L. REV. 1503, 1516 (2010) (reviewing LEE ANNE FENNELL, *THE UNBOUNDED HOME: PROPERTY VALUES BEYOND PROPERTY LINES* (2009)).

<sup>4</sup> See Peter Ganong & Daniel Shoag, *Why Has Regional Income Convergence in the U.S. Declined?*, 102 J. URB. ECON. 76, 78 (2017) (showing that restrictive land use regulation has contributed to economic segregation by limiting access of poorer workers to America's most productive cities); Jonathan T. Rothwell & Douglas S. Massey, *Density Zoning and Class Segregation in U.S. Metropolitan Areas*, 91 SOC. SCI. Q. 1123, 1133-34, 1140-41 (2010) (finding that zoning regulations that limit density are responsible for significant class segregation). But see Christopher Berry, *Land Use Regulation and Residential Segregation: Does Zoning Matter?*, 3 AM. L. & ECON. REV. 251, 270-71 (2001) (finding no statistically significant difference in residential segregation between zoned Dallas and unzoned Houston).

<sup>5</sup> Glaeser & Gyourko, *supra* note 3, at 5 (concluding that lower bound cost of restrictive residential land use regulation is at least 2% of national output); Chang-Tai Hsieh & Enrico Moretti, *Housing Constraints and Spatial Misallocation*, 11 AM. ECON. J. 1, 2 (2019) (concluding strict zoning laws in cities with strong productivity growth resulted in spatial misallocation of labor and lowered aggregate economic growth 36% between 1964 and 2009).

population in large metropolitan areas now live in suburbs,<sup>6</sup> and suburbs are home to three million more poor residents than big cities.<sup>7</sup> Cities, too, engage in restrictive zoning that inflates the cost of housing, but cities have less power and inclination to exclude members of minority groups.<sup>8</sup> The COVID-19 pandemic has exacerbated the impact of suburban exclusion as city dwellers with the means to do so have fled to suburban and exurban areas, driving up the price of suburban housing and aggravating preexisting racial and socioeconomic segregation.<sup>9</sup>

Race discrimination undoubtedly plays a role in suburban zoning practices.<sup>10</sup> But perhaps the biggest factor is that, even if American racism were somehow obliterated, restrictive zoning would be in the financial interest of most homeowners.<sup>11</sup> Those homeowners dominate most local governments.<sup>12</sup> In supporting restrictive zoning, the homeowners perceive, with some accuracy, that they are protecting the value of their most substantial investments—their homes.<sup>13</sup>

<sup>6</sup> Anthony V. Alfieri, *Black, Poor, and Gone: Civil Rights Law's Inner-City Crisis*, 54 HARV. C.R.-C.L. L. REV. 629, 649-50 (2019).

<sup>7</sup> Elizabeth Kneebone, *Urban and Suburban Poverty: The Changing Geography of Disadvantage*, PENN. INST. FOR URB. RSCH. (Feb. 10, 2016), <https://penniu.upenn.edu/publications/urban-and-suburban-poverty-the-changing-geography-of-disadvantage> [<https://perma.cc/8CX8-C2AB>].

<sup>8</sup> See Olatunde C.A. Johnson, *Unjust Cities? Gentrification, Integration, and the Fair Housing Act*, 53 U. RICH. L. REV. 835, 842 (2019) (noting that cities may not engage in as much exclusion as suburbs).

<sup>9</sup> See Sabrina Terry & Jason Richardson, *COVID-19 Is Speeding Up White Flight: Now Is the Time to Invest in Affordable Housing*, NAT'L CMTY. REINVESTMENT COAL. (Nov. 10, 2020), <https://www.ncrc.org/covid-19-is-speeding-up-white-flight-now-is-the-time-to-invest-in-affordable-housing/> [<https://perma.cc/AJX9-VD2S>].

<sup>10</sup> White suburbanites may use race as a proxy for a diminished quality of life. See Brian Patrick Larkin, *The Forty-Year "First Step": The Fair Housing Act as an Incomplete Tool for Suburban Integration*, 107 COLUM. L. REV. 1617, 1632 (2007).

<sup>11</sup> See Johnson, *supra* note 8, at 844 (noting that homeowners and developers desire neighborhood improvements that raise housing costs for low-income residents).

<sup>12</sup> Scholars have long recognized that homeowners dominate suburban local governments. See, e.g., Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 385, 405-07 (1977) (discussing homeowners' common interests in exclusion and dominance of local municipalities). More recently, Rick Hills and David Schleicher have stated that America's richest cities "increasingly look like collections of exclusive suburbs, with neighborhoods filled with homeowners stopping the construction of needed commercial and residential development." Roderick M. Hills, Jr. & David Schleicher, *Planning an Affordable City*, 101 IOWA L. REV. 91, 93 (2015). They have argued that, in major cities, the combination of one-party rule and aldermanic privilege has given neighboring homeowners considerable power over zoning. *Id.* at 111-13; see also David Schleicher, *City Unplanning*, 122 YALE L.J. 1670, 1709-13 (2013).

<sup>13</sup> See Johnson, *supra* note 8, at 844-45 (noting that a primary aim of property holders is to raise their own property values).

In those municipalities whose location or reputation confer on them a degree of market power, homeowners, acting collectively through their local officials, have financial incentives to exercise that power by reducing the supply of housing of all types—expensive and inexpensive. So long as a downward-sloping demand curve marks housing in the municipality, a reduction in the supply of housing results in an increase in the price of all housing—including the housing owned by existing residents.<sup>14</sup>

Even in municipalities without significant market power, homeowners have financial incentives to exclude uses that threaten home values. As William Fischel explains, because home value represents such a large fraction of the average homeowner's overall wealth, owners have reason to be risk averse with respect to their homes.<sup>15</sup> That risk aversion manifests itself as resistance to neighborhood changes, even if the likelihood is small that those changes will reduce property values.<sup>16</sup>

Of potentially greater significance, it is in the interest of homeowners in each municipality to engage in fiscal zoning, a practice in which the municipality attempts to exclude households who will pay less in taxes than they consume in municipal services.<sup>17</sup> Because most municipalities fund services through real estate taxes based on property values, municipalities accomplish their fiscal zoning objectives by acting to ensure that all new housing is expensive housing, often by imposing excessive minimum lot size restrictions.<sup>18</sup>

Fiscal zoning benefits existing homeowners—"homevoters" in Fischel's terminology<sup>19</sup>—in two related ways. First, it reduces the real estate taxes homeowners will have to pay on an annual basis for municipal services.<sup>20</sup> Second, because local real estate taxes are typically capitalized into home prices,<sup>21</sup> fiscal zoning increases the value of homes within the municipality—and therefore the wealth of existing residents.<sup>22</sup>

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<sup>14</sup> See Ellickson, *supra* note 12, at 400.

<sup>15</sup> WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES 8-10 (2001).

<sup>16</sup> Fischel has explained that, because homes represent such a large portion of the assets of most homeowners, homeowners are particularly risk-averse, which leads them to oppose change generally. *Id.*; see also AVENT, *supra* note 3 (describing risk aversion of residents and fear of change).

<sup>17</sup> See FISCHEL, *supra* note 15, at 65-67 (describing fiscal zoning as a way for municipal residents to ensure that new construction pays its own way in municipal costs).

<sup>18</sup> See Glaeser & Gyourko, *supra* note 3, at 6 (noting that the median Boston suburb has minimum lot size over one acre, and that minimum lot size is negatively correlated with new construction in greater Boston).

<sup>19</sup> See FISCHEL, *supra* note 15, at 8-10.

<sup>20</sup> *Id.* at 49-51.

<sup>21</sup> *Id.*

<sup>22</sup> See Glaeser & Gyourko, *supra* note 3, at 26 (noting that regulation has led to significant increases in housing equity for older, richer buyers in America's most regulated areas).

The benefits fiscal zoning generates for municipal residents come at a considerable cost. Restrictions on development impose costs on owners of vacant land by preventing them from developing the land to its full capacity.<sup>23</sup> But much of the cost is borne by outsiders in the form of reduced housing supply, higher housing costs, and reduced access to high-quality public services, particularly schools.<sup>24</sup> Prominent among those outsiders are members of economically disadvantaged minority groups; limiting their access to high-quality schools impedes the ability of their children to climb the economic ladder.<sup>25</sup>

Because wealthy municipalities are unlikely to account for these external costs, reform requires intervention by outside institutions—primarily the states or the federal government. The primary federal weapon against exclusionary zoning has been litigation, or the threat of litigation, under the Fair Housing Act (“FHA”). Although the exclusion caused by fiscal zoning is largely income-based,<sup>26</sup> fiscal zoning has an adverse impact on members of groups protected by the FHA. In *Texas Department of Housing & Community Affairs v. Inclusive Communities Project, Inc.*,<sup>27</sup> the Supreme Court explicitly endorsed disparate impact liability under the FHA<sup>28</sup> and indicated that statistical evidence might serve as a foundation for disparate impact claims.<sup>29</sup>

Although a number of disparate impact claims have challenged zoning regulations that increase the cost of housing and have focused on the statistical correlation between race and income, disparate impact litigation has two significant weaknesses that limit its effectiveness as a remedy for the exclusion generated by fiscal zoning. First, the statistical analysis underlying these claims

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<sup>23</sup> See Ellickson, *supra* note 12, at 430. Ellickson argues that in a suburb with perfect substitutes, the costs of excessive development restrictions are borne exclusively by owners of vacant land because the suburb’s exclusionary policies will not result in an increase in the price of housing; restrictions, which the suburb may “sell” to developers, simply redistribute wealth from vacant landowners to existing homeowners. See *id.* In developing this model, Ellickson explicitly assumes that new development would generate new fiscal impact. *Id.* at 427.

<sup>24</sup> See *id.* at 430 (noting that when suburbs face a downward-sloping demand curve, inefficient restrictions on development impose costs both on housing suppliers and housing consumers). Ellickson argues that a municipality’s normal profit-maximizing strategy is to discourage construction of modest-price housing suitable for occupancy by families with school-age children. See *id.* at 452.

<sup>25</sup> Cf. Larkin, *supra* note 10, at 1639 (noting that Black middle-class suburbs tend not to have high-quality public schools).

<sup>26</sup> See WILLIAM A. FISCHER, ZONING RULES!: THE ECONOMICS OF LAND USE REGULATION 201-02 (2015).

<sup>27</sup> 576 U.S. 519 (2015).

<sup>28</sup> *Id.* at 545.

<sup>29</sup> The court indicated that statistical disparity alone would be insufficient to support a disparate impact claim but simultaneously discussed how statistical evidence is relevant to such a claim. *Id.* at 540-41.



rests on questionable foundations. Second, local governments have no incentive to comply with FHA mandates until required to do so by court order.

Consider first the statistical difficulties. A typical disparate impact claim arises when a public interest group challenges a zoning regulation that prohibits multifamily housing, or that requires a minimum lot size of one acre in a single-family district. The challenged regulation, by increasing the cost of housing, makes housing unavailable to those who cannot afford the options permitted by the regulation. Members of protected groups disproportionately subsist on incomes below the threshold necessary to afford the housing permitted by the zoning regulation. Therefore, the challenged regulation has a disparate impact on members of a protected class.

This sort of disparate impact challenge is problematic for a number of reasons. First, because virtually all zoning increases the cost of housing, the logical implication of this form of attack would require elimination of all zoning—a result Congress did not contemplate in enacting or amending the FHA.<sup>30</sup> Second, to the extent fiscal zoning increases the cost of housing, it increases the cost at every price level,<sup>31</sup> making some housing unavailable to members of virtually all income groups, undermining the contention that the impact on protected groups is disparate. Third, the Court has recognized some sort of “business necessity” defense for FHA claims.<sup>32</sup> If excluding those who cannot pay for the services they consume does not qualify as a business necessity, FHA liability would extend to landlords and developers, who might then be required to

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<sup>30</sup> The text of the FHA never mentions zoning or local land use regulation. The bill’s legislative history has been the subject of some controversy. For a recent account disputing the conventional view that the bill was designed to be toothless, see Jonathan Zasloff, *The Secret History of the Fair Housing Act*, 53 HARV. J. ON LEGIS. 247, 248 (2016). Zasloff’s account, however, does not mention any discussion of zoning. In the Act’s legislative history, the closest to a statement about zoning is the following statement by Senator Walter Mondale, the bill’s principal sponsor:

[Black people] who live in slum ghettos, however, have been unable to move to suburban communities and other exclusively white areas.

In part, this inability stems from a refusal by suburbs and other communities to accept low-income housing. . . . An important factor contributing to exclusion of [Black people] from such areas, moreover, has been the policies and practices of agencies of government at all levels.

114 CONG. REC. 2277 (1968) (statement of Sen. Walter Mondale). The statement hardly amounts to a broad-based attack on zoning. The legislative history of the 1988 Fair Housing Act amendments do include a statement of intention “that the prohibition against discrimination against those with handicaps apply to zoning decisions and practices.” H.R. REP. NO. 100-711, at 24 (1988). But, of course, the statement that the statute applies to zoning decisions is a far cry from a prohibition against zoning practices that raise housing prices.

<sup>31</sup> See Edward L. Glaeser & Joseph Gyourko, *The Impact of Zoning on Housing Affordability* 4-5 (Nat’l Bureau of Econ. Rsch., Working Paper No. 8835, 2002) (noting that both poor and non-poor people suffer from high housing costs in highly regulated areas).

<sup>32</sup> See *Inclusive Cmty.*, 576 U.S. at 541.

provide housing at a price below the cost of production, ultimately reducing the incentive to create new housing.

A number of courts have suggested that even if a local zoning restriction does not have a disparate impact on protected groups, the restriction has a discriminatory effect (and therefore violates the FHA) if the restriction operates to perpetuate segregation.<sup>33</sup> The perpetuation of segregation theory—not discussed in *Inclusive Communities*—would overcome some of the statistical difficulties facing a plaintiff seeking to prevail on a disparate impact claim. But changes in the Supreme Court’s composition since *Inclusive Communities* reduce the likelihood that that the Court will embrace the theory.

Moreover, neither species of FHA claim provides local governments with any incentive to cooperate with nonprofit or private developers who seek to build low-cost or lower-cost housing. Resisting FHA litigation delays (and potentially avoids entirely) the fiscal impact of new development on existing residents. In addition, political pressure from “homevoters” concerned about the fiscal effect associated with an influx of lower-income residents or residents of color might cause even well-intentioned local officials to fight new development so that they can blame the courts for any unwanted development.

Although a number of states have attempted, with mixed success, to constrain exclusionary zoning, many of those efforts, too, rely on mandates imposed on reluctant municipalities.<sup>34</sup> These mandates have proven difficult to enforce; the officials responsible for upholding them risk electoral defeat if they do so.<sup>35</sup>

The federal government has made some use of incentives to eliminate regulatory barriers to low-cost housing. In particular, block grants to local governments require certification to the Secretary of Housing and Urban Development (“HUD”) that “the grantee will affirmatively further fair housing.”<sup>36</sup> These grants, however, are not generally conditioned on actual construction of housing, and are sometimes focused instead on removal of regulatory barriers<sup>37</sup> and have been ineffectively enforced.

Because local property taxation—a primary concern of many suburban residents—is largely a function of state law, states are in an ideal position to use tax incentives to combat exclusionary zoning. To date, states have not done so. In other contexts, states and municipalities have long used property tax relief to

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<sup>33</sup> See, e.g., *MHANY Mgmt., Inc. v. Cnty. of Nassau*, 819 F.3d 581, 619-20 (2d Cir. 2016) (noting district court findings that county restriction perpetuated segregation generally by decreasing housing available to minority populations).

<sup>34</sup> See generally John Infranca, *The New State Zoning: Land Use Preemption amid a Housing Crisis*, 60 B.C. L. REV. 823 (2019).

<sup>35</sup> See generally Michael C. Pollack, *Land Use Federalism’s False Choice*, 68 ALA. L. REV. 707 (2017) (noting difficulty that mandates create for democratic accountability).

<sup>36</sup> 42 U.S.C. § 5304(b); see also *id.* § 12705(b)(15) (regulating state and local housing strategies).

<sup>37</sup> See, e.g., *id.* § 12705(c).

alter the calculus of private developers.<sup>38</sup> And local government theory has long recognized that municipalities respond to financial incentives in the same way private firms do.<sup>39</sup> A thoughtfully designed adjustment of the property tax structure could provide municipal taxpayers and officials with appropriate carrots and sticks to induce them to abandon exclusionary policies and to cooperate in construction of more housing at a lower cost, alleviating the high housing costs and racial and socioeconomic segregation that plague critical areas of the country.

Part I provides a brief outline of the FHA's framework. Part II reviews the use of that framework in challenges to restrictive zoning enactments and explores the practical and conceptual difficulties with using correlations between race and income as the foundation for attacks on fiscal zoning. Part III examines HUD's limited use of incentives to promote fair housing. Part IV surveys existing state law efforts to combat exclusionary zoning. Finally, Part V outlines a system of property tax surcharges on exclusionary municipalities, combined with tax rebates for municipalities that accommodate more than their fair share of low-cost housing.

## I. THE FHA, DISPARATE IMPACT, AND PERPETUATION OF SEGREGATION

### A. Introduction

Originally enacted to eliminate discriminatory practices of landlords and real estate brokers,<sup>40</sup> the FHA quickly became a weapon against discriminatory zoning practices. Because the statute makes it unlawful to "make unavailable" housing based on any of the prohibited categories,<sup>41</sup> courts had little difficulty applying the statute to municipalities whose zoning ordinances fostered racial discrimination.

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<sup>38</sup> See, e.g., N.Y. REAL PROP. TAX LAW § 489 (LexisNexis 2021) (providing tax exemption for certain building improvements designed to eliminate fire and health hazards).

<sup>39</sup> See, e.g., Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 21 (1990) (discussing natural economic interests of local government); Ellickson, *supra* note 12, at 404-10 (discussing economic influences on behavior of voters and local officials).

<sup>40</sup> The section titles of the statutes included in the FHA indicate their focus. Section 3604 is entitled, "Discrimination in the sale or rental of housing and other prohibited practices." 42 U.S.C. § 3604. Section 3605 is entitled, "Discrimination in residential real estate-related transactions," and prohibits discrimination by "any person or other entity whose business includes engaging in residential real estate-related transactions." *Id.* § 3605. Section 3606 is entitled, "Discrimination in the provision of brokerage services." *Id.* § 3606. Moreover, most of the hearings and debates on the Act centered on private discrimination. See Robert G. Schwemm, *Discriminatory Effect and the Fair Housing Act*, 54 NOTRE DAME LAW. 199, 212 (1978).

<sup>41</sup> Section 3604(a) makes it unlawful "[t]o refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin."

