Can Miami Convince The Supreme Court That Subprime Loans Hurt Cities, Too?

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In the aftermath of the housing crisis of 2008, big banks such as Wells Fargo shelled out hundreds of millions of dollars to black and Latino borrowers who claimed they were steered into higher-risk, higher-fee loans than were white borrowers who presented the same credit risk. But these individual homeowners weren't the only ones affected by the foreclosures that left entire neighborhoods full of empty, boarded-up houses. City governments were also suddenly faced with maintaining these crumbling swaths of real estate. While property values and tax revenues fell, they dispatched police and firefighters to protect the homes from vandalism and criminal activity. Should they also be able to go after the banks for financial damages?

That's the question facing the Supreme Court on Tuesday. Cities such as Miami, Los Angeles, Providence, Birmingham, Memphis and Baltimore have all sued the banks, using the Fair Housing Act to argue that they were financially injured by the racially discriminatory lending practices. A few of these lawsuits have already settled, but the Supreme Court will hear arguments in Miami's case, which two banks — Wells Fargo and Bank of America — have asked the courts to dismiss, claiming that cities are abusing a law designed to protect against segregation, not guarantee municipal tax revenues.

While one important issue in the case is a purely legal question — whether cities have standing to sue — the heart of the case is an empirical challenge: Can the cities prove that they were directly and measurably harmed by the banks' discriminatory lending practices? The Fair Housing Act is cities' best chance to reclaim some of the money lost during the financial crisis, according to lawyers I spoke to, even though it means the cities can only claim damages caused by discrimination. The banks say it's impossible for Miami or any other city to prove that their actions led directly to the cities' financial troubles. But Miami nevertheless claims that there is ample evidence to suggest that when banks discriminate against borrowers, cities are victimized, too.

Because the lawsuit is still in an early stage, Miami has yet to produce a figure for damages — a number that would indicate the extent to which the city's attorneys and analysts believe it was materially harmed. And because the lawsuit is being filed under the Fair Housing Act, cities don't just need to prove that they were harmed by predatory lending, which affected borrowers of all races; they have to link their financial losses specifically to*discriminatory* lending

practices. But housing scholars such as Jacob Rugh, a sociologist at Brigham Young University, say that although it's difficult at this stage to assess the strength of Miami's particular case, there is a strong empirical argument for allowing cities to sue.

The story begins, Rugh said, in the late 1990s, when banks began marketing high-risk, high-fee home loans to black and Latino borrowers, especially those living in segregated neighborhoods. In a study published in 2015, Rugh and his co-authors examined 3,027 home loans in Baltimore (one of the few cities that has successfully settled a Fair Housing Act lawsuit against a bank) made between 2000 and 2008.

When they controlled for basic loan characteristics such as credit score, down payment, and income, they found that black borrowers were channeled into higher-risk, higher-fee loans than were white borrowers with similar credit histories. These findings were compounded for black borrowers living in predominantly black neighborhoods: The study found that relative to comparable white borrowers, the average black borrower in Baltimore paid an estimated $1,739 in excess mortgage payments from the time the loan was made, a figure that was even higher for black borrowers in black neighborhoods.

"When you look at the data, some of what you're seeing are just bad loans, distributed across racial groups; many white borrowers got these high-risk loans, too," Rugh said. "But it's clear at this point that black and Latino borrowers were likelier than similarly situated white borrowers to be channeled into high-risk products." As a result, minority borrowers were also substantially likelier than white borrowers to enter foreclosure. That these borrowers also tended to be concentrated in segregated areas meant that cities were suddenly faced with entire neighborhoods full of abandoned homes. And although not all of these foreclosures were the result of discrimination, Rugh said, there's evidence that a substantial subset of houses were lost because the banks disproportionately targeted these minority borrowers.

Some economists question whether findings such as Rugh's should be chalked up to overt discrimination on the part of the banks, or whether the racial disparities in high-risk lending were the result of other factors. Anthony Yezer, a professor of economics at George Washington University, said that the disparities can be explained — at least in part — by the fact that people from minority backgrounds are less likely to shop around while looking for a mortgage. "Any group that is relatively less educated, relatively less numerate, won't get the same price as the group that is financially literate," he said.

