Going Public: Implications for the Question of Minimizing Discrimination in the Residential Real Estate Industry

Richard H. Bennett*

This article looks at the practice of sourcing funds from the securities market and highlights the discrimination possibilities this funding provides. The author addresses whether the financial pressures of the stock market will generate the proper supply of affordable housing. Although equity funding can alleviate the developer from discriminatory impulses lenders may have, it also frees the developer to act upon those same impulses. By looking at what criteria and uses are currently covered by federal and state law, the author notes that the current legal regime does not prevent the equity-sourced developer from acting in a discriminatory manner in determining what types of housing to build.

A trend has developed in the real estate industry whereby developers, who have traditionally looked to lending institutions for funds, have decided to go public as an alternative source of money. The predominant reason given for this move is the lack of money lending institutions have or are willing to provide to commercial real estate development.[1] Although there may be other reasons for this change,

* JD, University of Georgia School of Law; MBA, University of Georgia School of Business. Special thanks to Prof. Randall Johnson for his comments and recommendations for this article. © Copyright 1994 by Richard H. Bennett.

[1] See, e.g., Lawrence Zuckerman, "Secretive Property Empires Made Public by Stock Sales," *The New York Times*, July 8, 1994, at A1; James J. Hanks. Jr., "Maryland Legislature Offers Protection to REIT Trustees and Officers," 6 No. 8 Insights 28 (1992); Bill Lubinger, "Jacobs Group Reportedly Plans to Form Realty Trust," *The Cleveland Plain Dealer*, May 17, 1994, at 5C. The US is not alone in this shortage of funds for commercial lending. See, e.g., Sam Jameson, "Old, Uncollectable Loans Jeopardize Japan's Financial System," *The Los Angeles Times*, Sept. 4, 1994, at D3 (shortage of funds from banks, due in large part to the collapse of real estate prices after land speculation in the 1980s, will choke off economic growth as businesses' needs for loan financing increase). See infra notes 36–46 and accompanying text for a discussion of whether there might be other reasons for the U.S. shift to equity financing.

one question this trend raises is what impact it is likely to have concerning discrimination in commercial development and lending. Should the move to equity be as prevalent as some believe,[2] then it is safe to say that the character of the industry will undergo a significant structural change.

Clearly, the way the company is run will be profoundly affected.[3] Being brought under the magnifying glass of the SEC carries its own burdens,[4] less obvious, however, is the impact the move to stocks is to have on the U.S. antidiscrimination regime. Are our laws set up in such a way as to cause this structural shift in the source of funds being used by developers? Will developers, because of the bottom line, decide to build only predominantly higher-cost facilities, thereby creating a shortage of medium-to lower-cost housing? Will developers be able to use their funds to fulfill discriminatory desires, because the money has not been sourced from a federally insured or funded institution?

To address these questions and better understand the impact the move to equity is likely to have on the nation's attempts to minimize discrimination, it is first necessary to have a firm understanding of the securities market and how the mere fact of being a public company will affect management decisions. Stock is not new to the developer. Several development companies, as closely held corporations, have had stock issued to some degree, it is having publicly traded sock that is new.

Primary and Secondary Markets

When people say the "securities market," what they principally are referring to is the secondary market. The secondary market refers to one holder of a security selling to another investor.[5] The most notable examples are the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX). While these two exchanges

[2] The commercial real estate industry is about $3 trillion in size, and $25 billion has been raised to date through the stock market. Some experts believe this amount will rise by a factor of ten or more over the next decade, Zuckerman, supra note 1, at A1. Although this belief provides for a 25 percent annual growth rate, the result could be anywhere between 8 and 20 percent of the entire market at that time, depending on the expected growth of the industry.

[3] See Andrew D. Hudders, "The End of a Private Affair: Public Stock Offerings Bring Companies Burdens as Well as Money," ABA Journal, Sept. 1994, at 49.

[4] See 15 USCA §§ 77a–78111 (1981 and Supp. 1994). See generally Hudders, supra note 3.

[5] Robert A. Haugen, Modern Investment Theory, 28 (2d ed.) (1990).

are auction-like in character, the other main channel for securities entails an intricate network of securities dealers over some geographical area. These over-the-counter markets, such as the National Association of Security Dealers Automated Quotation System (NASDAQ), basically involve the dealers buying and selling from their own securities.[6]

Companies that issue stock, however, are not involved in the secondary market.[7] Instead, they work within the primary market. The primary market is distinguished from the secondary market in that it involves the very first issuance of those shares of stock. The funds raised go directly to the company to be used for paying off debt, sustaining growth, or other financial needs. Often, the companies use the services of an investment banking firm to assist with this issuance. Investment bankers provide a knowledge base about the current state of the market, information on how much money can probably be raised, and what types of securities would optimize capitalization; they then prepare a prospectus disclosing relevant information to potential investors and synchronize with other investment bankers to coordinate relatively large or cumbersome transactions.[8]

The terms primary and secondary market can also be used in other contexts. In the lending area, for example, the primary market refers to the interface between lenders and borrowers. Unlike the primary market in securities, there is little in the way of an extensive, organized network to facilitate the movement of funds from the lender to the borrower.[9] Instead, a bulk of the transactions are handled in geographic pockets, the size of which is dependent on the class of borrower.[10]

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[6] See id.