Starting with *United States v. City of Black Jack*<sup>42</sup> in 1974, courts have held that the FHA prohibited zoning practices that had a discriminatory impact even though challengers could prove no discriminatory treatment.<sup>43</sup> Although most of these cases involved substantial evidence of discriminatory intent, courts sidestepped the need to prove intent by imposing on the municipality the burden to justify a regulation once a challenger established that the regulation had a discriminatory impact on members of a protected class.<sup>44</sup>

Although the various circuits articulated somewhat different frameworks, none rejected discriminatory impact analysis. The Supreme Court declined to resolve the issue in *Town of Huntington v. Huntington Branch, NAACP*,<sup>45</sup> noting that the town had conceded the applicability of disparate impact analysis and indicating that in light of the concession “we do not reach the question whether that test is the appropriate one.”<sup>46</sup> The Court granted certiorari to resolve the issue in *Magner v. Gallagher*,<sup>47</sup> but that case settled before the Court could hear arguments.

As courts endorsed discriminatory impact analysis, a number of them suggested a parallel basis for FHA liability: local regulations would violate the FHA, even if they did not have an adverse impact on members of a protected class, if they resulted in a perpetuation of segregation in the area. For instance, in *Metropolitan Housing Development Corp. v. Village of Arlington Heights*,<sup>48</sup> the Seventh Circuit indicated that if a facially neutral housing decision “perpetuates segregation and thereby prevents interracial association[,] it will be considered invidious under the Fair Housing Act independently of the extent to which it produces a disparate effect on different racial groups.”<sup>49</sup> The decisions recognizing the perpetuation of segregation theory did not identify the statutory

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<sup>42</sup> 508 F.2d 1179 (8th Cir. 1974).

<sup>43</sup> *Id.* at 1188; *see, e.g., Keith v. Volpe*, 858 F.2d 467, 485 (9th Cir. 1988) (finding that city’s refusal to permit low-income housing development violated FHA); *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 935 (2d Cir. 1988) (holding that *prima facie* case for disparate impact does not require showing of discriminatory treatment); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1294 (7th Cir. 1977) (finding that municipality’s zoning policies forbidding low-cost housing violated FHA).

<sup>44</sup> *See, e.g., Keith*, 858 F.2d at 484 (rejecting proffered justifications); *Huntington Branch, NAACP*, 844 F.2d at 936 (adopting the Third Circuit formulation that defendant must establish bona fide governmental interest and that no alternative would serve that interest with less discriminatory effect).

<sup>45</sup> 488 U.S. 15 (1988).

<sup>46</sup> *Id.* at 18.

<sup>47</sup> 565 U.S. 1013 (2011).

<sup>48</sup> 558 F.2d at 1283.

<sup>49</sup> *Id.* at 1290; *see also Huntington Branch, NAACP*, 844 F.2d at 937; *United States v. City of Black Jack*, 508 F.2d 1179, 1186 (8th Cir. 1974).

basis for the theory, nor did the cases turn on application of the theory because in each case, the court found disparate impact on members of a protected class.<sup>50</sup>

In 2013, when HUD promulgated regulations embracing liability for discriminatory effect, even if not accompanied by discriminatory intent, it explicitly included perpetuation of segregation as a species of discriminatory effect.<sup>51</sup> In support of the position, HUD cited legislative history and prior court decisions but no explicit statutory authority.<sup>52</sup>

## B. Inclusive Communities

Against that background, in *Inclusive Communities* the Court endorsed the basic principle that the FHA embraces disparate impact analysis.<sup>53</sup> At the same time, however, the Court limited disparate impact analysis in ways that make it difficult to use the FHA as a weapon against fiscal zoning. The Court's opinion did not discuss the perpetuation of segregation theory.<sup>54</sup>

*Inclusive Communities* was not a zoning case. Instead, a nonprofit challenged a Texas agency's allocation of federal low-income tax credits. The nonprofit contended that the agency had allocated too many credits to housing in minority inner-city neighborhoods and too few to housing in predominantly White suburban neighborhoods.<sup>55</sup> The district court held that the nonprofit had established disparate impact, and that, even if the Texas agency had a justification for its policies, the agency had failed to demonstrate the absence of less discriminatory alternatives.<sup>56</sup>

While the agency's appeal was pending, the Obama-era HUD issued a regulation interpreting the FHA to encompass disparate impact liability.<sup>57</sup> The regulation established a burden-shifting framework analogous to the framework applicable in Title VII employment discrimination cases. Under the HUD framework, once a defendant established a justification for the action that

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<sup>50</sup> See Robert G. Schwemm, *Segregative-Effect Claims Under the Fair Housing Act*, 20 N.Y.U. J. LEGIS. & PUB. POL'Y 709, 725 (2017) (noting that pre-2013 cases recognizing segregative effect theory did not have to determine whether liability should be based on the theory).

<sup>51</sup> 24 C.F.R. § 100.500(a) (2013).

<sup>52</sup> See Implementation of the Fair Housing Act's Discriminatory Effects Standard, 78 Fed. Reg. 11,460, 11,469-70 (Feb. 15, 2013).

<sup>53</sup> *Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 539 (2015).

<sup>54</sup> See Schwemm, *supra* note 50, at 714 (noting that *Inclusive Communities* "did not deal with—indeed, barely mentioned—the segregative-effect theory," and that the "theory has no clear analog in Title VII law"). But see Alfieri, *supra* note 6, at 678 (reading *Inclusive Communities* to "confirm the statutory and doctrinal plausibility of a segregative-effect theory").

<sup>55</sup> *Inclusive Cmty.*, 576 U.S. at 526.

<sup>56</sup> *Inclusive Cmty. Project, Inc. v. Tex. Dep't of Hous. & Cmty. Affs.*, 860 F. Supp. 2d 312, 331 (N.D. Tex. 2012).

<sup>57</sup> 24 C.F.R. § 100.500 (2013).

created a disparate impact, the plaintiff would bear the burden of establishing that a less discriminatory alternative could accomplish the defendant's legitimate objectives.<sup>58</sup>

The Fifth Circuit, applying its own precedent, agreed with the district court that the FHA encompasses disparate impact claims but held—consistent with HUD's newly promulgated regulation—that the nonprofit bore the burden of establishing the availability of a less discriminatory alternative.<sup>59</sup> As a result, the court reversed and remanded to allow the district court to consider alternatives proffered by the agency.<sup>60</sup> In a concurrence, Judge Edith Jones questioned whether the nonprofit's statistical evidence was even sufficient to make out a *prima facie* case.<sup>61</sup> She focused on the absence of any evidence that a policy of the agency caused the statistical disparity identified by the nonprofit.<sup>62</sup>

The Supreme Court affirmed and remanded, relying on the 1988 Fair Housing Act Amendments, which were enacted with awareness of the unanimous circuit court precedent endorsing disparate impact liability.<sup>63</sup> Justice Kennedy's opinion for a 5-4 majority explicitly included “zoning laws and other housing restrictions that function unfairly to exclude minorities from certain neighborhoods without any sufficient justification” as practices that reside “at the heartland of disparate-impact liability.”<sup>64</sup> The Court cited, with apparent approval, the burden-shifting framework promulgated by HUD.<sup>65</sup>

At the same time, however, the Court's opinion articulated a number of limitations on disparate impact liability. First, the Court noted that, as in Title VII cases, an FHA defendant avoids liability if the defendant offers adequate justification for the actions that generate disparate impact.<sup>66</sup> Second, the Court emphasized the need to dismiss some claims for failure to make out a *prima facie* case.<sup>67</sup> The Court indicated that to avoid dismissal, an FHA plaintiff may not

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<sup>58</sup> *Id.* § 100.500(c)(2). If the defendant satisfies that burden, the plaintiff can still prevail upon proving that the legitimate interests could be served by another practice that has a less discriminatory effect. *Id.* § 100.500(c)(3).

<sup>59</sup> *Inclusive Cmty. Project, Inc. v. Tex. Dep't of Hous. & Cmty. Affs.*, 747 F.3d 275, 282 (5th Cir. 2014).

<sup>60</sup> *Id.* at 283.

<sup>61</sup> *Id.* (Jones, J., concurring) (“[B]ecause FHA cases will now be modeled closely upon the Title VII formula, it is clear that the appellees could not rely on statistical evidence of disparity alone for their *prima facie* case.”).

<sup>62</sup> *Id.*

<sup>63</sup> *Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 536, 547 (2015).

<sup>64</sup> *Id.* at 522, 539.

<sup>65</sup> *Id.* at 541 (noting that burden shifting, similar to “business necessity” standard, is vital for allowing housing authorities and private developers to state and explain their interest).

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 542 (“Without adequate safeguards at the *prima facie* stage, disparate-impact liability might cause race to be used and considered in a pervasive way and ‘would almost

rely solely on statistical evidence of disparate impact; the plaintiff must also identify a policy of the defendant that generated that impact.<sup>68</sup> Finally, the Court imposed a “robust causality” condition: an FHA plaintiff must establish that the defendant’s policy caused the disparate impact.<sup>69</sup> The opinion, however, was less than pellucid about how those limitations should be applied in concrete cases.

### C. *Statistical Evidence*

Disparate impact claims inevitably rely on statistical evidence. Evaluating statistical evidence, however, presents a number of challenges. A concrete example illustrates those challenges. Consider a municipality that allocates its affordable housing stock to persons with income below \$40,000 and gives first preference to municipal employees. Assume further that the number of affordable units is small enough that it is clear that employees will fill all of the affordable units. One hundred municipal employees fall below the income limit; eighty of them are White, while twenty are Black. Four hundred nonemployees fall below the income limit; 240 are White and 160 are Black. Finally, of the other 4,500 municipal residents, 4,000 are White and 500 are Black.

In assessing a disparate impact claim, how should a court determine who has been adversely affected by the employee preference?<sup>70</sup> One might start with nonemployees who meet the income qualification—60% of whom are White and 40% of whom are Black. But there is no certainty that any particular nonemployee would want the affordable housing. Conversely, some nonresidents who meet the income qualification might want the housing. Moreover, should a court treat the income qualification as a given, or should the employment preference be treated in conjunction with the income qualification? If one treats the two qualifications as part of the same governmental action (that is, the government has simultaneously excluded nonemployees and “high-income” individuals), some residents or nonresidents who want the housing, but who do not meet the income qualification, would also be adversely affected.

Once a court determines who has been adversely affected by a government practice, the court must evaluate whether the impact of that practice has been disparate. Suppose, for instance, a court decides that all resident nonemployees

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inexorably lead’ governmental or private entities to use ‘numerical quotas,’ and serious constitutional questions then could arise.” (quoting *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 653 (1989), *superseded by statute on other grounds*, 42 U.S.C. § 2000e-2(k)).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> Courts have recognized that statistical evidence must identify “the subset of the population affected by the challenged policy.” *Reinhart v. Lincoln Cnty.*, 482 F.3d 1225, 1230 (10th Cir. 2007); *see also Hallmark Devs., Inc. v. Fulton Cnty.*, 466 F.3d 1276, 1286 (11th Cir. 2006) (noting need to determine “the impact on the total group to which a policy or decision applies”). *See generally* Robert G. Schwemm & Calvin Bradford, *Proving Disparate Impact in Fair Housing Cases After Inclusive Communities*, 19 N.Y.U. J. LEGIS. & PUB. POL’Y 685 (2016) (noting that affected population will vary depending on nature of the case).

who meet the income threshold are adversely affected. One approach is to compare the percentage of the group in protected classes with the percentage in nonprotected classes—in the hypothetical, 60% of those adversely affected are White, and 40% are Black. Those percentages, however, have meaning only in comparison to some baseline, which could be either the percentage of each group eligible for the housing, or the percentage of each group in the population at large (raising questions about what population should be considered).<sup>71</sup> That is, one could compare the 40% of those adversely affected who were Black with: (1) the 20% of those benefited who were Black, (2) the 36% of income-eligible residents who were Black, or (3) the 14% of the municipal population that was Black.<sup>72</sup> Alternatively, one could emphasize that the employment qualification excludes 89% of Black people who meet the income qualification but only 75% of White people who meet the qualification.<sup>73</sup> Framing, too, might be significant. The chance of a Black applicant being excluded by the policy (89%) is only 14% greater than the chance of a White applicant being excluded (75%). Or one might contend that the employment qualification makes housing available to 11% of potential Black applicants but to 25% of potential White applicants—so that the chance of a potential White applicant obtaining housing is more than 200% greater than the chance of a potential Black applicant.

All of these measures show some disparity between treatment of White people and Black people. That leads to the next question: How disparate must the impact be to support a disparate impact claim? Equal Employment Opportunity Commission guidelines suggest that the impact of Title VII's tests is disparate when the percentage of protected class members who pass is less than 80% of the percentage of nonprotected test-takers who pass.<sup>74</sup> Challenges to job tests, however, raise few questions about the persons affected by the test policy; persons who take the test present a discrete, well-defined class. By contrast, as the example above illustrates, many FHA claims, particularly those involving challenges to municipal zoning practices, involve considerably more speculation about who will be affected by the challenged practices. Section II.C will demonstrate that speculation rises to another level when the challenge is to zoning regulations that affect housing affordability. One might, therefore, demand greater disparity to support a disparate impact claim. And, in fact, most

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<sup>71</sup> See Schwemm & Bradford, *supra* note 70, at 699 (noting that absolute numbers are misleading because in a heavily White area, a policy might screen out more White people than Black people but still have a disproportionate impact on Black people).

<sup>72</sup> See *id.* at 704 (discussing comparison between percentage of those adversely affected who are Black with percentage of Black people in the overall population).

<sup>73</sup> Cf. *id.* at 703 (discussing job tests that exclude higher percentage of Black people than White people).

<sup>74</sup> See 29 C.F.R. § 1607.4(D) (2021).



successful claims have rested on significantly greater disparity, while not coalescing on any particular standard or test.<sup>75</sup>

#### D. Policy

In *Inclusive Communities*, the Court made it clear that statistical disparity alone is not sufficient to make out a prima facie disparate impact claim. Instead, the plaintiff must establish that the challenged action is the product of a “policy.”<sup>76</sup> To elaborate on what might not constitute such a policy, the Court posited “the decision of a private developer to construct a new building in one location rather than another . . . may not be a policy at all.”<sup>77</sup>

Whether a onetime decision to deny a zoning amendment to permit multifamily housing at a particular site constitutes a “policy” is a question the Court did not explicitly address. Perhaps every decision by a local legislative or administrative body constitutes a policy for purposes of the FHA. Indeed, several of the disparate impact cases the Court cited with apparent approval were cases involving zoning amendment denials.<sup>78</sup> But the Court’s opinion leaves open the possibility that some government decisions might not constitute policy.

#### E. Causation

Even a plaintiff who identifies a local government policy does not make out a prima facie case of disparate impact without establishing a causal connection between the policy and a statistical disparity. The Court emphasized that “[a] robust causality requirement ensures that ‘[r]acial imbalance . . . does not, without more, establish a prima facie case of disparate impact’ and thus protects defendants from being held liable for racial disparities they did not create.”<sup>79</sup>

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<sup>75</sup> See Schwemm & Bradford, *supra* note 70, at 707. Indeed, finding disparate impact is easiest in those FHA cases that do involve a discrete, well-defined class of affected persons. For instance, when, as in *Mt. Holly Gardens Citizens in Action, Inc. v. Township of Mount Holly*, 658 F.3d 375 (3d Cir. 2011), an urban renewal project involves displacement of a discrete group of residents, a disproportionate number of whom are members of protected classes, the only speculation is about the relevant comparison group; the persons adversely affected are beyond dispute. *Id.* at 382-83.

<sup>76</sup> *Tex. Dep’t of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 542-43 (2015) (asserting that if plaintiff is unable to show “causal connection” between the policy and the disparate impact, the case should be dismissed).

<sup>77</sup> *Id.* at 543.

<sup>78</sup> See, e.g., *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 942 (2d Cir. 1988) (holding that the town had violated Title VIII of the Civil Rights Act by using their zoning ordinance to restrict private construction of low-income housing); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1294-95 (7th Cir. 1977) (remanding the case for clarification of discriminatory effect of appellees’ refusal to rezone).

<sup>79</sup> *Inclusive Cmty.*, 576 U.S. at 542 (alterations in original) (quoting *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 653 (1989), *superseded by statute on other grounds*, 42 U.S.C. § 2000e-2(k)).

As with the policy requirement, the Court's opinion leaves open what evidence would satisfy causation. The Court's opinion offers two examples of when a plaintiff might be unable to prove causation. First, a plaintiff challenging a developer's decision to locate a building in a particular location might find it difficult to prove causation "because of the multiple factors that go into investment decisions about where to construct or renovate housing units."<sup>80</sup> Second, the Court noted that in *Inclusive Communities* itself, if the Inclusive Communities Project could not show a causal connection between the Texas Department of Housing and Community Affairs' policy and a disparate impact—"for instance, because federal law substantially limits the Department's discretion—that should result in dismissal of this case."<sup>81</sup>

If and when a governmental body with zoning authority has no discretion with respect to a zoning application there is, of course, little basis for concluding that the body's determination caused a disparate impact. But the Court's other example—no causation when multiple factors contribute to a decision—is more difficult to decipher. Most zoning decisions involve multiple factors—traffic, adequacy of water supply and sewers, fiscal impact, and environmental concerns.<sup>82</sup> If the Court's opinion indicates that the existence of multiple factors precludes a finding that a particular government policy caused the disparate impact, then virtually every FHA claim would fail to survive summary judgment. That appears inconsistent with the Court's endorsement of disparate impact liability, but how to reconcile the two strands of the Court's opinion remains unclear.

#### F. *Justification*

While the policy and causation requirements operate to foreclose FHA claims at the prima facie case stage, municipalities and other FHA defendants can also defend themselves by establishing adequate justifications for the challenged policy. Citing to HUD regulations, the Court analogized to the "business necessity" standard under Title VII, but noted that the Title VII framework "may not transfer exactly to the fair-housing context."<sup>83</sup>

The Court emphasized that FHA defendants must be given "leeway to state and explain the valid interest served by their policies,"<sup>84</sup> and emphasized that "[z]oning officials . . . must often make decisions based on a mix of factors" that

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<sup>80</sup> *Id.* at 543.

<sup>81</sup> *Id.*

<sup>82</sup> Section 3 of A Standard State Zoning Enabling Act explicitly includes among the permissible purposes of zoning "to secure safety from fire, panic, and other dangers; to promote health and the general welfare; to provide adequate light and air; to prevent the overcrowding of land; to avoid undue concentration of population; to facilitate the adequate provision of transportation, water, sewerage, schools, parks, and other public requirements." A STANDARD STATE ZONING ENABLING ACT § 3 (U.S. DEP'T OF COM. 1926).

<sup>83</sup> *Inclusive Cmty.*, 576 U.S. at 541.

<sup>84</sup> *Id.*

“contribute to a community’s quality of life and are legitimate concerns for housing authorities.”<sup>85</sup> The Court did not, however, explain how much deference is due to justifications offered by municipal officials for their zoning decisions. Moreover, the Court was silent about the plaintiff’s opportunity to demonstrate that the municipality’s legitimate objective could be achieved in a manner that generated less discriminatory impact, although the Court’s citation to the HUD regulations might suggest an implicit endorsement of HUD’s approach.