In an *amicus* brief filed in support of Miami, a group of housing scholars argued that there is a direct link between the harm to borrowers documented by people such as Rugh and financial losses incurred by cities. Citing more than a decade of economic and sociological research from a variety of sources, Justin Steil, a professor of law and urban planning at MIT and one of the authors of the brief, explained, "the data is well established that foreclosures do lead to decreases in neighboring property values, which then lead to decreases in city revenues. Foreclosures," he added, "also lead to more expenditures by the city in re-securing those properties, dealing with the vandalism, squatting, fires. And if the neighborhoods don't recover, it just remains an ongoing problem for those communities to deal with."

Supporters of the banks in this case say that if anything, leaders of cities like Miami encouraged the influx of credit into their municipalities. "I really think Miami wants to have this both ways,"

said Mark Calabria, director of financial regulation studies at the Cato Institute. “If the banks weren’t doing business in Miami, they’d have a problem with that. It’s hard for me to believe that Miami would have been better off if Bank of America and Wells Fargo hadn’t been there.”

There has been an effort to determine more generally what would have happened if the banks hadn’t offered such a glut of high-risk loans, especially to minority borrowers living in segregated neighborhoods, according to Dan Immergluck, an urban planning professor at Georgia Tech. Immergluck hasn’t looked at Miami specifically, but he has been studying the disparate impact of high-risk loans for more than 20 years. “You compare neighborhoods that were targeted for these loans with neighborhoods that weren’t targeted, and the results are clear: The neighborhoods that weren’t targeted did much better,” he said. He added that, if anything, the data about the relationship between foreclosures and surrounding property values are remarkably consistent. “It makes sense, in an intuitive way,” he said. “This cycle that inflates values unsustainably and then lets them crash — the housing prices end up lower than they were before the cycle started, and it’s very difficult for neighborhoods to recover.”

Establishing that cities suffered as a result of the banks’ lending practices is just the beginning, though. If the Supreme Court allows Miami’s lawsuit to go forward, the city will next have to figure out how much money to demand from the banks and be able to defend that number in court. Coming up with a compelling estimate of damages will be challenging but not impossible, according to Immergluck. “The most obvious avenue is to assess lost property value and its effect on marginal tax revenue over time,” he said. But there are other factors that can be traced back to individual foreclosure-related home vacancies: the cost of handling vacant properties, including fire prevention, police protection and code enforcement costs.

Pursuing this kind of analysis would be painstaking and expensive for the cities, said Kathleen Engel, a research professor at Suffolk University Law School. “It’s clear at this point that the cities have to point to specific pieces of property and say, ‘Wells Fargo, you made a loan on this property that was unaffordable and part of this pattern of racial discrimination, you foreclosed on it, it became dilapidated and we spent X dollars cleaning it up or tearing it down,’” she said.

In Baltimore’s case against Wells Fargo, which was settled in 2012 as part of a larger case brought by the Department of Justice, the city identified its out-of-pocket costs in maintaining nearly 200 properties that the city claimed were empty as a result of Wells Fargo’s discriminatory lending practices. The challenge was twofold: identifying properties that became vacant because of the banks’ lending practices, and then pulling together all the data related to the properties. “It’s really a lot of work, for an uncertain payoff,” Engel said. Baltimore received $7.5 million in damages from Wells Fargo.

Regardless of the outcome in each individual case, Engel thinks it’s important for cities to have a form of legal recourse. “The cities always get left out in the cold, because they don’t really have the power to prevent a crisis like this but they always have to bear the cost,” she said. Steil, the MIT professor, added that the cities have a legal obligation to act as advocates for their residents, especially in cases where an individual borrower might not be aware of the broader forces at work. “You need some sort of collective entity taking a look at what’s happening and evaluating patterns,” he said. “An essential part of this case is establishing that cities have a real stake in what’s happening to their residents, and they need to be able to act on their behalf.”

So far, civil rights advocates have argued that settlements such as Baltimore’s are just a drop in the bucket. Without more aggressive action, they claim, banks will just continue engaging in new but equally problematic behaviors. In the housing scholars’ amicus brief, Steil and his co-authors pointed to the new dearth of credit for black and Latino homeowners as another form of discriminatory lending that perpetuates segregation and stymies the recovery of black and Latino neighborhoods. But if the Supreme Court prevents them from suing under the Fair Housing Act, cities may have lost their best chance to hold the banks accountable for predatory lending.