[7] Companies may, of course, interact in the secondary market when they buy the stock of other companies or repurchase their own shares on the market.

[8] Haugen, supra note 5, at 27.

[9] In its broadest sense, financial institutions play this role because the money they are using is sourced from other individuals and companies. The financial institutions act as a conduit for money to flow from savers to users. However, for the purposes of this paper, the term "lenders" is used in a more narrow sense, referencing the financial institutions themselves rather then the savers from which the money comes. In this sense, there is no market of lenders which easily allows borrowers to compare rates among all available lenders and get the best deal. In essence, the author is more concerned over who has control over the disbursement of funds, because it is that entity that has the opportunity to act upon discriminatory desires.

[10] Corporate borrowers, because of their size and geographic expanse, often are able to shop around and leverage lenders to terms more favorable to the corporation. The individual home buyer, on the other hand, is generally limited to the few local banks whose terms are relatively non-negotiable and similar across the board.

Traditionally, there was not a true secondary market for the promissory notes and mortgages generated by the loans made through the financial institutions. The banks could sell the notes as an asset to a third party at a highly discounted rate, but these individual transactions were not only costly in the aggregate, but also exposed the buyers of the notes to substantial risks.[11] If the borrowers fail to pay, the assignee is out a great deal, because the reason for the default is generally due to lack of funds—and a person without money is not a good person to sue for breach of contract.[12]

Securitization

In an attempt to decrease these transaction costs and provide liquidity to the market, the federal government passed legislation that provided for the securitization of these financial assets.[13]

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[11] The two main risks faced by the holder of a mortgage is prepayment risk and default risk. A mortgagor usually prepays because either he has sold the house and is moving into another one or rates have fallen and he has refinanced. Either way, the mortgagee must reinvest this unexpected money, usually in a market with lower rates available. If the mortgagor defaults, the mortgagee may not be able to recover all his principal through foreclosure.

One way to reduce these risks is to hold a diverse set of mortgages. Portfolio theory demonstrates how, by holding assets in a proper mix, the risk of the entire portfolio can be reduced below the risk of any single asset in the group. The risk of a two-asset portfolio, for instance, is measured by the formula

$\sigma_P = \sqrt{W_1^2\,\sigma_1^2 + W_2^2\,\sigma_2^2 + 2\,W_1\,W_2\,\sigma_{12}}$ where σ_P is the portfolio standard deviation (risk), w_1 and w_2 are the percentage of the portfolio each asset comprises, σ_1 and σ_2 are the standard deviations of the two assets, and σ_{12} is the covariance between the two assets. If one asset has a standard deviation of 12 percent, another asset has a standard deviation of 15 percent and the covariance between them is .0072, then the standard deviation of the portfolio will be 11.32 percent where one holds 50 percent of each asset. Thus, the risk of the portfolio is less than the risk of either asset. Eugene F. Brigham and Louis C. Gapenski, Financial Management: Theory and Practice 119 (6th ed. 1991). This process is widely used in the stock market, and the more assets are placed in the portfolio, the larger this formula becomes, necessitating the need for a computer.

[12] This risk is theoretically taken account of in the discount rate the assignee required to purchase the security. Additionally, the assignee should be able to make a large number of individual purchases from multiple sources, thus spreading risks. See supra note 11 and accompanying text. However, a great deal of systematic risk is involved in the mortgage industry, so this form of diversification may not be too successful. See infra notes 19–20 and accompanying text. Additionally, the transaction costs involved in so many buying transactions may prove highly prohibitive.

[13] Secondary Mortgage Market Enhancement Act. Pub. L. No. 98–440. 98 Stat. 1689 (1984) (creating and editing various sections of Title 12 and Title 15). Two other goals, or possibly merely results, of the securitization process exist. First, agencies can smooth differences among regions for the demand of real estate capi-

Securitization is the process of taking an illiquid asset, packaging it into a pool of similar assets, and then issuing securities that are backed by the cash flow provided by the underlying pool of assets.[14] Under this situation, the banks take their mortgages, group them into like assets, and sell them to a third party, usually a government agency,[15] which in turn issues the securities. When the underlying assets are residential mortgages, the securities issued are referred to as mortgage-backed securities (MBSs).