### G. *Subsequent HUD Modifications*

In 2020, HUD revised its FHA regulations, ostensibly to “better reflect” the Court’s opinion in *Inclusive Communities*.<sup>86</sup> The revised regulations required plaintiffs to establish, at the pleading stage, that “the challenged policy or practice is arbitrary, artificial, and unnecessary to achieve a valid interest or legitimate objective such as a practical business, profit, policy consideration, or requirement of law.”<sup>87</sup> In justifying the change, HUD accurately noted Justice Kennedy’s concern that disparate impact liability operates to remove “artificial, arbitrary, and unnecessary barriers,”<sup>88</sup> but failed to note that the Court’s opinion nowhere suggested that a plaintiff would have to prove arbitrariness to make out a *prima facie* case.

The revised regulations also deleted the prior version’s explicit reference to the perpetuation of segregation theory. In explaining the change, HUD concluded that its rule “does not limit claims that result in unlawful segregation,” concluding that “segregation may be the harmful unlawful result of a policy or practice that violates the disparate impact standard.”<sup>89</sup> In other words, the 2020 revisions rejected the premise that perpetuation of segregation constitutes an independent FHA theory; instead, a policy or practice that perpetuates segregation is unlawful only if the perpetuation of segregation is a by-product of violation of the disparate impact standard.

Whether the 2020 revisions will have any impact on litigation remains to be seen. Although the Court cited the 2013 regulations in *Inclusive Communities*, the Court did not treat them as authoritative, and the 2020 revisions may fare no better in the Court’s hands. Moreover, they are not likely to survive for long with the Biden Administration. HUD has already taken steps to reinstate the Obama Administration’s requirement that recipients of federal funding take meaningful actions to replace segregated living patterns with “truly integrated and balanced

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<sup>85</sup> *Id.* at 542.

<sup>86</sup> HUD’s Implementation of the Fair Housing Act’s Disparate Impact Standard, 85 Fed. Reg. 60,288, 60,288 (Sept. 24, 2020) (codified at 24 C.F.R. pt. 100) (revising burden-shifting test for determining whether given practice has unjustified discriminatory effect).

<sup>87</sup> *Id.* at 60,332. Compare 24 C.F.R. § 100.500(b)(1) (2013), with HUD’s Implementation of the Fair Housing Act’s Disparate Impact Standard, 85 Fed. Reg. at 60,332.

<sup>88</sup> HUD’s Implementation of the Fair Housing Act’s Disparate Impact Standard, 85 Fed. Reg. at 60,299 (quoting *Inclusive Cmty.*, 576 U.S. at 543).

<sup>89</sup> *Id.* at 60,313.

living patterns.”<sup>90</sup> Revisions to the 2020 discriminatory effect standard may not be far behind. Whatever HUD does, however, the current Court may, like the drafters of the 2020 revisions, prove unwilling to recognize the claim that perpetuation of segregation represents an FHA violation even in the absence of a disparate impact on a protected class.

## II. THE FHA AND ZONING OUT THE POOR: STATISTICAL EVIDENCE BASED ON CORRELATIONS BETWEEN RACE AND INCOME

### A. Introduction

Fiscal zoning’s objective is to exclude those who pay less in taxes than they consume in services. Because real estate taxes are tied to home values,<sup>91</sup> those who occupy lower-value homes are natural targets of fiscal zoning. Municipalities engaged in fiscal zoning typically welcome lower value homes only if those homes are occupied by childless occupants who use fewer of the most expensive municipal services—public schools.<sup>92</sup> By contrast, families who do use local schools are welcome only if they pay for those schools through the high real estate taxes generated by expensive homes.<sup>93</sup>

In light of *Inclusive Communities*, can a plaintiff successfully challenge zoning policies that increase the cost of housing based on the statistical disparity in income and wealth between White families and Black or Hispanic families? Many fiscal zoning practices, including restrictions on multifamily housing and large-lot zoning, increase housing costs.<sup>94</sup>

Consider the following syllogism. Lower-value homes tend, on average, to be occupied by persons with lower incomes. Because members of minority groups, on average, have lower incomes than White people, fiscal zoning has a disparate impact on members of those minority groups. Because of this disparate impact, fiscal zoning constitutes a prima facie violation of the FHA.

As attractive as it may seem, the syllogism raises a number of interrelated problems. First, if the syllogism holds, it would invalidate nearly all zoning, not merely fiscal zoning, because virtually all zoning restrictions increase housing prices. Second, even if, on average, members of minority groups have lower incomes than White people, zoning restrictions do not operate “on average.”

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<sup>90</sup> Restoring Affirmatively Furthering Fair Housing Definitions and Certifications, 86 Fed. Reg. 30,779, 30,783 (June 10, 2021) (codified at 24 C.F.R. pt. 5).

<sup>91</sup> See, e.g., CAL. GOV’T CODE § 43004.5(a) (West 2021) (expressing tax rates as percentage of full value of property).

<sup>92</sup> On average, about two-thirds of property tax revenues are used to pay for school expenses. FISCHER, *supra* note 26, at 152-53.

<sup>93</sup> See Christopher Serkin, *Divergence in Land Use Regulations and Property Rights*, 92 S. CAL. L. REV. 1055, 1064-65 (2019) (“[L]ocal governments often seek to exclude affordable housing because low-income households generate relatively little revenue and yet place significant burdens on municipal budgets through impacts on schools and other municipal services.”).

<sup>94</sup> See, e.g., Glaeser & Gyourko, *supra* note 3, at 8.

Fiscal zoning restrictions do not cause disparate impact if, even absent those restrictions, housing costs would make housing in the area inaccessible to members of minority groups.<sup>95</sup> Third, assume that expenditure control (or maintaining low taxes) is a reasonable objective for any government entity. If no mechanism other than fiscal zoning would enable a municipality to achieve that objective, any municipality that engaged in fiscal zoning could cite that objective to rebut the prima facie case. It would then be pointless to conclude that fiscal zoning constitutes a prima facie violation of the FHA.

This Part explores these problems. The next Section examines existing case law, much of it decided before *Inclusive Communities* but some of it cited with approval in the *Inclusive Communities* opinion. The succeeding Section examines the limits on statistical evidence in cases involving fiscal zoning. The final Section explores how *Inclusive Communities*' policy, causation, and justification requirements limit claims that fiscal zoning violates the FHA.

### B. Case Law

Disparate impact claims based on the correlation between race and income often raise questions of discriminatory intent as well as disparate impact.<sup>96</sup> As a result, the vitality of discriminatory impact claims based solely on the correlation between race and income remains a matter of conjecture. In cases presenting claims of both disparate impact and disparate treatment, a court's natural instinct may be to deny summary judgment to the municipality on the disparate impact claim if evidence of discriminatory intent warrants denial of summary judgment on the plaintiff's discriminatory treatment claim. After all, as even the dissenters in *Inclusive Communities* recognized, evidence of disparate impact is relevant in assessing discriminatory treatment.<sup>97</sup> Moreover, allowing the disparate impact claim to go forward may encourage the municipality to settle the case without implicitly admitting to discriminatory intent.

Nevertheless, the case law does permit some generalizations. Courts generally reject challenges to restrictive zoning amendments when the challenges are brought by private developers of market-rate housing, even if the plaintiff offers evidence that the amendment will increase housing costs. *Reinhart v. Lincoln County* is illustrative.<sup>98</sup> The Tenth Circuit awarded summary judgment to the county on the developer's claim that an increase in minimum lot size violated the FHA because the larger lot size would significantly raise housing cost.<sup>99</sup> In

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<sup>95</sup> *Reinhart v. Lincoln Cnty.*, 482 F.3d 1225, 1230 (10th Cir. 2007) ("It is essential to be able to compare who could afford the housing before the new regulations with who could it afford it afterwards.").

<sup>96</sup> See, e.g., *Reyes v. Waples Mobile Home Park Ltd. P'ship*, 903 F.3d 415, 430 (4th Cir. 2018).

<sup>97</sup> *Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 588 (2015) (Alito, J., dissenting).

<sup>98</sup> 482 F.3d 1225 (10th Cir. 2007).

<sup>99</sup> *Id.* at 1231-32.

awarding summary judgment, the court observed that “[i]t is not enough for the Reinharts to show that (1) a regulation would increase housing costs and (2) members of a protected group tend to be less wealthy than others.”<sup>100</sup> The court did not decide whether a disparate impact claim could be premised on increased cost alone<sup>101</sup> but indicated that such a claim could certainly not succeed without a comparison between those who could afford the housing before the new regulation and those who could afford it after enactment.<sup>102</sup> *Reinhart* is not alone. Other cases have rejected FHA challenges to zoning amendments increasing minimum lot size or minimum square footage, even though challengers in those cases contended that the resulting increase in home prices would have a disparate impact on members of protected classes.<sup>103</sup>

By contrast, when a municipality enacts a restrictive zoning amendment in response to a particular project that includes a subsidized or affordable component, courts are more likely to sustain disparate impact challenges based on housing cost. For instance, in *City of Black Jack*, one of the earliest FHA challenges to zoning practices, the Eighth Circuit invalidated a zoning amendment prohibiting multifamily housing in a newly incorporated city.<sup>104</sup> The amendment was a response to a townhouse project designed to meet the needs of families whose incomes were between one-third and two-thirds of the average

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<sup>100</sup> *Id.* at 1230.

<sup>101</sup> The district court, relying on language in *Hemisphere Building Co. v. Village of Richton Park*, 171 F.3d 437 (7th Cir. 1999), had held that a disparate impact claim could not be founded solely on increased housing cost. See *Reinhart*, 482 F.3d at 1228, 1232 (affirming district court’s grant of summary judgment on the Reinharts’ disparate impact claim).

<sup>102</sup> *Id.* at 1230-31. The court observed, with the aid of a chart, that it might be that no members of protected classes could have afforded housing before enactment of the new regulations, or that all members who could have afforded housing before enactment could also afford it after enactment. *Id.* at 1230 n.2.

<sup>103</sup> See *Homebuilders Ass’n of Miss., Inc. v. City of Brandon*, 640 F. Supp. 2d 835, 842 (S.D. Miss. 2009) (holding that, despite evidence that “African Americans had a lower annual income than Whites, and that fewer African Americans would be able to afford a home with a minimum living space of 1,600 square feet than Whites,” plaintiffs did not establish invalidity of minimum square footage requirement); *NAACP v. City of Kyle*, No. 1:05-cv-00979, 2009 WL 6574497, at \*3 (W.D. Tex. Mar. 20, 2009) (holding that plaintiffs did not establish invalidity of zoning amendment with evidence that amendment would allegedly increase average prices of new homes from \$100,000 to \$133,000; the court noted that accepting plaintiffs’ argument would drastically reduce municipal zoning power because “any change to an ordinance that resulted in a price increase would arguably impact minorities more than the ethnic majority in the area examined”).

<sup>104</sup> *United States v. City of Black Jack*, 508 F.2d 1179, 1188 (8th Cir. 1974). For a discussion of the role of municipal incorporation in perpetuating segregated housing patterns and, specifically, the impact that losing a critical tax base has on the population left outside of an incorporated area, see Jenna Raden, Comment, *Fragmenting Local Governance and Fracturing America’s Suburbs: An Analysis of Municipal Incorporations and Segregative Effect Liability Under the Fair Housing Act*, 94 TUL. L. REV. 365, 394-95 (2020).

income of current residents of the city.<sup>105</sup> The city's Black residents made up between 1% and 2% of the total population,<sup>106</sup> and the developer's plan was "to assure that members of the black community would be aware of the opportunity to live" in the development.<sup>107</sup> Faced with a district court finding that plaintiffs had failed to establish discriminatory motivation,<sup>108</sup> the Eighth Circuit held that the zoning amendment had a discriminatory effect—emphasizing that the prohibition on multifamily housing foreclosed 85% of Black residents of the metropolitan area from living in the city.<sup>109</sup>

Municipalities often retain control over development by limiting as-of-right development and then scrutinizing individual development proposals.<sup>110</sup> As a result, in established municipalities, restrictive zoning amendments of the sort at issue in *Reinhart* and *City of Black Jack* are the exception rather than the rule. More commonly, developers seek amendment of zoning ordinances to enable more intensive development, and challenge municipal refusal to amend.<sup>111</sup> In an early influential case, *Arlington Heights*, the Seventh Circuit concluded that this difference in context should not matter for FHA purposes.<sup>112</sup>

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<sup>105</sup> See *City of Black Jack*, 508 F.2d at 1182-83. The district court, reversed by the Eighth Circuit, established that the incorporation itself was a response to another proposed development of low-cost single-family homes, a development never built. See *United States v. City of Black Jack*, 372 F. Supp. 319, 322-24 (E.D. Mo. 1974).

<sup>106</sup> *City of Black Jack*, 508 F.2d at 1183.

<sup>107</sup> *Id.* at 1186.

<sup>108</sup> *City of Black Jack*, 372 F. Supp. 319 at 329. The district court conceded that racial statements might be attributed to one zoning commissioner of twelve, as well as "a very insignificant number of Black Jack residents," but noted that the zoning commission, which had two Black members, had passed the ordinance unanimously. *Id.*

<sup>109</sup> See *City of Black Jack*, 508 F.2d at 1186.

<sup>110</sup> See Mark Fenster, *Takings Formalism and Regulatory Formulas: Exactions and the Consequences of Clarity*, 92 CALIF. L. REV. 609, 622-24 (2004). Sometimes that scrutiny involves a variety of local boards, each of which can block or delay development. See generally Stewart E. Sterk, *Exploring Taxation as a Substitute for Overregulation in the Development Process*, 78 BROOK. L. REV. 417, 421-27 (2013) (discussing various processes municipalities use to scrutinize individual developments).

<sup>111</sup> See, e.g., *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 928 (2d Cir. 1988) (involving town refusal to amend ordinance which restricted private multifamily housing projects to largely minority urban renewal areas); *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1286 (7th Cir. 1977) (pertaining to attempt to compel the village to rezone property in order to permit construction of federally financed low-cost housing); *Inclusive Cmty. Project, Inc. v. Town of Flower Mound*, No. 4:08-cv-00433, 2011 WL 13220388, at \*4 (E.D. Tex. Mar. 29, 2011) (considering claim by nonprofit organization, which implements affordable housing initiatives, that town refused to take steps to increase available affordable housing); *Dews v. Town of Sunnyvale*, 109 F. Supp. 2d 526, 529 (N.D. Tex. 2000) (challenging town zoning ordinance which banned apartments and implemented one-acre zoning requirement for residential developments).

<sup>112</sup> *Arlington Heights*, 558 F.2d at 1292-93 ("[N]either common sense nor the rationale of the Fair Housing Act dictates that the preclusion of minorities in advance should be favored

Nevertheless, courts have been divided over whether the correlation between race and income is enough in itself to make out a *prima facie* case of disparate impact when a municipality denies a zoning amendment to a developer of low-cost housing. In *Hallmark Developers, Inc. v. Fulton County*,<sup>113</sup> the Eleventh Circuit granted summary judgment to the county, dismissing the developer's challenge to the county's refusal to amend its ordinance to permit mixed-use development in what had previously been an agricultural district.<sup>114</sup> The developer had introduced expert testimony that, by blocking the developer's planned construction of affordable housing, the denial of the proposed rezoning would have a disparate impact on members of minority groups.<sup>115</sup> The court, however, discounted that testimony for two reasons: first, the expert's conclusions about who would move into the housing was inherently speculative, especially because the developer offered no assurances about what the ultimate sale prices would be; and second, because there was already an adequate supply of low-cost housing within the county, there was little reason to believe that refusal to amend the ordinance would make housing unavailable to members of protected groups.<sup>116</sup> The court emphasized that accepting the developer's expert testimony about cost as sufficient would effectively invalidate all refusals to rezone land for more intensive residential development.

By contrast, in *Avenue 6E Investments, LLC v. City of Yuma*,<sup>117</sup> the Ninth Circuit denied summary judgment to the city on the developer's claim that the city's refusal to reduce minimum lot size would have a disparate impact on potential Hispanic buyers.<sup>118</sup> The court acknowledged and rejected the *Hallmark* court's reliance on housing elsewhere in the municipality, noting first that *Hallmark* was decided before the Supreme Court's opinion in *Inclusive Communities*,<sup>119</sup> and then concluding that the character of different neighborhoods within the same municipality militates against the conclusion that available housing in other neighborhoods precludes a finding of disparate impact.<sup>120</sup> The court also dismissed the concern that its holding would require

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over the preclusion of minorities in reaction to a plan which would create integration."'). Earlier, the Supreme Court had indicated that, for equal protection purposes, where proof of discriminatory intent is critical, the context might matter. *See Vill. of Arlington Heights v. Metro. Hous. Dev. Corp.*, 429 U.S. 252, 267 (1977) ("Departures from the normal procedural sequence . . . might afford evidence that improper purposes are playing a role." (footnote omitted)).

<sup>113</sup> 466 F.3d 1276 (11th Cir. 2006).

<sup>114</sup> *Id.* at 1288.

<sup>115</sup> *Id.* at 1282.

<sup>116</sup> *Id.* at 1285-87.

<sup>117</sup> 818 F.3d 493 (9th Cir. 2016).

<sup>118</sup> *Id.* at 513.

<sup>119</sup> *Id.* at 510.

<sup>120</sup> *Id.* at 511.



approval of all rezoning applications, noting that the municipality would have the opportunity to rebut the *prima facie* case of disparate impact.<sup>121</sup>

### C. *Statistics and Economics*

In *Inclusive Communities*, the Court acknowledged that statistics would often serve as the foundation for disparate impact claims.<sup>122</sup> Both decided cases and scholarly literature have relied on statistical analysis to evaluate these claims.<sup>123</sup> Much of the discussion focuses on the availability of data and on statistical methods.<sup>124</sup> But the assumptions on which much of the statistical analysis is founded also raise a host of problems.

#### 1. Ascertaining Who Is Affected

In determining whether a challenged action has a disparate impact on members of a protected class, an initial step is determining who has been adversely affected by the action.<sup>125</sup> In Title VII cases—often invoked by analogy in FHA disputes<sup>126</sup>—the group of affected parties is sometimes easy to identify. For instance, if the challenge is to an employer’s layoff policies, the persons adversely affected are those who are laid off. If the challenge is to the use of test scores to select among job applicants, the applicants excluded by the test scores are the adversely affected parties. In other situations, however, stated job

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<sup>121</sup> *Id.* at 512-13.

<sup>122</sup> *Tex. Dep’t of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 543 (2015) (“A plaintiff who fails to allege facts at the pleading stage or produce statistical evidence demonstrating a causal connection cannot make out a *prima facie* case of disparate impact.”).

<sup>123</sup> *See, e.g., Reinhart v. Lincoln Cnty.*, 482 F.3d 1225, 1229-32 (10th Cir. 2007) (relying on an absence of evidence conveying percentages of protected and nonprotected persons who would be priced out of market to hold that Reinharts failed to show that specific policy caused significant disparate effect on protected group); *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 937-38 (2d Cir. 1988) (pointing to evidence indicating that Huntington’s zoning ordinance would impede integration by restricting low-income housing needed by minorities to an area already with a 52% minority population). Academic commentary on statistical analysis has been somewhat sparse. *Proving Disparate Impact in Fair Housing Cases After Inclusive Communities* is perhaps the leading article. *See* Schwemm & Bradford, *supra* note 70. Schwemm is also the author of a treatise on FHA litigation while Bradford has testified as an expert in support of discriminatory impact claims. *See also* Brian J. Connolly, *Promise Unfulfilled? Zoning, Disparate Impact, and Affirmatively Furthering Fair Housing*, 48 URB. LAW. 785, 833-36 (2016) (evaluating *MHANY Management v. Village of Garden City*’s use of statistics in its holding).

<sup>124</sup> *See* Schwemm & Bradford, *supra* note 70, at 710-18 (discussing data sources); *id.* at 697-709 (discussing statistical methods).

<sup>125</sup> *See id.* at 719 (noting that identifying group of persons affected by policy, and persons within affected group who are members of the protected group, are essential steps in FHA disparate impact cases).

<sup>126</sup> *See, e.g., Wetzel v. Glen St. Andrew Living Cmty., LLC*, 901 F.3d 856, 863 (7th Cir. 2018).

requirements may discourage potential applicants from applying, leaving courts to rely on more speculative data.<sup>127</sup>

With some subset of land use cases, ascertaining the affected parties is not problematic. For instance, when an urban renewal project would displace existing residents of an area, the parties affected are the households evicted. If the municipality refuses to permit construction of a subsidized housing project, and there is a waiting list for subsidized housing, the persons on that list are likely to be adversely affected. The effect, however, is less concrete because members of the waiting list might not have been willing to move to the particular project the municipality has nixed.

When restrictions on minimum lot size or prohibitions on apartments limit the ability of developers to provide affordable housing, ascertaining the persons affected is more speculative. There is no way to know for sure who would have taken advantage of the housing opportunities the municipality has denied. From what geographical area would the prospective residents have come? How much would potential residents have stretched their financial resources to buy the rejected housing? Even if it were certain what housing developers would have built and at what price the prohibited housing would have sold, difficult questions would remain about the effect of the prohibitions on the housing market. These questions are even more challenging in the absence of guarantees about developer pricing.

## 2. Identifying the Comparison Pool

Once a court determines the persons affected by a zoning decision, the next step is determining whether the impact on members of a protected class is disparate.<sup>128</sup> Suppose, for instance, 100 prospective residents were excluded as a result of a zoning determination, and 50% of them were members of a protected class. Determining whether that percentage is high or low requires a basis for comparison. Geographically, the comparison group might be drawn from residents of the municipality, residents of the county, or residents of the metropolitan area. But should the comparison group include all households within the geographical area, or only households who currently live in rental housing, or who currently live in new construction? Logic does not generate an

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<sup>127</sup> See, e.g., *Dothard v. Rawlinson*, 433 U.S. 321, 330 (1977) (authorizing use of national statistics on height and weight in making out prima facie case challenging minimum height and weight requirements for prison guards because requirements themselves might cause those who do not meet requirements not to apply). See generally RAMONA L. PAETZOLD & JASON R. BENT, *THE STATISTICS OF DISCRIMINATION: USING STATISTICAL EVIDENCE IN EMPLOYMENT DISCRIMINATION CASES* § 5:4, Westlaw (database updated Oct. 2020) (“When other populations must be used to demonstrate the nature of the impact, the considerations regarding qualification, interest, and geographic location are similar to those described for systemic disparate treatment cases.”).

<sup>128</sup> See Schwemm & Bradford, *supra* note 70, at 719 (noting that identifying proper comparison group is essential step in FHA disparate impact cases).

answer to these questions, and the disparity might vary depending on the chosen comparison pool.

### 3. Assumptions in Practice: Case Law

When faced with FHA challenges to land use determinations, courts have had to make assumptions about the affected group and the appropriate comparison group. The following cases illustrate how statistical analysis can be problematic even in disparate impact cases that one might consider relatively simple.

#### a. Mt. Holly Gardens

*Mt. Holly Gardens Citizens in Action, Inc. v. Township of Mount Holly*<sup>129</sup> illustrates the most straightforward of FHA challenges to land use practices: one in which the persons most directly affected can easily be identified. Neighborhood residents challenged an urban redevelopment plan that would have demolished homes, a large percentage of which were occupied by Black and Hispanic residents.<sup>130</sup>

In determining that the residents had made out a *prima facie* case, the Third Circuit concluded that the impact on minority residents was disparate by comparing the percentage of Black and Hispanic residents of the town who were displaced by the demolition (22.54% and 32.31%, respectively) with the percentage of White households displaced (2.73%).<sup>131</sup> But the court offered no explanation for why town households were the appropriate comparison group and, indeed, went on to use residents of the county, rather than the town, for another comparison.<sup>132</sup> In *Mt. Holly Gardens* itself, the choice of comparator was not a significant issue because the impact on the affected group was disparate by any reasonable measure, but the court's opinion highlights one of the problems with statistical analysis.

#### b. Huntington Branch

Unlike *Mt. Holly Gardens*, most FHA challenges involve some speculation about who might be adversely affected by government action. When that action forecloses construction of subsidized housing, a court might use the waiting list for that housing as an estimate of the persons adversely affected. In *Huntington Branch, NAACP v. Town of Huntington*,<sup>133</sup> the Second Circuit took that course.

The court held that the town violated the FHA when it refused to amend its zoning ordinance to permit construction of a subsidized apartment complex in

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<sup>129</sup> 658 F.3d 375 (3d Cir. 2011).

<sup>130</sup> *Id.* at 379-89.

<sup>131</sup> *Id.* at 382.

<sup>132</sup> *See id.* ("[T]he 2000 data showed that only 21% of African-American and Hispanic households in Burlington County would be able to afford new market-rate housing in the Gardens, compared to 79% of White households.").

<sup>133</sup> 844 F.2d 926 (2d Cir. 1988).

an all-White neighborhood.<sup>134</sup> In finding disparate impact, the court emphasized that Black families were disproportionately represented among families occupying subsidized housing and those on the waiting list for that housing.<sup>135</sup> In a footnote, the court acknowledged that Title VII case law generally requires that statistics bear “a proven relationship to the actual applicant flow,” noting that minority groups made up 74%, 45%, and 61% of the waiting list for three already-existing subsidized housing developments within the town.<sup>136</sup> The court did not indicate how it would have dealt with the disparate impact claim in the absence of that applicant flow data.

c. City of Black Jack

In another class of cases, courts have found disparate impact despite the complete absence of evidence about applicant flow. *City of Black Jack*’s invalidation of a zoning ordinance prohibiting all multifamily housing is illustrative.<sup>137</sup> Despite compelling evidence of discriminatory treatment,<sup>138</sup> the Eighth Circuit rested its decision on the ordinance’s discriminatory effect. In doing so, the court relied solely on the income disparity between Black and White residents in the St. Louis metropolitan area, without any evidence about who might choose to move into the apartments proposed by the developer whose project triggered the zoning amendment.<sup>139</sup> Moreover, the court rejected the trial court’s analysis, which found no disparate impact because 29% of Black residents and 32% of White residents in the metropolitan area (a difference the court deemed immaterial) had incomes in the range the development was designed to serve.<sup>140</sup> Instead, the Eighth Circuit noted that 85% of the Black residents of the metropolitan area would be foreclosed from housing in the city,<sup>141</sup> without acknowledging that many of those residents would not qualify for the subsidized housing provided by the developer.

Consider the court’s own numbers. Fifteen percent of the Black residents of the St. Louis metropolitan area had the financial capacity to move to Black Jack—even without the zoning amendment—but Black Jack’s population was between 1% and 2% Black.<sup>142</sup> That is, Black residents of the metropolitan area found Black Jack an unattractive community—perhaps because existing

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<sup>134</sup> *Id.* at 941-42.

<sup>135</sup> *Id.* at 929.

<sup>136</sup> *Id.* at 938 n.11.

<sup>137</sup> *United States v. City of Black Jack*, 508 F.2d 1179, 1188 (8th Cir. 1974).

<sup>138</sup> The court acknowledged that opposition to a proposed multifamily project was repeatedly expressed in racial terms by those lobbying for the prohibition and by zoning commissioners. In the court’s words, “[t]he uncontradicted evidence indicates that, at all levels of opposition, race played a significant role.” *Id.* at 1185 n.3.

<sup>139</sup> *Id.* at 1186.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 1183.

residents made them unwelcome.<sup>143</sup> But if Black homeseekers chose to forego Black Jack even when they had financial capacity, how could the court know that a significant number of Black households would have moved to the proposed subsidized apartment complex—especially when a large percentage of White people were also within the development's target population?

Other courts have been less willing to indulge in the speculation inherent in *City of Black Jack*.<sup>144</sup> Nevertheless, the case illustrates the pitfalls of using statistical evidence that relies only on broad correlations between race and income.

#### 4. Assumptions: Academic Commentary

The preceding Section focused on one problem with the court's analysis in *City of Black Jack*: the difficulty of ascertaining who would move into the housing blocked by the city's zoning ordinance. But *City of Black Jack* presents a more global problem, one that infects much academic analysis of the FHA: the questionable assumption that the housing market can be neatly segmented. That is, the *City of Black Jack* court focused on the zoning ordinance's effect on housing for persons with incomes within the range targeted by the project developer. The court ignored the possibility that prohibition of apartments within the city might increase the price of other available housing, creating an adverse impact on all potential residents of the area, Black and White alike.

Academic treatment of the statute has often made the same assumptions about market segmentation. The analysis of Robert Schwemm, perhaps the most noted academic analyst of the FHA, provides concrete examples. Schwemm and his coauthor, Calvin Bradford, offer FHA analyses of three different zoning practices: zoning that limits multifamily housing,<sup>145</sup> zoning that raises the cost of rental housing,<sup>146</sup> and zoning that raises the cost of home ownership.<sup>147</sup> In

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<sup>143</sup> See Larkin, *supra* note 10, at 1634-36 (noting that African Americans may consciously choose not to integrate because majority Black middle-class communities can offer a concentration of political and economic control over local affairs not available when the Black community remains a minority).

<sup>144</sup> See, e.g., *Macone v. Town of Wakefield*, 277 F.3d 1, 8 (1st Cir. 2002) (dismissing disparate impact claim for absence of proof that minority applicants would move into proposed low-income project).

<sup>145</sup> Schwemm & Bradford, *supra* note 70, at 752-53.

<sup>146</sup> *Id.* at 753-55 (explaining that a town might change height limits for multifamily housing, so that apartment developer cannot build as many units on that site, resulting in developer having to increase monthly rent rates).

<sup>147</sup> *Id.* at 756-60 ("Assume that a suburb . . . rezones a large undeveloped parcel of land zoned for single-family housing to require larger lot sizes. . . . Because of the cost of land, developers are now proposing that the new homes will sell [at a higher price point].").

each case, their sophisticated statistical analysis rests on questionable assumptions about segmentation of the housing market.<sup>148</sup>

a. *Zoning That Limits Multifamily Housing*

Schwemm and Bradford consider a zoning amendment that rezones a large segment of undeveloped land from a category that permits both single- and multifamily housing to a category that permits only single-family housing.<sup>149</sup> They assert that the first step in a disparate impact analysis is to identify the group that is adversely affected,<sup>150</sup> and then state (without further discussion) that the group is “all households that live in buildings defined by the city’s zoning code as multifamily structures.”<sup>151</sup> They then conclude that if the disparity between the percentage of Black households who live in multifamily dwellings and the percentage of White families who live in such dwellings is sufficiently great, challengers have made out a *prima facie* case of discriminatory impact.<sup>152</sup>

Assuming the demand for housing in the area is not completely elastic, residents who currently live in the city’s rental housing would indeed be adversely affected—more so than those excluded by the zoning code.<sup>153</sup> That is because the zoning amendment would inflate housing prices, benefiting homeowners and landlords, who could increase the rents charged to tenants.<sup>154</sup> But the amendment would also adversely affect new tenants—those who move into rental apartments after the amendment suppresses housing supply.<sup>155</sup> That group is more difficult to identify at the time a court considers the amendment’s validity.

The more fundamental error in Schwemm and Bradford’s analysis is the assumption that the group affected is households living in multifamily housing. Apartments and single-family homes are substitutes for one another, albeit imperfect substitutes. More housing of any sort increases supply and drives

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<sup>148</sup> As a trio of housing experts succinctly explained, “additions to the housing stock in one submarket can fairly quickly affect prices and rents in other submarkets by alleviating competition that would otherwise be diverted to those other submarkets.” Vicki Been, Ingrid Gould Ellen & Katherine O’Regan, *Supply Skepticism: Housing Supply and Affordability*, 29 HOUS. POL’Y DEBATE 25, 28 (2018).

<sup>149</sup> Schwemm & Bradford, *supra* note 70, at 752.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 753.

<sup>153</sup> Those who choose to rent within the city despite the increase in price bear the full cost of the price increase generated by the exclusionary policies, while those who choose to rent elsewhere bear only part of the cost. See Ellickson, *supra* note 12, at 402 (noting that the two groups worst affected will be current tenants who do not want to move out and thus have to pay higher rents when they renew their leases, and households that move into the area in future).

<sup>154</sup> See *id.* at 400.

<sup>155</sup> *Id.* at 402.

down prices—of both apartments and single-family homes. A government restriction on housing limits supply and, other things being equal, increases the price of all housing. Thus, the prohibition on apartments has the potential to affect all residents and all potential residents, not just residents of apartments. Current owners of housing in the municipality—both single-family homes and apartments—will be beneficiaries, and all nonowners, whether they seek apartments or single-family homes, will be adversely affected.

b. *Zoning That Raises the Cost of Rental Housing*

Schwemm and Bradford next hypothesize a municipal ordinance that reduces the height limits for multifamily construction.<sup>156</sup> Because a developer will not be able to build as many units on the site, Schwemm and Bradford assume that the developer will have to increase monthly rents.<sup>157</sup> The groups adversely affected, they assert, are households that rent units in the lower rent ranges that would have been charged under the prior height limits.<sup>158</sup> By contrast, they assert that households that rent at the higher rents would find an increased supply of housing.<sup>159</sup> If the difference between the percentage of Black renter households in the lower range minus the percentage in the higher rent range is significantly greater than the comparable difference for White renters, challengers make out a *prima facie* case of disparate impact.<sup>160</sup>

The assumptions that underlie this analysis, however, are questionable. Schwemm and Bradford's underlying assumption must be that the market for housing in the city is significantly segmented from the market for housing elsewhere in the area. Otherwise, the assumption that the developer could respond to a height limit by raising rents is implausible. The prices the developer charges are not a function of cost alone. Prices also reflect demand, and if comparable housing were available in neighboring municipalities at lower rents, the developer would not be able to raise rents in response to the height limits. The effect of the limits would primarily be to reduce the value of the land subject to the height restriction.<sup>161</sup>

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<sup>156</sup> Schwemm & Bradford, *supra* note 70, at 753.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 755. Schwemm and Bradford also suggest an alternative method for making out a *prima facie* case. *Id.* at 754-55. The alternative method is subject to the same criticisms applicable to the method discussed in the text.

<sup>161</sup> The developer would never choose to build unless projected rents are greater than or equal to building costs. If the developer is a price-taker and projected rents are equal to building costs, land value (at least for rental housing) should be zero. If projected rents are higher than building costs, the developer will build no matter what; the greater the difference between projected total rents and building costs, the higher the value of the underlying land. The only way the height limits would affect the quantity of apartments produced would be if the height limit reduces economies of scale and increases the per-unit building cost.

If, however, housing within the municipality commands a premium over housing elsewhere in the area, the result of a height limitation will be to increase housing prices across the board, benefitting existing homeowners at the expense of newcomers at every price point.<sup>162</sup> The increased price of apartments will lead some people who would have rented or bought inexpensive apartments to rent or buy more expensive apartments or homes, and would lead some of the people who would have rented or bought those more expensive apartments to rent or buy still more expensive housing. But if potential residents of all income groups would be adversely affected, Schwemm and Bradford's formula for measuring disparate impact is no longer tenable.

c. *Zoning That Raises the Cost of Home Ownership*

Schwemm and Bradford's discussion of a zoning change that increases the minimum lot size is plagued by analogous difficulties. For example, their discussion assumes that the lot size increase will lead developers who would have built homes in the \$170,000 to \$225,000 range to now build homes that will sell in the \$230,000 to \$285,000 range.<sup>163</sup> They assume that those affected are persons who purchase in the lower price range because the "increase in housing costs restricts their opportunities in the market," while households who purchase homes in the higher range face increased opportunities.<sup>164</sup>

As with zoning that raises the cost of rental housing, the assumption that the zoning change benefits people who look for housing in the higher price range is a questionable one. If the municipality has market power that causes housing within its borders to command a premium, the reduction in supply of housing will increase prices across the board, adversely affecting all potential entrants into the housing market.

If the municipality has no market power, the assumption that the zoning change will increase housing prices is more plausible than in the rental housing case—but only if the increased lot size increases the price potential consumers are willing to pay for homes.<sup>165</sup> If lot size were irrelevant to potential consumers, the increase in lot size would not permit developers to increase prices.<sup>166</sup>

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<sup>162</sup> Cf. Ellickson, *supra* note 12, at 400 (finding that those who already own residential structures in the municipality benefit most from antigrowth measures).

<sup>163</sup> Schwemm & Bradford, *supra* note 70, at 756 (finding developers will increase price because of "cost of land").

<sup>164</sup> *Id.*

<sup>165</sup> One study concludes that the average consumer would be willing to pay a premium for a lot of 15,000 square feet rather than a lot of 10,000 square feet, but that the increased price of large lots is largely due to zoning regulation and not to the premium consumers would be willing to pay. Edward Glaeser & Joseph Gyourko, *Zoning's Steep Price*, REGULATION, Fall 2002, at 24, 27-30 (2002) (concluding that zoning and other land use controls are "more responsible" for high prices of housing).

<sup>166</sup> See Ellickson, *supra* note 12, at 396-97.



## 5. Summary

Because zoning restrictions constrain the supply of housing, they ordinarily increase housing prices, not just of new housing but of all housing. Just as the price increase will exclude some low-income households from housing they would otherwise be able to afford, the increase will exclude high-income households from other housing they would previously have been able to afford. Whether the primary effect of the restriction will fall on persons with lower incomes or on other potential residents is a matter of conjecture and will depend on the overall structure of the housing market.

Even if disparate impact analysis were to focus solely on the housing excluded by a zoning ordinance rather than the ordinance's effect on the overall housing market, uncertainty about the price of homes that would be built with and without the restrictions calls into doubt many assumptions about the ordinance's impact on persons with low incomes. Both uncertainties—about the effect of restrictions on the overall housing market and about the price of new housing developers would build absent the challenged restriction—undermine statistical evidence of disparate impact. However sophisticated the statistical analysis might be, its conclusions cannot be stronger than the assumptions on which the analysis rests.

Some of these difficulties are mitigated when the challenge is brought by a developer of subsidized housing who relies on data about applicants for that housing. When the proposed housing will have income qualifications, the price uncertainty that undermines statistical evidence in cases of market development largely disappears. As a result, disparate impact claims should be easier to substantiate, although, even in these cases, the exclusion of housing may well have a broader effect on the overall market for housing.

## D. Policy, Causation, and Justification

The preceding Section establishes that, in light of the interdependence of various segments of the housing market, proving that particular zoning determinations have a disparate impact on persons in a particular income group is challenging. Moreover, even if one concludes that a housing policy has a disparate impact on persons in a particular income group, it does not always follow that the impact correlates with race.