The key feature to this process is the pooling. If the assets are not properly matched, then there is a differential between the cash flows the buyer of the security desired and the flows actually received.[16] If

tal, allowing growth to be maximized. Additionally, funds for real estate capital can be raised by issuing short-term notes and long-term bonds by the agencies, which in turn use the money to purchase the mortgage pools. This second goal creates a link between the real estate capital market and national and international capital markets. Michael H. Schill, "Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets," 64 Cal. L. Rev. 1261, 1269 (1991). This act, however, only provided for the securitization of residential loans. Congress recently passed a law that will provide for the securitization of small business loans and is also considering a bill that will promote commercial loan securitization. See infra note 36.

[14] James C. Van Horne, Financial Market Rates and Flows 10 (3d ed.) (1990).

[15] There are three main government agencies or quasi-agencies that deal with securitization. They are the Federal National Mortgage Association (12 USCA §§ 1716–1723i (1989 and Supp. 1994)), the Government National Mortgage Association (split from FNMA by 12 USCA § 1716b (1989), retaining powers under 12 USCA § 1721 (1989 and Supp. 1994)) and the Federal Home Loan Mortgage Corporation (12 USCA §§ 1451–1459 (1989 and Supp. 1994)). These agencies are commonly referred to as Ginnie Mae, Fannie Mae, and Freddie Mac, respectively. Ginnie Mae primarily handles low-income housing subsidy programs and securitizes loans guaranteed by the FHA, FmHA, and VA. The other two agencies securitize conventional loans and seasoned FHA/VA loans. Edward L. Pittman, "Economic and Regulatory Developments Affecting Mortgage Related Securities," 64 Notre Dame L. Rev. 497, 499–500 (1989). The involvement of these agencies has grown substantially. In 1980, the combined market share of these three agencies was about 20 percent. Eight years later, their share had grown to approximately 80 percent, "Freddie and Fannie Do More Harm Than Good," Am. Banker, Aug. 9, 1994, at 8.

[16] The MBS is a pass-through security. Whatever payments are made by the mortgagors are passed along to the security holder. Financial institutions have created a myriad of security products from the standard MBS to provide various expected cash flows. The collateralized mortgage obligation (CMO) divides the payment stream into different maturities. There are traditionally four classes or tranches carved out of the standard mortgage pool. The first three tranches get interest payments as they accrue. During the first period, the first tranche also receives all the principal payments. The second and third tranches then get principal payments during their terms. The fourth tranche, referred to as a Z bond, gets nothing until

this differential is too great, the liquidity for that security is hindered. At first, matching like instruments was relatively easy. The primary mortgage had a fixed rate, and thus, mortgages were grouped by geographic location, age of the loan, and the interest rate.[17] The introduction of adjustable-rate mortgages (ARMs) made the matching process much more difficult.[18]

The major distinguishing feature of MBSs from other securities, and the feature that makes them so difficult to be valued, is the prepayment possibility.[19] This feature can be equated to a call feature, which some traditional securities (e.g., bonds) have. There, the entity supplying the stream of money decides to call the security, paying a set amount to each security holder in return for the security. In this sense, a call is similar to a prepayment option. However, when a call is exercised, the call price is known beforehand, and all the securities in that class are bought back. With an MBS, prepayment may occur in only a portion of the underlying assets. In a call situation, an investor gets a good idea of the conditions under which the call will be exercised and the amount that will be received if it is called. With an MBS, the investor may receive some of his principle one month and more the next, resulting in erratic interest payments and increased reinvestment risk. Because this prepayment feature can create so many problems with valuation, the price offered for MBSs will be reduced to reflect the risks of prepayment, including an error factor that cannot be explained by the model used to value the security.[20]

the previous tranches have expired. It then receives whatever payments remain, both principal and interest. Other derivative products include stripped mortgage-backed securities (SMBSs), interest-only securities (IOs), and principal-only securities (POs). See Van Horne, supra note 14, at 243–244.

[17] Lynn Bartholomew, Jonathan Berk and Richard Roll, Adjustable Rate Mortgages: An Introduction 3 (1986).

[18] Goldman, Sachs identifies ten features of the ARM that could be used to classify mortgages into pools. They include the index the rate is tied to, the amount added to the index, the frequency the rate is adjusted, the caps on interest rate movement (periodic and lifetime), the teaser rate (an initial interest rate usually below market rates to entice customers to the bank), prepayment catch-up provisions, increment requirements (usually in .125 blocks), the option not to raise the interest rate, and the possibility of negative amortization. Id. at 4–14.