Suppose, however, one concludes that a fiscal zoning practice has a disparate impact on members of a protected class. *Inclusive Communities* establishes that an FHA claim must still surmount the hurdles of policy, causation, and justification.<sup>167</sup> In the context of fiscal zoning, identifying government policy generally will not be difficult. Proving causation poses more challenges, and avoiding justification presents hurdles that an FHA plaintiff may find impossible to surmount.

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<sup>167</sup> See *Tex. Dep't of Hous. & Cmty. Affs. v. Inclusive Cmty. Project, Inc.*, 576 U.S. 519, 527 (2015).

### 1. Policy

In discussing decisions that might not constitute policies, *Inclusive Communities* provided a single example, and one that involved a private sector actor: the decision to construct a building in one location rather than another.<sup>168</sup> That decision may well be dictated by the location's potential return on investment, and the Court may have signaled that investment decisions do not constitute policy. By contrast, when elected officials determine to permit a particular category of housing in one location rather than another (or in no location at all), it is much more difficult to contend that the decision does not reflect a policy. *Inclusive Communities* offered no examples of decisions by elected officials that would not constitute a policy.

### 2. Causation

Justice Kennedy's cryptic discussion of causation makes it difficult to determine when causation would serve as an obstacle to a disparate impact claim. Of course, if challengers are unable to establish disparate impact, government policy cannot have caused disparate impact. Thus, if disapproval of a zoning amendment or other project has no impact on members of a protected class or has the same impact on members of the population at large as on members of a protected class, the disapproval has no disparate impact and therefore cannot have caused the disparate impact. For instance, as the Tenth Circuit noted in *Reinhart*, if no members of a protected group could afford homes in a projected development before the county increased minimum lot size, the increase would have no impact, and therefore no disparate impact, on members of the protected group.<sup>169</sup>

When challengers can establish both a government policy and a disparate impact, *Inclusive Communities* provides only modest insight into the role of causation. If federal mandates eliminated municipal discretion, the Court's opinion makes it clear that the federal mandates, not the municipal decision, caused the disparate impact.<sup>170</sup> Federal law, however, rarely eliminates all municipal zoning discretion.<sup>171</sup>

Beyond that situation, *Inclusive Communities* provided only that, with respect to a private developer, causation may be difficult to establish "because of the multiple factors that go into investment decisions about where to construct or renovate housing units."<sup>172</sup> Perhaps the opinion is designed to absolve private

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<sup>168</sup> *Id.* at 543 ("[A] plaintiff challenging the decision of a private developer to construct a new building in one location rather than another will not easily be able to show this is a policy causing a disparate impact because such a one-time decision may not be a policy at all.").

<sup>169</sup> *Reinhart v. Lincoln Cnty.*, 482 F.3d 1225, 1230-31 (10th Cir. 2007).

<sup>170</sup> *Inclusive Cmty.*, 576 U.S. at 543 (suggesting that if federal law substantially limits Department's discretion, there may be no causal connection, mandating dismissal of case).

<sup>171</sup> See generally Stewart E. Sterk, *Federal Land Use Intervention as Market Restoration*, 99 B.U. L. REV. 1577 (2019) (discussing role of federal government in land use regulation).

<sup>172</sup> *Inclusive Cmty.*, 576 U.S. at 543.

developers who behave like ordinary market actors concerned about ensuring that the housing they build will sell to potential consumers. In this view, when developers respond to market demand, it is the market demand, not the developer's decision, that causes disparate impact. But if market demand is deemed the cause of disparate impact, one might apply the same analysis to municipal decisions to argue that market demand (influenced by poverty) causes disparate impact when a municipality zones to permit only single-family homes. The Court's limited discussion of causation does not resolve the issue and leaves unclear how much of an obstacle causation might be for disparate impact claims.

### 3. Justification

Consider fiscal zoning—one of the most plausible explanations for zoning policies that increase housing costs. The municipality acts to keep costs low for existing residents by excluding new residents who would pay less in taxes than they consume in services.<sup>173</sup> The municipality does this by imposing building constraints that ensure that new housing will be expensive,<sup>174</sup> effectively excluding the poor, who often consume more in services than they generate in tax revenue. This explanation for exclusion of the poor is plausible because it is entirely consistent with other widely adopted municipal policies—particularly the quest for tax ratables that keep local property taxes low.

This explanation is troubling from a broad policy perspective. It is in the financial interest of residents of every municipality to exclude the poor in favor of clean industry and wealthy residents.<sup>175</sup> If municipalities were to tolerate housing for the poor, the poor they would prefer are the elderly, non-childbearing poor, who won't burden the public schools—typically the most costly municipal service.<sup>176</sup> But if all municipalities act out of the same financial self-interest, the poor are left largely in locations that cannot exclude them: areas where existing housing and municipal facilities have become unattractive to those with the resources to avoid them.<sup>177</sup>

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<sup>173</sup> See FISCHER, *supra* note 15, at 65-67 (describing relationship between zoning and local taxation).

<sup>174</sup> As Fischer notes, municipalities can accomplish this result through a combination of minimum lot sizes and building quality standards. *Id.* at 66 ("No zoning law can legally specify a minimum dollar value, but the matrix of lot size and quality standards that are legal can come pretty close.").

<sup>175</sup> See Aaron J. Saiger, *Local Government Without Tiebout*, 41 URB. LAW. 93, 95 (2009) (noting that allocative efficiency "encourages the rich to withdraw into enclaves that exclude the poor").

<sup>176</sup> See Myron Orfield, *The Region and Taxation: School Finance, Cities, and the Hope for Regional Reform*, 55 BUFF. L. REV. 91, 133 (2007) (noting that school funding is the largest or second-largest local expenditure that taxpayers encounter).

<sup>177</sup> As Richard Schragger has noted, "Mount Laurel exists because it has the legal ability to displace lower-income residents to neighboring Camden." Richard Schragger, *Consuming Government*, 101 MICH. L. REV. 1824, 1850 (2003); see also David A. Super, *A New New*

The FHA issue, however, is a narrower one: does the fiscal zoning explanation qualify as an adequate justification within the statutory context? By analogy to Title VII, is the desire to keep taxes low the equivalent of a “business necessity” for a local municipality?<sup>178</sup>

Important strands of local government and land use scholarship have treated municipalities as entities with objectives similar to those of private firms. The pioneering work of Charles Tiebout argued that competition among municipalities could lead to an efficient level of public services.<sup>179</sup> William Fischel has developed a model that views municipal corporations as “deliberate, value-maximizing agents of homeowners.”<sup>180</sup> The family home is the primary asset of most municipal residents who live outside of major cities.<sup>181</sup> Municipal officials acting on behalf of their residents—the equivalent of their shareholders—seek to maximize home value by keeping taxes low and by reducing stress on municipal services.<sup>182</sup> They do this by ensuring that potential “customers” of municipal services pay for the services they receive, and they accomplish the result somewhat indirectly by requiring that improvements to real estate will generate taxes sufficient to offset the cost of services the improvements will require.<sup>183</sup>

Once we conceptualize municipalities as private firms with the same profit-maximizing objectives, then excluding those who consume more in services than they generate in revenue appears, at least *prima facie*, an adequate justification for fiscal zoning practices.<sup>184</sup>

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*Property*, 113 COLUM. L. REV. 1773, 1833-34 (2013) (noting that central cities often cannot pursue exclusionary policies, in part because a critical mass of low-income people would oppose efforts to drive them out, and in part because in many central cities, demand is too slack to attract anybody other than low-income buyers).

<sup>178</sup> Title VII provides that a disparate impact claim is established when the complaining party established separate impact “and the respondent fails to demonstrate that the challenged practice is job related for the position in question and consistent with business necessity.” 42 U.S.C. § 2000e-2(k)(1)(A)(i).

<sup>179</sup> Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418-20 (1956) (assuming communities below optimum size seek to attract new residents to lower average costs, and those above optimum do the opposite).

<sup>180</sup> FISCHEL, *supra* note 15, at 72.

<sup>181</sup> RAKESH KOCHHAR, RICHARD FRY & PAUL TAYLOR, PEW RSCH. CTR., WEALTH GAPS RISE TO RECORD HIGHS BETWEEN WHITES, BLACKS AND HISPANICS 15, 24-25 (2011), [https://www.pewresearch.org/wp-content/uploads/sites/3/2011/07/SDT-Wealth-Report\\_7-26-11\\_FINAL.pdf](https://www.pewresearch.org/wp-content/uploads/sites/3/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf) [<https://perma.cc/UAC9-QJQG>] (“An owned home is the most important asset in the portfolio of most households.”).

<sup>182</sup> FISCHEL, *supra* note 15, at 30 (treating homeowners as shareholders of municipal corporations and municipal officials as managers of the “shares”).

<sup>183</sup> See *id.* at 66; Schleicher, *supra* note 12, at 1682 (observing “Coasean bargaining” between developers and city).

<sup>184</sup> Treatment of municipalities as private firms has not gone without objection. Richard Schragger has identified the commodification objection to the analogy as holding

Consider the practices of private developers and landlords. They routinely charge for housing. Landlords do not provide apartments rent-free. Developers do not build homes and give them away. But the very act of charging for housing discriminates on the basis of income and wealth. Those without resources have fewer choices than those with more income.<sup>185</sup> Yet attacks on developers and landlords on the ground that they charge for housing appear certain to fail because developers and landlords have valid business reasons for charging: they are in the business of maximizing revenue. Charging less than the market will bear is inconsistent with that business objective.

Private developers and landlords price their products and services to exclude potential purchasers and tenants who seek to enjoy those products and services while paying less than their cost. Residents of a municipality may have similar objectives: to ensure that potential residents do not enjoy municipal services without paying the cost of those services. Municipal officials, acting on their behalf, implement zoning policies designed to implement the reasonable preferences of existing residents.<sup>186</sup> To be sure, municipal residents protecting home values and private developers maximizing profits are not identically situated in every respect, but the differences do not appear relevant from the

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that certain basic public goods like education, environmental quality, sanitation, housing, and policing should be provided on a relatively equal basis regardless of individuals' private resources. The normative intuition that it is unjust to distribute public services based on ability to pay animates the fair housing, school funding equalization, and environmental justice movements.

Schragger, *supra* note 177, at 1835. Various state law doctrines have operated to restrict the authority of municipalities to act as private firms. For instance, the New Jersey Supreme Court's *Mount Laurel* doctrine requires municipalities to consider the effects of land use policies on nonresidents of the municipality. See *S. Burlington Cnty. NAACP v. Twp. of Mount Laurel (Mount Laurel I)*, 336 A.2d 713, 726 (N.J. 1975). State court decisions in a number of states have invalidated school funding schemes that rely exclusively on local property taxes. See, e.g., *Serrano v. Priest*, 557 P.2d 929, 944 (Cal. 1976) (en banc) (invalidating California school funding plan enacted in response to court's earlier decision in *Serrano v. Priest*, 487 P.2d 1241 (Cal. 1971) (en banc)). In the absence of these state law restrictions, however, the Supreme Court has upheld school funding schemes that rely on local property taxes, rejecting the argument that wealth is a suspect classification and holding that a state system of school funding that relies on property taxation has a rational basis because it promotes local control and participation in the decision-making process. See *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 49-50 (1973) ("The Texas system of school finance . . . permits and encourages a large measure of participation in and control of each district's schools at the local level."). Whatever the merits of the *Rodriguez* decision, the Court established that, absent constraints imposed by Congress or state law, municipalities are free—even in an area of great public concern—to act in the interest of local constituents.

<sup>185</sup> As Professor Saiger has put it, "The rich consume more and better public goods than the poor for the same reason that rich people eat better, are housed better and go on better vacations than the poor: . . . because the rich can afford to buy these expensive items more easily." Saiger, *supra* note 175, at 105-06.

<sup>186</sup> For instance, Fischel argues that land use controls are best analyzed as collective property rights under the control of economically rational voters. FISCHEL, *supra* note 26, at 1-26.

perspective of the FHA, which draws no distinction between actions of private actors and actions of governmental entities.<sup>187</sup> If, for FHA purposes, ensuring that potential users pay their share of the cost of services they consume is a legitimate justification for charging rent, it also ought to be a legitimate justification for fiscal zoning.

As the Court recognized in *Inclusive Communities*, justification is a defense to liability under the FHA.<sup>188</sup> In Title VII cases, the justification defense is only available if there is no less discriminatory alternative that would achieve the defendant's legitimate objective.<sup>189</sup> But if the municipality's legitimate objective is excluding those who will not pay for the cost of services the municipality provides, it is difficult to see how any less discriminatory alternative would achieve that goal.

The HUD guidelines and the Court's *Inclusive Communities* opinion suggest that justification is a defense to be raised only after a plaintiff makes out a prima facie case that municipal policy caused a disparate impact.<sup>190</sup> But if exclusion of those who do not or cannot pay for municipal services is a sufficient justification for fiscal zoning practices, and if every municipality can justify fiscal zoning on the same basis, it would seem pointless to hold that a disparate impact challenge to an exclusionary zoning practice makes out a prima facie case. Because every municipality could invoke the same justification to rebut any challenge, disparate impact claims would appear doomed in the first instance—at least with respect to zoning that excludes those likely to pay less in taxes than they consume in services.

#### E. *Perpetuation of Segregation Claims*

If the Court recognizes perpetuation of segregation claims at all, those claims would face some, but not all, of the challenges that confront disparate impact claims. When a lily-white suburb excludes lower-cost housing that would be financially accessible to persons of color in nearby areas, challengers should be

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<sup>187</sup> See *Avenue 6E Investments, LLC v. City of Yuma*, 818 F.3d 493, 502 (9th Cir. 2016) (“A private developer or governmental body cannot refuse to sell or rent housing to someone because of that person’s race, religion, gender, or other protected characteristic . . .”).

<sup>188</sup> *Tex. Dep’t of Hous. & Cmty. Affs. v. Inclusive Cmty. Project*, 576 U.S. 519, 541 (2015) (noting opportunity for FHA defendants to “state and explain the valid interest served by their policies”).

<sup>189</sup> 42 U.S.C. § 2000e-2(k)(1)(A), (C) (“An unlawful employment practice based on disparate impact is established under this subchapter only if . . . the complaining party makes the demonstration . . . with respect to an alternative employment practice and the respondent refuses to adopt such alternative employment practice.”); see *Ricci v. DeStefano*, 557 U.S. 557, 587 (2009) (citing 42 U.S.C. § 2000e-2(k)(1)(A), (C) to establish liability if municipality failed to adopt less discriminatory alternative that would serve defendant’s needs).

<sup>190</sup> HUD regulations explicitly set forth a burden of proof that shifts to the defendant upon proof of discriminatory effect. 24 C.F.R. § 100.500(c)(2) (2021). In *Inclusive Communities*, the Court’s discussion of the need for “adequate safeguards at the prima facie stage” constitutes an implicit endorsement of the burden-shifting framework. 576 U.S. at 542.

able to make out a *prima facie* case even if the municipality's restrictive policy has as much impact on White persons as on persons of color. Most of the cases discussing the perpetuation of segregation theory exhibit this fact pattern. For instance, in *Arlington Heights*, the municipality was "almost totally white in a metropolitan area with a significant percentage of black people."<sup>191</sup>

The fiscal justification for exclusionary policies, however, is equally strong whether the claim is one for disparate impact or perpetuation of segregation. If the FHA precludes the municipality from acting in a way that protects taxpayer pocketbooks, the Court will have to explain why municipalities should be treated differently from other economic actors.

### III. FEDERAL USE OF INCENTIVES TO INDUCE FAIR HOUSING

The last Part highlighted the logical and doctrinal problems with relying on FHA litigation to ensure that wealthy municipalities assume responsibility for providing services—particularly schools—to families of color and others whose resources are insufficient to cover the cost of those services. In particular, reading the statute to preclude discrimination based on income—even when income does correlate with race—would, as a matter of logic, undermine market provision of housing in ways the statute's drafters could not have intended and that would ultimately constrain the supply of housing.

Even if courts could overcome those logical and doctrinal problems, FHA litigation by developers or nonprofit groups creates few incentives for recalcitrant local governments to cooperate with those seeking to develop affordable housing. The longer the local government resists the FHA claim, the longer it will be before affordable housing is built and local taxpayers bear the cost of providing services to new residents.

Incentives provide an alternative to mandates as a strategy for generating more low-cost housing.<sup>192</sup> And, indeed, Congress has recognized that incentives might play a role in inducing municipalities to further fair housing. Statutes authorizing HUD to make grants to municipalities condition those grants on documentation designed to ensure that the grantee will use the funds to advance

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<sup>191</sup> *Metro. Hous. Dev. Corp. v. Vill. of Arlington Heights*, 558 F.2d 1283, 1288 (7th Cir. 1977). Similarly, in *United States v. City of Black Jack*, 508 F.2d 1179, 1183 (8th Cir. 1974), Black Jack had a Black population between 1% and 2% while the City of St. Louis had a Black population of 40.9%. In *Huntington Branch, NAACP v. Town of Huntington*, 844 F.2d 926, 931 (2d Cir. 1988), 98% of the population within a one-mile radius of a proposed development site was White.

<sup>192</sup> The debate between mandates and incentives has long played a central role in environmental law scholarship. See, e.g., Bruce A. Ackerman & Richard B. Stewart, *Reforming Environmental Law*, 37 STAN. L. REV. 1333, 1342-43 (1985) (arguing that market-based strategy of incentives is superior to mandating that polluters use best available technology). Within the land use realm, Michael Pollack has framed the issue, with respect to federal intervention, as whether the federal government should use "decision-displacing rules" or "decision-channeling constraints" on local government. See Pollack, *supra* note 35, at 712 (emphasis omitted).

fair housing objectives.<sup>193</sup> Conditioned grants, however, have had limited effectiveness in combatting exclusionary zoning for a variety of reasons. First, the conditions have typically focused on promises and other preliminary activities rather than actual construction of housing. Second, HUD monitoring of the grants was spotty until a 2015 regulation imposed new obligations on municipalities that were sufficiently onerous that some municipalities chose not to participate. Finally, HUD repealed that regulation under the Trump Administration, thus limiting the use of incentives to promote fair housing.

A. *Block Grant Programs and the Requirement to Affirmatively Further Fair Housing*

Congress has enacted several programs authorizing HUD to make funds available to local governments for housing-related initiatives.<sup>194</sup> For instance, the Community Development Block Grant Program, initially enacted in 1974, authorizes funding for a laundry list of enumerated activities<sup>195</sup> and provides a formula for allocation of funds based on population, extent of poverty, and extent of housing overcrowding.<sup>196</sup>

Funding for these HUD programs requires a certification by the grantee that the jurisdiction “will affirmatively further fair housing.”<sup>197</sup> The programs do not, however, require actual construction of housing. Moreover, compliance with grant conditions has been less than perfect. Protracted litigation over grants made to Westchester County, New York, provides a glimpse into the problem. Beginning in 2000, the county, acting on behalf of itself and its participant municipalities, annually applied for and received grants from the Community Development Block Grant Program.<sup>198</sup> As required by HUD, the county certified that it would affirmatively further fair housing and that the projected use of funds would give maximum feasible priority to activities which would benefit low- and moderate-income families.<sup>199</sup> The county submitted an Analysis of Impediments to Fair Housing (“AI”), but the AI did not study discrimination based on race and did not require any participating municipality to increase the availability of affordable housing.<sup>200</sup> HUD took no action against the county

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<sup>193</sup> See, e.g., 42 U.S.C. § 12705 (requiring submission of housing affordability strategy, including certification that jurisdiction will affirmatively further fair housing).