[19] Van Horne, supra note 14, at 243.

[20] In valuing MBSs and determining the possibility of prepayment, both types of prepayment situations must be factored into the models. Looking at historical data put out by the FHA, investors can determine roughly what percentage of the pool will be prepaid as a result of people moving and other non–interest rate related factors. The FHA tables may suggest that 1 percent of the pool will be prepaid in the first year, $3^1/_2$ percent in the second year, 5 percent in the third year, and so

Valuing the Pool of Assets

Ideally, then, people who buy the pools of assets behind the MBSs and sell the securities on the secondary market wish to have access to information that would allow them to place a more accurate value on their securities. If they can account for certain price fluctuations, they can sell the MBS for a higher price then they could by merely throwing in an error term. Aside from the purely financial terms of the underlying asset,[21] current models also include various macroeconomic indicators,[22] but these do not provide the complete picture about why particular loans are prepaid. Ideally, those purchasing the pools would want to know particular demographic information *about the borrower,* such as age, number of dependents, education, and income.[23] If a model could be built on these factors and the necessary information provided, a more accurate valuation would likely occur.

Age, for instance, is a protected class under the Equal Credit Opportunity Act (ECOA).[24] However, just because the *creditor* cannot use this information in the decision to extend credit does not mean that the information cannot be used by *investors* in attempting to valuate the mortgage pools. Furthermore, certain information is easily amassed through the Home Mortgage Disclosure Act.[25] This act

forth. CMO pricing usually relies on assumptions modeled on data from the Public Securities Association (PSA). The PSA assumes a .2 percent prepayment per month for $2^1/_2$ years, then 6 percent per year prepayment for the rest of the pool's life. Thus, if someone says prepayments are occurring at 250 percent PSA, they are occurring at $2^1/_2$ times these rates.

The second prepayment factor is due to refinancing. This risk is determined by looking at the spread between the market interest rate and the mortgage interest rate of the pool. If the spread is greater than 1 percent, accelerated prepayment will occur. If the spread is greater than 2 percent, heavy prepayment of up to 50 percent per year will occur. Van Horne, supra note 14, at 245–246.

[21] See supra note 18.

[22] These include disposable personal income, housing starts, housing turnover, and other indicators compiled and reported by the government. Van Horne, supra note 14, at 246–247.

[23] See id. Other general factors worth knowing are the precise location of the property, migration patterns, and past sensitivity of prepayments to rate declines. Id.

[24] 15 USCA § 1691(a)(1) (1982 and Supp. 1994). There are, however, proper uses of age under the act. For instance, age may be used if the purpose is to determine the probable continuance of current income levels. Id. at (b)(2).

[25] 12 USCA §§ 2801–2810 (1989 and Supp. 1994).

requires disclosure of loans grouped by census tract, income level, racial characteristics, and gender, among others.[26] The concern exists that these characteristics can be used to discriminate against home buyers.[27] If the entities that purchase the pools rely on these criteria, they may discount pools that contain lower-income housing or are in certain geographical areas in which the values of the properties are expected to decline. These discounts will result in the loan originators charging greater interest to those homeowners than homeowners in other areas and therein lays the injury. If developers source from equity, though, there is no change in the law's applicability to this conduct.[28]

Popularity of Stocks

Many real estate developers have decided to use the real estate investment trust (REIT) for issuing stock. Merely meeting the requirements to become a REIT, as outlined in the Internal Revenue Code, is a daunting task.[29] The main requirements are:

- Beneficial ownership must be held by at least 100 people;[30]
- The trust cannot be closely held;[31] and
- Income sources and assets must be derived from precise areas[32] and dividend payments of a certain amount.[33]

[26] 12 USCA § 2803(b)(4) (1989 and Supp. 1994).

[27] Cf. Mollee Bennett, "Resolving the Community Reinvestment Act Dilemma: Eliminating "Whites Only" Mortgage Lending while Reducing Regulatory Red Tape," 24 Tex. Tech L. Rev. 1145, 1166 (1993). See also Cartwright v. American Sav. and Loan, 880 F2d 912 (7th Cir. 1989) (prohibition against denying loan because of the property's location does not require the lender to disregard its business interest and make investments that are not economically sound).

[28] See infra note 99.

[29] 26 USCA §§ 856–860 (1988 and Supp. 1994).

[30] 26 USCA § 856(a)(5) (1988 and Supp. 1994). Any stock held by a trust is thought of as being held by that trust's beneficiaries in proportion to the beneficiaries' interest in the trust. USCA (h)(3)(A)(i).

[31] USCA (a)(6). This requirement is met when, during the last half of any taxable year, more than 50 percent of the value of the outstanding stock is owned, directly or indirectly, by more than five individuals. 26 USCA § 542(a)(2) (1988 and Supp. 1994). It is also known as the "5 or 50" rule. Lawrence G. Preble, "The Recapitalization of Real Estate," Probate and Property, March/April 1994, at 45.

[32] 26 USCA §§ 856(c)(2)–(5) (1988 and Supp. 1994). The lease detailed requirement, as an example, states that at least 75 percent of the value of the company's

One major benefit of the REIT over the corporate form is that the REIT is not subject to federal income taxes on the portion of its ordinary or realized capital gains distributed to its shareholders, thereby avoiding the double taxation problem.[34]

The popular reason behind this increased activity in the stock market by real estate developers is the unwillingness of the banks to be faced with another S&L crisis–like situation;[35] thus, they have made fewer funds available for lending to commercial real estate. Although this point may be true concerning the initiation of this movement, the continuation of the trend toward public offerings will survive only if there are other reasons for these companies to issue stock.[36] REITs

total assets must be in the form of real estate, cash, cash items, and government securities. USCA (c)(5)(A).

[33] This is really a requirement to continue being a REIT, not a requirement to become a REIT. Dividends paid must equal or exceed 95 percent of the taxable income, plus 95 percent of the after tax income or foreclosures, minus any excess noncash income. 26 USCA § 857(a)(1) (1988 and Supp. 1994). Excess non-cash income is defined in 26 USCA § 857(e) (1988).

[34] 26 USCA § 857 (1988 and Supp. 1994). Accord, Preble, supra note 31, at 45. Another benefit identified by Preble is the creation of liquidity. Prior to becoming a REIT, a company has a large real estate holding, which itself is highly illiquid. The company's money is tied up in the real estate. The company cannot benefit much from the real estate's increase in value and takes direct hits should the value decrease (e.g., tenants in a shopping center are leaving and thus little income is flowing to the owners). Forming a REIT and selling stock initiates an influx of capital that reflects the current value of the otherwise illiquid asset, and the stocks issued can now be bought and sold freely. Preble at 46. In this fashion, the REIT looks very much like the securitization process for real estate debt, particularly because the payments of dividends on the REIT is tied to the net income of the REIT, thereby looking a great deal like a pass-through security. See supra note 16.

[35] See supra note 1.

[36] Without other reasons, current legislation in front of Congress will likely bring an end to real estate company stock. At the end of September 1994, HR 3474 was passed into law, allowing for the securitization of small business loans much as residential loans are currently securitized. Small Business Loan Securitization and Secondary Market Enhancement Act, Pub. L. No. 103–325, 108 Stat. 2160, 2198 (1994). In the wings is a bill that will allow the securitization of commercial loans. HR 2600, 103d Cong., 2d Sess. (1994). If passed, this bill will greatly increase the liquidity of the commercial loan market, thereby making more funds available to banks to lend out to commercial ventures and removing much of the temerity banks may have toward lending to this industry. There is good reason to believe, however, that the benefit will not be as great as it has been for the residential market. See Developing a Secondary Market for Commercial Loans. Hearing on HR 3474 and HR 2600 Before the Subcomm. on Telecommunications and Finance of the House Committee on Energy and Commerce, 103d Cong., 2d Sess. (1994) (non-

have a certain tax advantage over corporations,[37] but no such advantage exists over a general or limited partnership. Nevertheless, certain other advantages exist for management, advantages that other industries have discovered decades ago and have equal application to the commercial real estate industry.

First, management obtains access to a large source of cash[38] that, for all practical purposes, is unrestricted.[39] There is no requirement that the company pay back the money to stockholders at regular intervals, as must be done for loans and bonds. Dividends need not be distributed as long as the money is put to use.[40]

Closely bound with the need to make interest and dividend payment is the issue of leverage. Leverage occurs when a company can

standardized format of commercial loans, overlapping jurisdiction between new supervisory agencies with the SEC, and policy concerns over fraud–like behavior by investors among other reasons). A quasi–securitization market exists for commercial loans today, but it is structured very differently from the residential market. See supra notes 13–18 and accompanying text on the residential market. The basic commercial real estate MBS transaction involves the issuance of debt, which is secured by a mortgage on the real estate, combined with the simultaneous issuance of an indenture by the land owner of the owner's interests under the mortgage. This arrangement may be further secured by letters of credit, surety bonds, and other equivalents. See, David Alan Richards, "'Gradable and Tradable': The Securitization of Commercial Real Estate Mortgages," 16 Real Est. L.J. 99, 123 (1987). It seems, however, that at least one bank, the Bank of Boston, is either acting to create a true secondary market or is merely anticipating HR 2600. See, Richard Kindleberger and Joe Clements, "Bank May Sell Shares in Commercial Mortgages," *The Boston Globe*, June 9, 1994, at 41.