<sup>194</sup> In addition to the Community Development Block Grant Program, the Cranston Gonzalez National Affordable Housing Act of 1990 authorizes grants “for the costs of developing and implementing strategies to remove regulatory barriers to affordable housing.” *Id.* § 12705c. For discussion of several other HUD block grant programs, see Connolly, *supra* note 123, at 796-98.

<sup>195</sup> 42 U.S.C. § 5305(a).

<sup>196</sup> *Id.* § 5306(b).

<sup>197</sup> *Id.* §§ 5304(b)(2), 12705(b)(15).

<sup>198</sup> *United States ex rel. Anti-Discrimination Ctr. of Metro N.Y., Inc. v. Westchester Cnty.*, 495 F. Supp. 2d 375, 377 (S.D.N.Y. 2007).

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*



until an antidiscrimination organization brought an action against the county, pursuant to the False Claims Act,<sup>201</sup> alleging that the county's certifications were false. Even then, HUD did not intervene until after the district court held that the county's certifications were false.<sup>202</sup> The parties entered into a consent decree, which the county subsequently breached.<sup>203</sup>

HUD's failure to monitor Westchester's compliance with grant conditions was not an isolated event. A 2010 report by the General Accounting Office ("GAO") estimated that 29% of all AIs were outdated and that a majority included no timeline for implementing recommendations.<sup>204</sup> The report also found that HUD did not require grantees to submit AIs to the Department for review and that HUD officials rarely requested the AIs during on-site monitoring reviews.<sup>205</sup>

#### B. *The 2015 AFFH Rule (and its Repeal and Reinstatement)*

In response to the Westchester litigation and the GAO report, HUD proposed and subsequently adopted a new "Affirmatively Furthering Fair Housing" ("AFFH") rule.<sup>206</sup> The AFFH rule, finally adopted in 2015, replaced AIs with a more demanding Assessment of Fair Housing ("AFH") which grantees were required to submit to HUD for approval. Not only were AFHs required to include statistical analysis of segregation in the region<sup>207</sup> and summaries of progress in reaching milestones,<sup>208</sup> but the new rule also required public engagement in preparation of AFHs.<sup>209</sup> One result of the more demanding rule, in the limited time it was in effect, was that smaller municipalities elected not to participate in the block grant programs subject to the AFFH rule.<sup>210</sup>

In 2018, the Trump Administration HUD withdrew the AFH assessment tool, concluding that it was unduly burdensome and unworkable.<sup>211</sup> Two years later, HUD repealed the AFFH rule altogether, citing federalism concerns and statutes

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<sup>201</sup> See 31 U.S.C. § 3729.

<sup>202</sup> *Cnty. of Westchester v. U.S. Dep't of Hous. & Urb. Dev.*, 802 F.3d 413, 418-19 (2d Cir. 2015).

<sup>203</sup> *United States ex rel. Anti-Discrimination Ctr. of Metro N.Y., Inc. v. Westchester Cnty.*, 712 F.3d 761, 771 (2d Cir. 2013) (holding Westchester breached its duty to promote under the consent decree).

<sup>204</sup> U.S. GOV'T ACCOUNTABILITY OFF., GAO-10-905, HOUSING AND COMMUNITY GRANTS: HUD NEEDS TO ENHANCE ITS REQUIREMENTS AND OVERSIGHT OF JURISDICTIONS' FAIR HOUSING PLANS 9 (2010), <https://www.gao.gov/assets/320/311065.pdf> [<https://perma.cc/5F2C-QLRF>].

<sup>205</sup> *Id.* at 22.

<sup>206</sup> Affirmatively Furthering Fair Housing, 24 C.F.R. §§ 5.150-.166 (2015).

<sup>207</sup> *Id.* § 5.154(c).

<sup>208</sup> *Id.* § 5.154(d)(7).

<sup>209</sup> *Id.* § 5.158.

<sup>210</sup> See Connolly, *supra* note 123, at 827-29.

<sup>211</sup> Preserving Community and Neighborhood Choice, 85 Fed. Reg. 47,899, 47,901 (Aug. 7, 2020) (codified at 24 C.F.R. pt. 5).

barring HUD from using funding to force grantees to change public policy or law.<sup>212</sup>

The Biden Administration has reversed course and is in the process of reinstating the AFFH rule.<sup>213</sup> Nevertheless, conditioned HUD grants might not be the most effective form of incentive to generate low-cost housing in affluent municipalities. First, to be effective, grants should be conditioned on results—actual construction of housing—rather than on paperwork reflecting promises and progress. But that would require municipalities to permit construction of fiscally undesirable housing in the hope that federal monies would later be forthcoming. Second, federal grants themselves tend to be for targeted purposes which may have limited attraction in affluent areas. Taxpayers in those areas might not feel the benefit of the federally funded program, but they will certainly feel the tax burdens associated with providing services to lower-income newcomers. Third, a onetime federal grant, even with the prospect of renewal, may not outweigh the long-term financial consequences of a change in neighborhood composition. Incentives would be more effective if local residents felt the financial consequences of exclusion on an ongoing basis—as they would if they had to pay for exclusion in their annual property tax bill.

#### IV. STATE LAW MANDATES

##### A. *Introduction*

The federal government has not been alone in addressing the problem of affordable housing available to persons of modest means, including persons of color. A number of states have intervened to address the twin problems caused by fiscal zoning: increased housing costs and avoidance by affluent communities of the responsibility for providing services—particularly schools—to families whose resources are insufficient to cover the cost of those services. These state initiatives recognize that municipalities are unlikely to eliminate fiscal zoning,<sup>214</sup> which exists because it is in the financial self-interest of each affluent municipality to impose external costs on other municipalities by blocking construction of lower-cost housing within its borders.<sup>215</sup> This Part explores existing state initiatives to increase the availability of affordable housing and offers an explanation for why those initiatives—largely in the form of mandates

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<sup>212</sup> *Id.* at 47,900.

<sup>213</sup> In June 2021, HUD promulgated an interim rule that became effective on July 31, 2021. Restoring Affirmatively Furthering Fair Housing Definitions and Certifications, 86 Fed. Reg. 30,779, 30,783 (June 10, 2021) (codified at 24 C.F.R. pt. 5).

<sup>214</sup> See Megan Haberle & Philip Tegeler, *Coordinated Action on School and Housing Integration: The Role of State Government*, 53 U. RICH. L. REV. 949, 952 (2019) (noting that “[t]he state is a unique leverage point” because of its direct control over drivers of school and housing segregation).

<sup>215</sup> See Fischel, *supra* note 3, at 1524 (discussing concentration of poverty that can result from each municipality’s self-interested zoning decisions).

on municipalities—have not been adopted more widely (and have had only checkered success in states where they have been implemented).

### B. *New Jersey*

Perhaps the best-known initiative to curb fiscal zoning came not from a state legislature but from the New Jersey Supreme Court. In a series of cases starting in 1975 with *Southern Burlington County NAACP v. Township of Mount Laurel* (*Mount Laurel I*),<sup>216</sup> the court construed the state constitution to require municipalities to absorb their fair share of low- and moderate-income housing.<sup>217</sup> In 1983, in *Mount Laurel II*,<sup>218</sup> the court expanded the obligation to require municipalities to take affirmative steps, including the use of density bonuses and mandatory set-asides, to ensure construction of affordable housing.<sup>219</sup> The court has adhered to the state constitutional mandate for nearly fifty years.<sup>220</sup>

Although *Mount Laurel II* initially provided a direct recourse to the courts for any party challenging a municipality's compliance with its fair share obligation,<sup>221</sup> the state legislature responded by enacting a state fair housing act which was designed to replace litigation with administrative resolution of fair-share disputes.<sup>222</sup> The statute established the Council on Affordable Housing ("COAH"),<sup>223</sup> an agency charged with establishing the state and regional need for low- and moderate-income housing and adopting criteria for municipal determination of its fair share of that housing need.<sup>224</sup> The statute also authorized COAH to consider and approve applications from municipalities for certification of their fair-share plans.<sup>225</sup> Certification created a presumption of validity in any exclusionary zoning case filed against the municipality.<sup>226</sup>

Although COAH published needs estimates and compliance regulations in 1986 and 1994,<sup>227</sup> and the courts upheld those estimates,<sup>228</sup> COAH subsequently defaulted on its statutory obligations, leading the New Jersey Supreme Court to

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<sup>216</sup> 336 A.2d 713 (N.J. 1975).

<sup>217</sup> *Id.* at 724.

<sup>218</sup> *S. Burlington Cnty. NAACP v. Twp. of Mount Laurel* (*Mount Laurel II*), 456 A.2d 390 (N.J. 1983).

<sup>219</sup> *Id.* at 448.

<sup>220</sup> *See, e.g., In re Declaratory Judgment Actions Filed by Various Muns.*, 152 A.3d 915, 917-18 (N.J. 2017) (reaffirming state constitutional obligation).

<sup>221</sup> 456 A.2d at 452.

<sup>222</sup> N.J. STAT. ANN. §§ 52:27D-302, -303 (West 2021).

<sup>223</sup> *Id.* § 52:27D-305.

<sup>224</sup> *Id.* § 52:27D-307.

<sup>225</sup> *Id.* § 52:27D-313.

<sup>226</sup> *Id.* § 52:27D-317.

<sup>227</sup> *See* N.J. ADMIN. CODE § 5:93 (2002).

<sup>228</sup> *In re Six Month Extension of N.J.A.C. 5:91-1 et seq.*, 855 A.2d 582, 601 (N.J. Super. Ct. 2004).

place enforcement of the fair-share obligation back in the hands of the judiciary.<sup>229</sup> The *Mount Laurel* doctrine has clearly resulted in construction of more affordable housing than would have been built in the doctrine's absence, but whether the effect has been substantial remains controversial.<sup>230</sup>

### C. Massachusetts

Massachusetts has, by statute, taken two parallel steps to increase the availability of affordable housing statewide but particularly in municipalities where less than 10% of existing housing is affordable. First, the statute, known as Chapter 40B, authorizes nonprofit developers and public agencies to obtain centralized review by the municipal board of appeals of any low- or moderate-income housing development.<sup>231</sup> The centralized review process enables the developer to bypass the review by multiple boards that might otherwise be necessary to obtain approval of any housing development—affordable or otherwise.<sup>232</sup>

Second, if the local board of appeals denies the application, the statute authorizes an appeal to a statewide appeals committee.<sup>233</sup> That committee has authority to overturn the denial but only if the municipality has not reached the 10% threshold.<sup>234</sup> For municipalities below the threshold, the threat of state intervention encourages local boards to approve applications, and when those boards remain recalcitrant, state review operates to override local opposition.<sup>235</sup>

Chapter 40B has been credited with facilitating a significant number of low-income housing units<sup>236</sup> but has had little effect on housing prices in the state

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<sup>229</sup> *In re Adoption of N.J.A.C. 5:96 & 5:97 ex rel. N.J. Council on Affordable Hous.*, 110 A.3d 31, 34 (N.J. 2015).

<sup>230</sup> See, e.g., John Charles Boger, *Mount Laurel at 21 Years: Reflections on the Power of Courts and Legislatures to Shape Social Change*, 27 SETON HALL L. REV. 1450, 1454-61 (1997) (detailing mixed success of *Mount Laurel* cases).

<sup>231</sup> MASS. GEN. LAWS ch. 40B, § 21 (2021).

<sup>232</sup> See Rachel G. Bratt & Abigail Vladeck, *Addressing Restrictive Zoning for Affordable Housing: Experiences in Four States*, 24 HOUS. POL'Y DEBATE 594, 600 (2014).

<sup>233</sup> MASS. GEN. LAWS ch. 40B, § 22 (2021).

<sup>234</sup> The statute permits the committee to overturn a denial when the denial is not "consistent with local needs." *Id.* A regulation is deemed to be consistent with local needs whenever the municipality includes low- and moderate-income housing in excess of 10% of all housing units. *Id.* § 20.

<sup>235</sup> See Infranca, *supra* note 34, at 838 n.73. As Infranca notes, Chapter 40B is a "decision-channeling" rule that incentivizes preferred municipal decisions rather than compelling the municipality to make those preferred decisions. *Id.*; see also Pollack, *supra* note 35, at 729-30 (discussing federal decision-channeling land use rules).

<sup>236</sup> See Sharon Perlman Krefetz, *The Impact and Evolution of the Massachusetts Comprehensive Permit and Zoning Appeals Act: Thirty Years of Experience with a State Legislative Effort to Overcome Exclusionary Zoning*, 22 W. NEW ENG. L. REV. 381, 392-95 (2001) (concluding that Chapter 40B has directly resulted in construction of affordable housing in half of all Massachusetts municipalities); Carolina K. Reid, Carol Galante &

because its streamlined process for nonprofit projects has no parallel for market-rate housing.<sup>237</sup> Local communities remain free to block other housing projects that would generate more in service costs than in tax revenue. More recent administrative efforts have focused on providing municipalities with modest financial incentives to authorize new housing,<sup>238</sup> but the jury is out on the effectiveness of those efforts.

#### D. *California*

California, known both for its high housing prices and for its stringent regulatory environment,<sup>239</sup> has long had statutes in place requiring each municipality to develop a plan for meeting local housing needs.<sup>240</sup> The plan, called a “housing element,” must include an analysis of zoning and other constraints on housing.<sup>241</sup> The statutes also require that municipalities develop a timeline for taking actions—including rezoning sites to increase density—to meet regional housing needs determined by state and regional bodies.<sup>242</sup>

Until recently, however, California had no mechanism for enforcing these statutory obligations. Developers had no standing to sue municipalities in court, and the statutes did not create an administrative body with power to review local action or inaction. In 2017, the state legislature took several steps to address the

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Ashley F. Weinstein-Carnes, *Addressing California's Housing Shortage: Lessons from Massachusetts Chapter 40B*, 25 J. AFFORDABLE HOUS. & CMTY. DEV. L. 241, 250-53 (2017) (concluding that as of 2010, Chapter 40B had been used to produce about 58,000 housing units, approximately 31,000 of which were for low- and moderate-income households).

<sup>237</sup> Massachusetts law requires a two-thirds vote of the local legislative body to amend a zoning ordinance. MASS. GEN. LAWS ch. 40A, § 5 (2021). The two-thirds rule serves as an obstacle to zoning changes that would liberalize zoning requirements, and Governor Baker proposed abolishing the rule as a means to pave the way for additional housing. *See AP, Gov. Baker Pushing Bill to Overhaul Housing Zoning Rules*, CBS 6 NEWS: WRGB ALBANY (Sept. 7, 2019), <https://cbs6albany.com/news/local/gov-baker-pushing-bill-to-overhaul-housing-zoning-rules> [<https://perma.cc/33V4-ZA9R>] (noting that Massachusetts is one of few states that require supermajority to change local zoning rules).

<sup>238</sup> *See, e.g.*, Press Release, Exec. Off. of Hous. & Econ. Dev., Baker-Polito Administration Opens Two New Grant Programs Under Housing Choice Initiative (July 20, 2018), <https://www.mass.gov/news/baker-polito-administration-opens-two-new-grant-programs-under-housing-choice-initiative> [<https://perma.cc/AR6G-SMFN>] (announcing that up to \$4 million would be made available for certain cities and towns designated as Housing Choice Communities).

<sup>239</sup> *See, e.g.*, FISCHER, *supra* note 15, at 1515 (claiming that California became notorious for difficult housing development due to the Supreme Court of California's “antidevelopment ethos”).

<sup>240</sup> CAL. GOV'T CODE § 65583(7) (West 2021) (citing “existing and projected housing needs and a statement of goals, policies, quantified objectives, financial resources, and scheduled programs for the preservation, improvement, and development of housing” as housing elements of the statute).

<sup>241</sup> *Id.* § 65583(a)(5).

<sup>242</sup> *Id.* § 65583(c).

enforcement issue.<sup>243</sup> In particular, the legislature provided developers of multifamily housing on infill sites with a streamlined approval process in any municipality that has issued too few building permits to meet its fair share of regional obligations.<sup>244</sup> The statute limits the power of officials in these municipalities to inject their “personal or subjective judgment” into evaluation of applications.<sup>245</sup>

More recently, in 2019, the California legislature limited the ability of municipalities to reduce permissible housing density,<sup>246</sup> restricted the number of hearings a municipality can conduct on any proposed housing development project,<sup>247</sup> narrowed the duration of environmental review of development projects,<sup>248</sup> and required ministerial approval of building permits for accessory dwelling units in residential and mixed-use zones.<sup>249</sup> It remains too early to measure the effectiveness of the recent California efforts. Moreover, other recent California enactments—particularly the imposition of statewide rent controls<sup>250</sup>—may undermine whatever positive effects recent zoning legislation might generate. Nevertheless, the recent zoning and planning statutes do demonstrate at least some legislative will to attack the housing-cost problem. But, in early 2020, Senate Bill 50, a more ambitious effort to authorize apartments near transit centers and fourplexes in most single-family neighborhoods, failed to pass the state senate.<sup>251</sup>

#### E. Other States

Other states plagued with high housing costs have taken steps to limit local power to stymie affordable residential development. Oregon has eliminated

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<sup>243</sup> See S.B. 167, 2017-2018 Reg. Sess. (Cal. 2017).

<sup>244</sup> CAL. GOV'T CODE § 65913.4 (West 2020) (explaining that for the streamlined approval process to apply, the development must be a multifamily housing development that contains two or more residential units and meet other criteria).

<sup>245</sup> *Id.* § 65913.4(5). For more detailed discussion of the amendments, see Christopher S. Elmendorf, *Beyond the Double Veto: Housing Plans as Preemptive Intergovernmental Compacts*, 71 HASTINGS L.J. 79, 114-28 (2019).

<sup>246</sup> CAL. GOV'T CODE § 66300(b) (West 2020) (limiting reductions to other factors such as to height, floor area ratio, and lot size requirements).

<sup>247</sup> *Id.* § 65905.5(a) (limiting the number of hearings to five).

<sup>248</sup> *Id.* § 65950(a) (limiting duration to 60-180 days, depending on certain factors).

<sup>249</sup> *Id.* § 65852.2(e) (requiring ministerial approval of building permit applications if certain conditions are met).

<sup>250</sup> CAL. CIV. CODE § 1947.12 (West 2020). The statute includes an exemption for housing that has been issued a certificate of occupancy within the previous fifteen years. *Id.* § 1947.12(d)(4). The result is that a California developer of rental housing is only assured of market-rate returns for a fifteen-year period.