[37] See supra note 33 and accompanying text.

[38] As of May 17, 1994, the Richard E. Jacobs Group was planning to issue $700 million in public stock, the second largest REIT equity sale at that time. Simon Property Group, another mall developer, raised nearly $1 billion in December 1993. Lubinger, supra note 1, at 5C.

[39] Hudders, infra note 3, at 49. This money is not truly unrestricted, of course. Management must put that money to its best use and not squander the money away. See infra note 80 and accompanying text.

[40] Although REITs must distribute certain percentages of their net income (see supra note 33), if the money is spent to pay down debt or buy other assets, the issuance of stock would not itself increase net income. There may be an indirect increase in net income from various uses of these funds, however. If the company uses the money to pay off debt, future interest payments, which are tax deductible, would increase taxable income and therefore increase taxes. Depending on the tax and interest rates involved, this may increase net income. Buying more properties provides more sources of income and additional expenses. Again, net income may rise as a result. Nevertheless, the point remains that equity, unlike debt, does not have the additional necessary result of cash disbursements.

earn more on the borrowed capital than it costs to pay for that debt.[41] At given debt-to-equity ratios, increased earnings per share (EPS) can be attained above those of a similarly situated firm with no debt.[42] An increased EPS, in light of a REIT's required dividend policy,[43] equates to an increased stock value.[44] However, a company running on extremely high debt-to-equity ratios incurs various agency costs and bankruptcy risks that can decrease the value of the firm.[45] Therefore, some optimal level of debt and equity exists that provides the company with the benefits of debt without the risks of too much debt. When developers finance their assets solely from loans, they run the risk of financial distress. Therefore, the addition of equity sourced outside of management provides substantial benefits.[46]

[41] Hamilton, Fundamentals of Modern Business 338 (1989).

[42] Picture two companies, one with no debt and one with 50% debt. Their respective EPSs may be:

	Company A	Company B
EBIT	$4,000,000	$4,000,000
Interest ($10M @ 8%)	—	(800,000)
Taxes (30%)	(1,200,000)	(960,000)
Net Income	2,800,000	2,240,000
Shares of Stock	1,000,000	500,000
EPS	$2.80	$4.48

(adapted from Brigham, supra note 11, at 448–53).

[43] See supra note 33.

[44] See infra note 80.

[45] Agency costs reflect the tensions that arise when management wants to favor stockholders, yet bondholders, funding a majority of the company, feel they should have preference. Favoring equity holders could lead to decisions such as selling low-risk assets to acquire higher-risk, higher-return assets. The benefits of debt are minimized where the tax shelter gained by the debt is less than the present value of the financial distress and agency costs incurred because of the level of debt. See Brigham, supra note 11, at 461–463.

[46] Although a development company may be started as a closely held company, the need for cash to grow with the market can easily outstrip the resources of the original equity holders, and increased debt positions carry the already mentioned risks. Thus, the move to the public securities market is a natural progression and should be sustained whether or not banks free more money for real estate development in the future.

Effect of Funding Development With Stocks

If the stock market continues to provide developers with the long-term money supply they need, what effects will this structural change in the real estate market have on the type of housing developed? Prior to this move to equity, the commercial developer went to banks for financing. Banks, of course, lend money to make a profit. There is some evidence, however, that suggests that banks are not driven solely by the bottom line. For example, when Property Trust of America, a real estate company in New York, went to the banks for loans, the bank was able to influence the type of developments undertaken by Property Trust by advancing loans for certain projects and denying them for others. During the past five years, Property Trust directed a bulk of its development on luxury housing because that was the submarket industry capital was interested in. The people looking for housing, however, were interested in more affordable housing. The end result was the overdevelopment of the luxury market and its eventual collapse in pricing.[47]

Something, then, went wrong with the "free market" in this situation. The demand for affordable housing existed. Apparently, Property Trust and other developers recognized this demand.[48] Nevertheless, because the source of funds was able to control its use, the market was not truly a free market and this failure occurred.

This particular market failure may be avoided by sourcing funds from the stock market. After Property Trust completed a public issuance of stock, its management began to focus the development of

[47] Zuckerman, supra note 1, at A1.

[48] Some may argue that Property Trust's failure to develop the affordable housing market does not mean that another developer could not step in. Furthermore, the fact that no one adequately developed the market would be evidence that demand was not really there or the market was not sufficiently profitable to attract investors. This view overlooks two points. First, the source of funds may be the failure, not supply and demand or profitability. Where banks are the source of funds, their failure to lend will affect all development companies, not just Property Trust. Secondly, it ignores the noneconomic choices that are made by people. In this case, there are certain cultural and psychological choices being made by bankers to lend primarily to the luxury market. See, Anthony D. Taibi, "Banking, Finance, and Community Economics Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice," 107 Harv. L. Rev. 1465, 1467–1469 (1994). For the economic argument to stand, however, all the available banks in an area must decide not to lend to a given market. Because the luxury market in New York was overbuilt and collapsed and the affordable housing market was underbuilt, this suggests all developers were similarly treated in terms of funds availability.

apartment complexes for families earning approximately $30,000 per year.[49] Although the prospects for strong resale appreciation are not as probable as with the luxury home market,[50] affordable apartment complexes provide a steady stream of income that in turn can be used for other projects, wherever demand points.[51] If these apartments were funded by debt, a portion of the rental income would have to go toward servicing the debt, leaving less to develop other projects.[52]

One reason, then, why sourcing from the equity markets can fight affordable housing problems is that the money a company gains from an issuance has no strings attached.[53] Management must, however, use the money they raise in a manner that satisfies shareholders. Shareholders are happy when they have either capital gains or dividends.[54] At today's low interest rates,[55] the average dividend yield paid by REITs of 7 percent is appealing to some investors.[56] Capital appreciation has been around 5 percent to 6 percent on average.[57] The key to strengthening capital appreciation is to focus on earnings growth, not working toward increasing resale values of the real estate.[58] This point ties back into Property Trust's strategy of meeting the need for affordable housing because such buildings provide better cash flows, although with less resale value than provided by luxury homes.[59]

[49] Zuckerman, supra note 1, at A1.

[50] Id. This premise rests on the assumption that the luxury market is not overbuilt and subject to collapse, as happened in New York. See supra, note 47 and accompanying text.

[51] Zuckerman, supra note 1, at A1.

[52] This point does not mean debt should not be used at all. See supra notes 42–44 and accompanying text on the leverage concept.

[53] See supra note 39.

[54] See infra note 80.

[55] The federal funds rate was 4.67 percent as of November 3, 1994. *The Wall Street Journal*, at C1. Savings accounts still hover below 3 percent.

[56] Zuckerman, supra note 1, at A1.

[57] Jeff Brown, "Inflation Hedge: The REIT? Right Investing in Real Estate Is as Easy as Investing in the Stock Market. But the REIT Is Complicated, and Price May Be Too High," *The Philadelphia Inquirer*, Sept. 25, 1994, at D1.

[58] Barry D. Libert, "Real Estate: Time to Get Corporate," *The New York Times*, Aug. 14, 1994, at C9.

[59] See supra notes 50–51 and accompanying text. Capital appreciation of real estate is of little use to a company because that money cannot be reached, unlike rental income.

Because the stock market is driven by cash flows, companies should be driven toward using their money to meet demand, which is currently for affordable housing, in order to increase the value of the company's net worth.

Theoretically, the same analysis should apply to low–income housing. A developer wishing to properly diversify its holdings in real estate would not build only residences, shopping centers, and office space; it would also build a mix of each type.[60] In residential, this would be accomplished by building lower–, medium–, and upper–income housing as well as multifamily structures. Because the value of the low–income housing would be dependent on a steady stream of income,[61] the availability of Section 8 vouchers[62] provides such a flow.[63]

Economic Versus Cultural Decisions

From a purely economic standpoint, developers should hold a diversity of properties, the weighted balance of which is determined by

[60] Some states now require developers to build a certain percentage of their structures or rooms for low–income families. See Cal. Gov't Code §§ 65580–65590 (West 1983 and Supp. 1994); N.J. Stat. Ann. §§ 52:27D–301–52:27D–329 (West 1986 and Supp. 1994); Or. Rev. Stat. §§ 197.005–860 (1991 and Supp. 1992). These codes may not be as strong as they appear, however, See Richard A. Judd and David Paul Rosen, "Inclusionary Housing in California: Creating Affordability without Public Subsidy," ABA J. Affordable Hous. and Community Dev. L., Fall 1992, at 4 (some jurisdictions allow fees to be paid by developers in lieu of providing the affordable housing); James J. Hartnett, "Affordable Housing, Exclusionary Zoning, and American Apartheid: Using Title VIII to Foster Statewide Racial Integration," 68 NYU L. Rev. 89, 115–123 (1993). However, some believe forcing people to pay for the right to discriminate may be the only solution. See, e.g., Derrick Bell, Faces at the Bottom of the Well. 47–64 (1992).