<sup>251</sup> See Liam Dillon & Taryn Luna, *Bill to Expand Housing Fails Again; SB 50 Would Have Allowed More Mid-Rise Apartments Near Transit and Job Centers*, L.A. TIMES, Jan. 31, 2020, at B1.

local prohibitions on mobile homes and other manufactured homes<sup>252</sup> and imposes strict time limits on local review of multifamily development.<sup>253</sup> Rhode Island has a state appeals board much like the one in Massachusetts.<sup>254</sup> Connecticut places the burden of proof on municipalities when affordable housing developers challenge municipal obstacles to proposed developments.<sup>255</sup> John Infranca has recently catalogued the many state initiatives to require municipalities to permit accessory dwelling units in single-family homes.<sup>256</sup> At best, however, these efforts have made a small dent in the twin problems of fiscal zoning: excessive housing cost and inequitable distribution of school and other service costs.<sup>257</sup>

#### F. *Barriers to Effectiveness*

As Anika Lemar has recently observed, in a number of instances, states have successfully intervened to overcome local zoning restrictions on four disfavored uses: family day care homes, manufactured housing, small-scale alternative energy infrastructure, and group homes.<sup>258</sup> In each of these areas, organized interest groups maintain significant lobbies at the state level, and those lobbies have managed to overcome the dominance “homevoters” enjoy at the local level.<sup>259</sup> By contrast, the benefits of more housing and lower housing costs are diffuse, making it more difficult for lobbies to coalesce in light of the strong lobby in favor of retaining local control—a lobby fueled by “homevoters” and their representatives who stand to suffer if housing prices decline.<sup>260</sup>

One discrete and potentially powerful group would benefit significantly from state intervention to eliminate fiscal zoning: municipalities who currently provide services to low- and moderate-income households shut out of wealthy municipalities. Representatives from poorer communities, however, have little political incentive to devote their political clout to rooting out fiscal zoning. The

<sup>252</sup> OR. REV. STAT. § 197.314 (2020).

<sup>253</sup> *Id.* § 197.311 (limiting review to 100 days).

<sup>254</sup> 45 R.I. GEN. LAWS § 45-53-4 (2020).

<sup>255</sup> CONN. GEN. STAT. § 8-30g (2013).

<sup>256</sup> Infranca, *supra* note 34, at 857-75.

<sup>257</sup> Robert Ellickson’s recent study concludes that the impact of Connecticut’s statute has been minor in New Haven’s most exclusionary suburbs. Robert C. Ellickson, *Zoning and the Cost of Housing: Evidence from Silicon Valley, Greater New Haven, and Greater Austin* 67 (Jan. 14, 2020) (unpublished manuscript) (available at <https://ssrn.com/abstract=3472145>).

<sup>258</sup> Anika Singh Lemar, *The Role of States in Liberalizing Land Use Regulations*, 97 N.C. L. REV. 293, 296 (2019).

<sup>259</sup> *Id.* at 346-47 (“Because homevoters are numerous, it is difficult for lobbyists to reach them. And because homevoters are highly and self-interestedly risk averse, it is difficult for lobbyists to persuade them, even when those lobbyists are armed with otherwise convincing data and facts.”).

<sup>260</sup> *Id.* at 349; see also Roderick M. Hills, Jr. & David N. Schleicher, *Balancing the “Zoning Budget,”* 62 CASE W. RES. L. REV. 81, 90 (2011) (noting diffuse benefits of new development and concentrated interest of landowners near any proposed new development).

constituents who benefit most directly by elimination of fiscal zoning are those who would leave for greener pastures. But politicians have little reason to employ their capital to benefit departing constituents.<sup>261</sup>

Instead, state representatives from areas with poorer schools and other services are more likely to seek state assistance to improve local services. And increased funding for schools in less affluent areas is less likely to provoke opposition from representatives of wealthier areas than the more threatening state interference with their own schools and neighborhoods, which would present more of a perceived threat to home values. Mobilizing opposition to fiscal zoning, then, would be easier if potential opponents could realize a more direct benefit from eliminating zoning constraints in wealthier municipalities.

## V. TAX INCENTIVES AS AN ALTERNATIVE APPROACH TO FISCAL ZONING

### A. *Mandates v. Incentives*

When a municipality adopts land use policies that exclude those who consume more in services than they pay in taxes, the municipality effectively imposes external costs on other municipalities, who must now provide services to those excluded. To date, legislative efforts to overcome those externalities and generate affordable housing have focused primarily on mandates. In New Jersey, for instance, each municipality must absorb its fair share of low-cost housing; regional contribution agreements, which would allow bargaining among municipalities, are prohibited.<sup>262</sup> The California statutes take the same approach.<sup>263</sup>

Mandates ensure that wealthy communities do not buy their way out of the obligation to provide housing. That fairness advantage was undoubtedly the impetus for New Jersey's prohibition on regional contribution agreements. But that perceived fairness advantage is undercut by the potential for the wealthiest to exit—particularly from public school systems.<sup>264</sup> Mandatory affordable

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<sup>261</sup> Moreover, facilitating the departure of residents would be unlikely to benefit the residents who remain—especially if the departing residents are among the more affluent constituents in a generally poor municipality. Departures of the wealthier constituents would further deplete an already challenged tax base.

<sup>262</sup> N.J. STAT. ANN. § 52:27D-329.6 (West 2021).

<sup>263</sup> CAL. GOV'T CODE § 65584.04(m)(2) (West 2020) (mandating adherence to development plan).

<sup>264</sup> For instance, in wealthy areas of large cities where public schools are perceived as inferior, large percentages of children are enrolled in private schools. One study concludes that on Upper Connecticut Avenue in Washington, D.C., private school enrollment represents 73% of all school-age children, and on the Upper East Side of Manhattan, 72% of children are enrolled in private schools. By contrast, in Chappaqua and Jericho, two New York suburbs with high housing prices and a reputation for strong schools, only 2% of children are enrolled in private schools. Jed Kolko, *Where "Back to School" Means Private School*, TRULIA (Aug. 13, 2014), <https://www.trulia.com/research/private-vs-public-school/> [<https://perma.cc>



housing in wealthy municipalities may result in escape to private schools rather than participation in a more racially and economically integrated school system. Moreover, when mandates are directed at developers—for instance, a requirement that developers include a percentage of affordable housing in any new development—the mandate may work to reduce the amount of housing developers will ultimately produce.<sup>265</sup> Finally, mandates are not self-enforcing. Because it is not in the interest of the municipality to comply with mandates, the municipality has every reason to delay and resist.<sup>266</sup> As a result, if a state imposes mandates, it must also develop an effective enforcement mechanism.

Carefully designed incentives, by contrast, can enlist cooperation from an otherwise recalcitrant municipality. Perhaps for this reason, much of the most creative scholarly work in the area has focused on incentives rather than mandates. Much, though not all, of that work has suggested use of the tax system to create those incentives. Lee Anne Fennell, in considering the effect of exclusion on public schools, has suggested that a community be given an opportunity to signal to the state the value it places on an exclusionary measure by agreeing to pay a tax equal to that value.<sup>267</sup> If the state concludes that the tax is insufficient to compensate for the exclusion, the state could override the exclusionary measure and refund the tax.<sup>268</sup> David Schleicher has suggested, in the context of cities, that neighbors receive a tax abatement whenever a community board approves new development.<sup>269</sup> Both of these suggestions recognize the utility of taxation as a motivating tool. Christopher Elmendorf and Darien Shanske have advocated a nontax incentive: municipalities willing to upzone to permit more intensive residential use should be permitted to auction off newly created development rights.<sup>270</sup>

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/G94U-25VF] (noting that more than two-thirds of parents with children under twelve say that neighborhood school district is among their most important considerations when choosing a home).

<sup>265</sup> See EDWARD L. GLAESER & JOSEPH GYOURKO, *RETHINKING FEDERAL HOUSING POLICY: HOW TO MAKE HOUSING PLENTIFUL AND AFFORDABLE* 85 (2008) (“[I]nclusionary zoning programs represent a tax on new market-rate development, so some market units that would have been delivered in the absence of the tax are not delivered.”).

<sup>266</sup> See Elmendorf, *supra* note 245, at 110-12 (noting ability of municipalities to thwart state mandates by insisting on more review or by imposing conditions that make it difficult for developers to build or market units).

<sup>267</sup> Lee Anne Fennell, *Properties of Concentration*, 73 U. CHI. L. REV. 1227, 1271-72 (2006).

<sup>268</sup> *Id.*

<sup>269</sup> Schleicher, *supra* note 12, at 1679 (“[T]hese payments would not constitute a tax on developers, but instead would seek to pay off opposition from a different source—the fiscal benefits a city as a whole gets from new development—and would therefore reduce housing costs.”).

<sup>270</sup> Christopher S. Elmendorf & Darien Shanske, *Auctioning the Upzone*, 70 CASE W. RES. L. REV. 513, 518 (2020).

### B. *State v. Federal Incentives*

We have seen that HUD has attempted to use incentives to enforce the FHA, with limited effectiveness. Of course, the federal government could develop other incentives to combat zoning that artificially inflates housing costs and contributes to exclusion of the poor. State law incentives, however, have significant advantages over federal intervention.

First, recent changes to the federal income tax structure reduce the potential to use the income tax as an effective weapon against exclusion. Absent a new and unlikely federal tax on real estate, the principal tactic available to the federal government is a reduction of tax benefits available to real estate owners in exclusionary municipalities. Historically, the principal benefits have been the mortgage interest deduction and the deduction for state and local property taxes. The recently enacted \$10,000 cap on the deductibility of state and local taxes<sup>271</sup> reduces the potential to use loss of that deduction as a weapon against exclusionary municipalities. Similarly, the recently enacted increase in the standard deduction means that fewer homeowners benefit from the mortgage interest deduction,<sup>272</sup> again making withdrawal of that incentive a less powerful incentive to exclusionary municipalities.

Second, even before these changes in tax structure, federal tax incentives would have had to account for significant local variation. Leading supporters of federal tax incentives recognized this and conceded that a federal scheme would have to delegate significant authority to the states to implement the federal incentive scheme. For instance, in proposing to impose a cap on the mortgage interest deduction in high-cost municipalities with inelastic supply of housing, Professors Glaeser and Gyourko emphasized differences between areas in which tiny localities are responsible for land use decisions and school, spending and areas in which those decisions are centralized in county government.<sup>273</sup> As a result, they concluded that “there cannot be a uniform national policy that rewards communities that build more and penalizes ones that do not.”<sup>274</sup>

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<sup>271</sup> 26 U.S.C. § 164(b)(6).

<sup>272</sup> The Tax Foundation estimates that the share of taxpayers itemizing deductions in 2019 will be only 13.7%, compared to the 31% who would have itemized under prior law. Even among relatively prosperous taxpayers—those whose income places them in the eightieth to ninetieth percentile, only 30.30% of those were projected to itemize deductions in 2019, compared to 67.80% under prior law. SCOTT EASTMAN & ANNA TYGER, THE TAX FOUND., THE HOME MORTGAGE INTEREST DEDUCTION 5 (2019), <https://files.taxfoundation.org/20191011104310/The-Home-Mortgage-Interest-Deduction.pdf> [<https://perma.cc/C55L-JSMM>]. Homeowners who do not itemize deductions obtain no benefit from the mortgage interest deduction.

<sup>273</sup> GLAESER & GYOURKO, *supra* note 265, at 168.

<sup>274</sup> *Id.*

### C. *State Finance of Education and Other Services*

States could reduce municipal incentives to engage in fiscal zoning by assuming responsibility for financing municipal services—particularly local schools.<sup>275</sup> In most jurisdictions, local property taxation plays a major role in financing schools.<sup>276</sup> States typically supplement property tax revenue, but, at least in communities prone to fiscal zoning, those supplements may constitute a small percentage of total school budgets.<sup>277</sup> The result is the familiar tax incentive for exclusion of those who consume more in services than they pay in taxes.

State finance would change the calculus because an influx of less wealthy students would no longer have an impact on local property taxes. As a result, local taxpayers and their representatives would have less financial incentive to engage in exclusionary practices. Litigation in a number of states has forced state legislatures to increase state funding as a means to level the educational playing field.<sup>278</sup> A complete state takeover of education funding might address the fiscal zoning problem, but it would generate other problems that make it an unappealing alternative.<sup>279</sup>

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<sup>275</sup> The current level of state finance of public schools varies considerably by state. In Hawaii and Vermont, more than 89% of public school revenues are derived from state government; in Illinois, the state provides less than 25% of public school funding. REBECCA R. SKINNER, CONG. RSCH. SERV., R45827, STATE AND LOCAL FINANCING OF PUBLIC SCHOOLS 3-4 tbl.2 (2019), [https://www.everycrsreport.com/files/20190826\\_R45827\\_7a8d531e7ae1e7fabafeffb87cdfd1b3d03ced49.pdf](https://www.everycrsreport.com/files/20190826_R45827_7a8d531e7ae1e7fabafeffb87cdfd1b3d03ced49.pdf) [<https://perma.cc/6KPB-YDBD>].

<sup>276</sup> See generally ANDREW RESCHOVSKY, LINCOLN INST. OF LAND POL'Y, THE FUTURE OF U.S. PUBLIC SCHOOL REVENUE FROM THE PROPERTY TAX (2017), [https://www.lincolninst.edu/sites/default/files/pubfiles/future-us-public-school-revenue-policy-brief\\_0.pdf](https://www.lincolninst.edu/sites/default/files/pubfiles/future-us-public-school-revenue-policy-brief_0.pdf) [<https://perma.cc/N68A-C7XX>] (noting that as of 2013-14, property taxation provided 36.4% of public education revenue).

<sup>277</sup> For instance, in Scarsdale, New York, property tax revenues make up more than 90% of school district revenues; nonproperty revenues (largely state aid) make up less than 7% of district revenues. See SCARSDALE PUB. SCHS., 2019-20 SCHOOL BUDGET 35 (2019), [https://www.scarsdaleschools.k12.ny.us/cms/lib/NY01001205/Centricity/Domain/5/BudgetForum\\_Mar25\\_2019.pdf](https://www.scarsdaleschools.k12.ny.us/cms/lib/NY01001205/Centricity/Domain/5/BudgetForum_Mar25_2019.pdf) [<https://perma.cc/WQ32-TP62>] (comparing property tax revenues versus non-property revenues).

<sup>278</sup> See Laurie Reynolds, *Full State Funding of Education as a State Constitutional Imperative*, 60 HASTINGS L.J. 749, 761-76 (2009) (detailing judicial challenges and legislative responses).

<sup>279</sup> One such effect might be less overall funding of education. As Professor Laurie Reynolds notes, without a separate and untouchable stream of revenue devoted to education, the give and take of the legislative process means that education will not enjoy the same budget priority as when local property is taxed to fix local schools. *Id.* at 759. In addition, state funding appears to provide a less stable base for overall school funding because state revenue sources are typically more variable than local property taxes. See DAPHNE A. KENYON, LINCOLN INST. OF LAND POL'Y, THE PROPERTY TAX—SCHOOL FUNDING DILEMMA 41 (2007), [https://www.lincolninst.edu/sites/default/files/pubfiles/the-property-tax-school-funding-dilemma-full\\_0.pdf](https://www.lincolninst.edu/sites/default/files/pubfiles/the-property-tax-school-funding-dilemma-full_0.pdf) [<https://perma.cc/DM93-KDJF>].

While state finance would eliminate the financial incentive underlying fiscal zoning, it provides no affirmative reason for municipalities to zone to provide more housing. Risk aversion would remain a factor that would militate against rezoning; wealthy homeowners are unlikely to see any positive gain in zoning to permit more lower-income (or less White) neighbors to enter the community. California's experience with state finance and Proposition 13 illustrates the problem. Although *Serrano v. Priest*<sup>280</sup> has substantially increased state finance of schools<sup>281</sup> and Proposition 13 ensures that new development will not significantly increase property taxes for any existing homeowner,<sup>282</sup> California municipalities continue to be among the most exclusionary in the nation.<sup>283</sup>

Although the evidence is not conclusive, there is some reason to believe that state finance of education reduces overall education expenditures.<sup>284</sup> And, in any event, state finance would undermine Tieboutian competition among municipalities—competition that might result in a better match between the types of services schools provide and the services individual residents prefer.<sup>285</sup>

#### D. Tax Incentives for Inclusion

A more promising approach would impose a property tax surcharge on municipalities whose zoning policies have effectively excluded low- and moderate-income families. The goal would be to make the surcharge onerous enough to create an incentive to approve lower-cost housing. Moreover, the proceeds from the surcharge would be used to fund schools in less affluent

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<sup>280</sup> 569 P.2d 1303 (Cal. 1977) (en banc).

<sup>281</sup> The California legislature initially planned to respond to *Serrano* with a “power equalization” program that would have permitted districts with high assessed value per pupil to raise taxes to fund their own schools, but only if they shared the tax revenue with low-assessed value districts. The legislature shelved the plan when voters enacted Proposition 13, limiting property tax increases. See CAL. CONST. art. 13A, § 2(b). As a result, the state increased state aid to local governments. Eric J. Brunner & Jon Sonstelie, *California's School Finance Reform: An Experiment in Fiscal Federalism*, in THE TIEBOUT MODEL AT FIFTY 66 (William A. Fischel ed., 2006).

<sup>282</sup> Proposition 13, now entrenched in the California constitution, limits increases in assessed value of property to 2% each year. CAL. CONST. art. 13A, § 2(b).

<sup>283</sup> See Erin Baldassari, *California Cities Rethink the Single-Family Neighborhood*, KQED (Feb. 16, 2021), <https://www.kqed.org/news/11860308/why-just-allowing-fourplexes-wont-solve-californias-housing-affordability-crisis> [<https://perma.cc/N3NW-DCV3>] (noting that both cities and suburbs in California are heavily restricted to single-family zoning).

<sup>284</sup> See Bradley W. Joondeph, *The Good, the Bad, and the Ugly: An Empirical Analysis of Litigation-Prompted School Finance Reform*, 35 SANTA CLARA L. REV. 763, 774 (1995) (concluding that states that have reduced interdistrict disparities on school expenditures the most have increased educational funding the least).

<sup>285</sup> William Fischel has argued that areas in which competition exists among multiple school districts produce students who achieve higher test scores and other educational accomplishments. FISCHEL, *supra* note 15, at 143-45.

areas—creating a political incentive for voters and representatives in those areas to lobby for the surcharge.<sup>286</sup>

### 1. The Basic Model

There are many ways to structure such a surcharge, but consider the following model. Suppose data collected by the state establishes the median household income in the applicable region, the twenty-fifth percentile household income, and the tenth percentile household income. The state could then impose a surcharge on the property tax bill of each taxpayer based on the following formula:

$$\text{Surcharge} = \frac{(10 - A) + (25 - B) + (50 - C)}{100} \times (\text{Local Property Tax}),$$

where A is the percentage of municipal households whose income falls below the region's tenth percentile, B is the percentage that falls below the twenty-fifth percentile, and C is the percentage that falls below the median. Using this formula, a municipality perfectly representative of the region would incur no surcharge because A would equal ten, B would equal twenty-five, and C would equal fifty. But now consider a municipality in which 1% of households had income at the region's tenth percentile, 5% had income at the twenty-fifth percentile, and 20% at the region's median. Taxpayers in the municipality would be liable for a surcharge of 59%, on top of the taxes they would otherwise authorize, computed as follows:

$$\frac{(10 - 1) + (25 - 5) + (50 - 20)}{100} = \frac{59}{100}.$$

Note that taxpayers could reduce the surcharge only by taking steps to ensure that less affluent residents moved into town. The incentives would be greatest to attract the poorest households because those households count in the formula three times, while just-below-median households count only once.

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<sup>286</sup> Although many states have dedicated tax revenue to fund schools in property-poor districts, few have limited the power of wealthy districts to use additional tax revenue to fund enhanced educational expenditures. Vermont is an exception. The state permits school districts to approve budgets that exceed state spending norms, but if a district approves such a budget, the district's property taxes rise by the percentage by which the proposed spending exceeds the state norm. *See* VT. STAT. ANN. tit. 32, §§ 5401(13), 5402 (2021). The result is that if a wealthy municipality decides to budget for more generous school spending, its taxpayers, in the aggregate, will pay more than the total increase in spending, while if a poorer municipality budgets for more generous spending, it will not bear the full cost of that spending. *See* Reynolds, *supra* note 278, at 783-84.

The state could design a similar formula to determine how surcharge moneys would be distributed.<sup>287</sup> Taxpayers in municipalities with a disproportionate number of low-income households would receive a tax rebate (or the municipality could elect, instead, to devote the equivalent of the rebate to improve the quality of public services).<sup>288</sup> In either event, the payment to those municipalities would be calibrated to reflect both the percentage of households below the median income and the percentage of households below the tenth and twenty-fifth percentile.

The surcharge's overall effect would be progressive. Because property taxes are generally capitalized into home prices,<sup>289</sup> homes in exclusionary suburbs would become less valuable. Conversely, homes in municipalities entitled to share in surcharge funds would become more valuable as they become more attractive to affluent buyers seeking to avoid surcharges.

Moreover, by focusing on income rather than property value, the model avoids imposing surcharges on income-poor municipalities that happen to be property-rich by virtue of their significant industrial or commercial properties.<sup>290</sup>

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<sup>287</sup> The formula highlighted in the text could serve as the basis for calculating the rebate available to municipalities with high concentrations of low-income households. Using the formula, a municipality with 30% of its households below the tenth percentile in income, 50% below the twenty-fifth percentile, and 70% below the median, would obtain a 65% rebate on property taxes:

$$\frac{(10 - 30) + (25 - 50) + (50 - 70)}{100} = \frac{-65}{100}.$$

Municipalities with an even greater concentration of poverty could receive a rebate of all property taxes. However, adjustments to the formula might be necessary because there is no guarantee that the surcharges on exclusionary municipalities would precisely equal the formula's rebates to municipalities with more low-income households. The state, of course, could elect to make up any shortfall, and to keep any balance if surcharges exceeded rebates.

<sup>288</sup> So long as both lower taxes and increased public services are capitalized into home values, these two alternatives will have a similar effect on home values in the municipality. For a discussion of capitalization of property taxes into housing prices, see FISCHEL, *supra* note 15, at 40-42.

<sup>289</sup> *Id.*

<sup>290</sup> In the wake of the California Supreme Court's invalidation of the state's school finance system in *Serrano v. Priest*, 487 P.2d 1241 (Cal. 1971) (en banc), three scholars suggested a system that would have allowed districts to spend more on schools than the state's basic grant, but that would have permitted property-rich districts to spend only a fraction of the additional taxes they collected for excess spending, with the remainder to be redistributed to less property-rich districts. John E. Coons, Wm. H. Clune, III & Stephen D. Sugarman, *A First Appraisal of Serrano*, 2 YALE REV. L. & SOC. ACTION 111, 116-17 (1971). The problem with this approach is that assessed value does not correlate well with family income. See Brunner & Sonstelie, *supra* note 281, at 61-63 (discussing empirical evidence establishing that correlation between median family income and assessed value per family was low, and sometimes negative, in California). As Fischel has observed, "[t]he focus on the property tax

Surcharging these municipalities would be counterproductive because they tend to be the least exclusionary municipalities.

## 2. Implementation Issues

One of the model's virtues is that it would require almost no new state bureaucracy. Existing property tax assessments would remain in place, subject to the usual reassessment process to reflect changes in value. Municipalities would continue to set local spending policies as before—with the caveat that the taxes collected would have to reflect a surcharge based on the previous year's income distribution. The state's role would be limited to collecting income data (which would generally be available from tax returns and other existing sources), and then collecting and redistributing surcharge proceeds.

The model would not affect existing tax exemptions, most of which are mandated by state law. Implementation might lead to renegotiation of Payments in Lieu of Taxes ("PILOT") paid by exempt nonprofits.<sup>291</sup> If the municipality and the nonprofit have based the PILOT on a share of the municipality's overall tax burden, increases or decreases in that overall burden might lead to a reassessment of the dollar amount of the PILOT.<sup>292</sup> PILOTs, however, are significant revenue sources only in municipalities that house universities or hospitals.<sup>293</sup>

For the model's incentives to reach their full potential, municipalities might need reassurance that the incentives will remain in place over time.<sup>294</sup> Although legislation that commands a consensus may prove difficult to change, entrenchment in the state constitution would generally provide even better insurance. In California, for instance, Proposition 13, which is codified in the

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base unnecessarily conflicts with assisting the poor and disadvantaged, because many of them live in districts that have large amounts of the tax base per pupil." William A. Fischel, *Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff's "Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?"*, 51 UCLA L. REV. 887, 930 (2004).

<sup>291</sup> For background on PILOT and case studies of its programs, see generally DAPHNE A. KENYON & ADAM H. LANGLEY, LINCOLN INST. OF LAND POL'Y, PAYMENTS IN LIEU OF TAXES: BALANCING MUNICIPAL AND NONPROFIT INTERESTS (2010), [https://www.lincolninst.edu/sites/default/files/pubfiles/payments-in-lieu-of-taxes-full\\_0.pdf](https://www.lincolninst.edu/sites/default/files/pubfiles/payments-in-lieu-of-taxes-full_0.pdf) [<https://perma.cc/Z7QG-34W7>].

<sup>292</sup> A recent study concludes that at least in Massachusetts, PILOTs are positively correlated with local property tax rates: the higher the tax rate, the higher the PILOT rate. Fan Fei, James R. Hines, Jr. & Jill R. Horwitz, *Are PILOTs Property Taxes for Nonprofits?*, 94 J. URB. ECON. 109, 110 (2016).

<sup>293</sup> PILOTs tend to be concentrated in the Northeast, and it appears that universities and hospitals account for 92% of PILOT revenues in Massachusetts and Pennsylvania. *Id.* at 111-12 (noting that this "is sensible given their considerable financial resources").

<sup>294</sup> *Cf.* FISCHEL, *supra* note 15, at 49-51 (noting that homeowners may not fully rely on tax assessments when they are unsure the assessments will remain in place).

state constitution, is viewed as a political “third rail,” well insulated from repeal.<sup>295</sup>

### 3. Effect on Housing Supply and Housing Cost

As described, the model addresses the principal impetus for fiscal zoning: the tax advantages associated with excluding the poor. The tax surcharge model does not directly address the problem of housing cost, which is largely the product of zoning restrictions that limit the overall density of development.<sup>296</sup> The effect of the model’s incentives, however, would be to expand the supply of housing and to lower its cost.

Start with the unlikely assumption that municipalities would make no changes to their land use policies in response to the surcharges and rebates. So long as the surcharges and rebates are capitalized into the value of land within the municipality, the model would not significantly alter the volume of development, either positively or negatively. The surcharge imposed on an exclusionary municipality will result in a reduction in the price of vacant land,<sup>297</sup> but that reduction will not make development more or less attractive to a potential developer because the reduction in land prices will be the product of a reduction in the selling price for new homes. Similarly, the rebate available to a lower-income municipality would increase the price of vacant land, but that increase will be matched by a comparable increase in the sale price of new housing. From a developer’s perspective, the potential return on investment in new housing would remain similar with or without the surcharge model.

But the assumption that the surcharge model would not result in a change in land use policies is unrealistic. Local governments, pushed by “homevoters” are likely to respond to the economic incentives the model generates. The prospect of surcharges and rebates makes “affordable housing” more valuable to residents of every municipality than it would be in the absence of surcharges and rebates. Assume that municipalities generally attempt to exclude households who consume more in services than they generate in revenue. The surcharge model changes the municipal calculus by increasing the marginal revenue generated from inclusion of low-income households, and it increases marginal revenue

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<sup>295</sup> See George Skelton, *Proposition 13 Is a Political Third Rail. Interest Groups Are Plotting Reform, but Convincing Tax-Weary Voters Will Be a Hard Sell*, L.A. TIMES, Aug. 26, 2019, at B1 (discussing how Proposition 13 may now be untouchable due to reelection concerns by legislators).

<sup>296</sup> See FISCHER, *supra* note 15, at 1525 (criticizing proposals for requiring certain housing types for failure to provide incentives to increase total volume of housing).

<sup>297</sup> Because land is the most inelastically supplied factor in housing production, owners of vacant land bear most of the cost of exclusionary policies. See Ellickson, *supra* note 12, at 401 (“An owner of vacant land will be unable to escape serious losses from antigrowth ordinances in the common situation where his tract is much more valuable for residential development than, for example, for agricultural, commercial, or industrial use.”). The same inelasticity of supply ensures that owners of land will bear most of the cost of an increase in taxes that is not accompanied by an increase in services.



most significantly for the lowest-income households. As a result, exclusionary municipalities would now have financial incentives to liberalize land use policies to attract residents it previously tried to exclude. At the same time, less wealthy municipalities have an incentive to compete for low-income households to maintain their rebate payments.

While the surcharge model would drive municipalities to develop land use policies that promote housing for lower-income households, it is unlikely to reduce development of housing attractive to high-income households. Although high-income households become less attractive under the surcharge model, land use policies in exclusionary municipalities have historically been designed to attract housing far more expensive than the local mean<sup>298</sup>—housing that would remain fiscally attractive to almost all municipalities under the tax surcharge model. The primary effect of the surcharge model on market-rate housing would be to drive down the value of land, not to constrain the supply of new housing.

#### 4. Adapting the Model to Reward Increases in Overall Housing Supply

The basic model focuses on counteracting the fiscal incentives for municipalities to exclude affordable housing. It does not directly address the many non-fiscal reasons municipalities might have for imposing inefficient restrictions on density that constrain housing supply and increase its cost. Risk aversion, for instance, may be a major contributor to homeowner opposition to new development. Even if a homeowner were to believe that new development would be unlikely to depreciate property values, the homeowner might still oppose the development because of the small risk that it would depreciate the value of the homeowner's primary asset.<sup>299</sup>

To deal with these concerns, the state could adapt the model to reward municipalities for liberalizing zoning requirements in ways that make it more attractive to build more housing of any type, including housing appealing to more affluent consumers. Many affordable housing units are created through filtering, as affluent consumers move to newer homes and their existing homes

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<sup>298</sup> Robert Ellickson's recent study reveals that of the residentially zoned, privately owned, undeveloped tracts of land in Silicon Valley, 96.5% is zoned to require homes of at least one acre, while in Greater New Haven, the percentage is 90.9%. Ellickson, *supra* note 257, at 30. Yet, only 3.5% of the undeveloped Silicon Valley residential land is zoned to permit homes on lots equal to or less than 8,000 square feet, and the percentage in Greater New Haven is 0.4%. *Id.* Large lot sizes tend to be a proxy for higher housing prices. A recent study of Eastern Massachusetts towns found that minimum lot size restrictions can increase housing prices by up to 20%. Jeffrey Zabel & Maurice Dalton, *The Impact of Minimum Lot Size Regulations on House Prices in Eastern Massachusetts*, 41 REG'L SCI. & URB. ECON. 571, 581 (2011).

<sup>299</sup> William Fischel has explained that this fear of change may be rational for homeowners whose home represents their largest single investment; even if they do not expect change to have a dramatic impact on home values, the variance in potential outcomes may generate opposition to change. FISCHEL, *supra* note 15, at 10-11.

are purchased by less-affluent households.<sup>300</sup> Increased housing supply inevitable leads to more affordable housing.

To encourage new construction, states could give municipalities a time-limited credit against the surcharge for substantial increases in the number of dwelling units, regardless of the income of the households who live in those units. For instance, for any year in which a municipality exceeds its five-year average for new residential permits by more than 10%, the state could reduce the basic surcharge by 10%. To qualify for the reduction in a second year, the municipality would have to issue even more permits because the previous year's increased permit level would be included in the following year's base. Conversely, for any municipality that falls below its five-year average, the state could impose an additional surcharge of 10%. Again, as with the basic model, these adjustments would require no new bureaucracy beyond the need to collect readily available data.

### 5. Objections to the Tax Surcharge Model

Consider the objections to the tax surcharge model. One is purely practical: municipal boundaries are not coterminous with the boundaries of school districts.<sup>301</sup> Should the surcharge be based on the demographic mix in the school district or in the municipality with authority to make zoning decisions? Although the issue would require some attention, a national survey has found that the divergence between boundaries is more apparent than real.<sup>302</sup>

A second objection is that the tax surcharge model, like any incentive model, would enable wealthy and exclusive municipalities to buy their way out of providing housing for less fortunate households. The wealthy can, of course, buy their way out of many problems that afflict the poor, but the objection here is that exclusion from housing causes exclusion from schools and prevents less affluent children from competing on a level playing field. The problem with that objection is that, so long as we permit the wealthy to escape from public school systems altogether by enrolling their children in private schools, the playing field

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<sup>300</sup> See EVAN MAST, W.E. UPJOHN INST. FOR EMP. RSCH., *THE EFFECT OF NEW MARKET-RATE HOUSING CONSTRUCTION ON THE LOW-INCOME HOUSING MARKET* 4 (2019), [https://research.upjohn.org/cgi/viewcontent.cgi?article=1012&context=up\\_policybriefs](https://research.upjohn.org/cgi/viewcontent.cgi?article=1012&context=up_policybriefs) [<https://perma.cc/QEZ3-J8VS>] (finding that “100 new market-rate units create 70 equivalent units in neighborhoods with household incomes below the metro area median, and 39 in neighborhoods without household incomes from the bottom fifth”); see also Been et al., *supra* note 148, at 6-7 (discussing empirical evidence of filtering); Nicole Stelle Garnett, *Unsubsidizing Suburbia*, 90 MINN. L. REV. 459, 494 (2005) (claiming that new housing developments foster filtering process).

<sup>301</sup> See generally William A. Fischel, *The Congruence of American School Districts with Other Local Government Boundaries: A Google-Earth Exploration* (Apr. 1, 2010) (unpublished manuscript) (available at <https://ssrn.com/abstract=967399>) (discussing differences between municipal and school districts).

<sup>302</sup> FISCHEL, *supra* note 15, at 152-53.

will never be entirely level.<sup>303</sup> The wealthy in urban areas have long used that escape valve; as of 2013, 24% of elementary school students from high-income families attend private school.<sup>304</sup> No model that does not include an absolute prohibition on private school education ensures that wealthy children will attend the same schools as poorer children. The tax surcharge model at least makes it more expensive for the wealthy to insulate themselves and their children from association with the poor.

Another objection cuts in the opposite direction: unfairness to owners in wealthy municipalities who purchased without knowledge of a new and substantial tax burden. States could cushion the blow with transition rules that give municipalities time to make zoning changes before the surcharge becomes effective and that ratchets up the surcharge to its full effect over a period of years.

Perhaps the most significant objection is that the surcharge would induce an inefficient level of public goods and services. Residents in municipalities subject to the surcharge will opt for fewer services than they would be willing to pay for because they will be charged more than a dollar for each dollar's worth of services.<sup>305</sup> Conversely, residents in areas that benefit from the surcharge might support more services than they would be willing to pay for because they won't bear the full cost of the services.

That inefficiency, however, would be the price of greater equality: more money would be spent on schools in less wealthy municipalities, while less would be spent in wealthy ones. The equality advantages of the surcharge would be tempered by the probability that some of the wealthiest families in exclusionary suburbs would follow the example of their urban counterparts and abandon the public school system altogether in favor of private schools. But families willing to take that step would be more likely to move to less exclusionary municipalities to escape the tax surcharges. Even if that sort of relocation would not create social and economic integration of schools, it would increase the tax base of less exclusionary municipalities, and, at the same time, increase the social and economic integration of neighborhoods.

Finally, the surcharge model would present a hard political sell to representatives of affluent communities. The model does, however, have one feature that makes it more attractive to those communities than other alternatives: retention of local control. That local control strengthens the

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<sup>303</sup> Cf. Larkin, *supra* note 10, at 1639 (noting that enrollment in private schools is both a cause and a response to poorer quality public schools in Black middle-class suburbs).

<sup>304</sup> Richard J. Murnane & Sean F. Reardon, *Long-Term Trends in Private School Enrollments by Family Income*, 4 AERA OPEN 1, 10 (2018). Olatunde Johnson has noted that, even in cities, parents in gentrifying neighborhoods exercise school choice to avoid schools in their zoning districts. Johnson, *supra* note 8, at 847-48 (noting that more than half of parents exercised school choice).

<sup>305</sup> William Fischel, for instance, has explicitly made this argument. FISCHEL, *supra* note 15, at 151 (claiming that homeowners supported raise in property taxes because decline in school quality would hurt their home values).

potential for Tieboutian competition among municipalities, even with the constraints of the tax surcharge. Moreover, so long as surcharge funds are distributed to municipalities at the other end of the economic spectrum, there should at least be a ready constituency to support enactment.

#### CONCLUSION

By increasing the cost of housing, overly restrictive zoning isolates disadvantaged minority groups and impedes movement to the most productive areas of the country. Relaxing zoning restrictions would promote more housing and more lower-cost housing. Unfortunately, neither of those objectives is in the interest of the municipal residents who largely control the zoning process.

The FHA has provided one avenue for combatting housing discrimination and for making housing more available to those with modest means. Discriminatory treatment claims promise some success in cases with sufficient evidence of racial animus, but at least three factors limit the potential of discriminatory impact litigation as a remedy for exclusionary zoning. First, because overly restrictive land use restrictions increase the price and limit the availability of housing at all price levels, it is difficult to prove that those restrictions have a disparate impact on any racial or income group. Second, a “business necessity” defense to FHA claims may encompass municipal restrictions designed to protect taxpayers from incurring the additional costs associated with an increase in lower-income residents. Third, even if Congress removed the doctrinal obstacles to FHA claims, relying on litigation to promote affordable housing provides incentives for municipalities to delay and resist rather than to cooperate in providing lower-cost housing. This third difficulty also plagues states’ mandates designed to preclude municipalities from pursuing exclusionary practices.

Tax policy, however, remains an underutilized tool for combatting exclusion. Because economic motives lie behind much exclusionary zoning—and particularly fiscal zoning—economic incentives and disincentives have the potential to alter the calculus facing municipal decisionmakers. Unlike mandates, incentives may make municipalities willing participants in liberalizing zoning restrictions. In particular, property tax surcharges that increase the cost of exclusionary zoning hold considerable promise as a weapon against exclusionary policies.