[61] See supr. notes 50–51. Different economic cycles result in varying demands for each type of housing, thus having holdings of each type should smooth cash flow over time.

[62] 42 USCA § 1437f (1994).

[63] See, e.g., "HUD Unveils Plan for Pension Funds to Invest in Housing," *The Wall Street Journal* Aug. 3, 1994, at A2 (with federal grants to provide partial guarantees for low–income housing payments under Section 8, six pension funds have agreed to invest in affordable housing projects). Under Section 8, families pay 30 percent of their income to live in private–market housing. The federal government pays the rest, subsidizing up to a price that is 95 percent of the median rent in that housing market. This median rent must pass a reasonableness test, thus preventing landlords from artificially increasing rents to take advantage of Section 8. Id.

demand. Some valid arguments exist, however, that suggest that this theory does not mesh with reality. Professor Taibi of the University of Illinois provides a strong case for denying that behavior dependant on economic rationales is a sound basis for decision making, in light of continued discriminatory behavior.[64] The neoclassical economic school assumes that if an investment opportunity is unfunded, the project must not make returns comparable to similarly risky investments. Therefore, the project will remain unfunded, and this result is favorable because it leads to the efficient allocation of resources.[65] Professor Taibi believes that this viewpoint is dubious. First, all investments are uncertain, and therefore the actual returns a project makes are by definition unknown until the events occur.[66] Because there is uncertainty, some rational person would invest in the "less profitable" venture, because expectations may not work out in reality.

Second, however, neoclassical thought refuses to acknowledge that choices are not made purely on economic terms. Cultural and psychological influences exist in every decision made by people. When investors make choices based on racial, ethnic, or class biases, those investments will be undervalued and subsequently underdeveloped.[67]

One may argue as a counterpoint that these cultural and psychological factors are nebulous and too difficult to objectify. The costs involved in factoring in such quantities would be time- and cost-prohibitive. Therefore, efficiency demands that we allow people to make their cost–benefit analysis from a purely economic standpoint, and whatever result occurs is the "right" result, even if it means sustained segregation.

This argument seems to be the core foundation around which many of our antidiscriminatory laws are built. Professor Taibi, pointing to the ECOA,[68] identifies this foundation as the equality paradigm.[69] This paradigm seeks to treat everyone alike, thereby giving all people equal access to various services and opportunities. By relying on the

[64] Taibi, supra note 48. Professor Taibi makes other main points, which are raised later in this article.

[65] Id. at 1467.

[66] Id. at 1468.

[67] Id. The Property Trust example seems to support this proposition. See supra notes 47–52 and accompanying text.

[68] 15 USCA §§ 1691–1691f (1982 and Supp. 1994).

[69] Taibi, supra note 48, at 1466. The professor also identifies the affirmative action paradigm, which equally ignores the structural defect in our system. See infra note 70.

economic theory that allocative efficiency and efficient results are good results, problems due to what Professor Taibi refers to as structural defects are not solved.[70]

A hypothetical may help demonstrate this point.[71] Two African-American families want to move to Atlanta and purchase a home. The first family looks in an African-American community, while the other family looks in a predominantly white community. The houses each family is considering are identical in all other respects. The house in the minority subdivision can be expected to be priced lower and to experience a lower increase in value over time than the same house in the white subdivision. The second family may be concerned that other minority families may move in over time, causing white flight and the decrease of the market value of their home. Because of this serious economic possibility, the second family may decide to move to an African-American neighborhood to at least preserve their capital. If this pattern continues, which seems to be in part what is happening,[72] then community disinvestment will occur. This in turn results in an eroding job base and small business credit crunch—problems that affect all races.[73]

Additionally, there is evidence to suggest that segregation also makes life more difficult for minorities. In Chicago, the Gautreaux Assisted Housing Program[74] relocated more than 4,700 minority families from the city to suburban areas, giving advice on finding apartments and providing rent subsidies. A ten–year study revealed that access to suburbs increased the quality of life for these families. Adults were able to find jobs easier because of the greater availability of jobs in suburbs and the fewer concerns about child care as a result of increased safety. Children in the program were five times more likely to attend college.[75] This study suggests, despite the economic argu-

[70] Id. at 1466–1470. The structural defect here is that people rely on noneconomic factors to make decisions, yet our legal models presume the results of such decisions are good, when in fact they are not. Id.

[71] This hypothetical was presented to a property seminar class by Professor Randall Johnson at the University of Georgia School of Law.

[72] See, e.g., Taibi, supra note 48, at 1469.

[73] Id. at 1470. Accord Hartnett, supra note 60, at 107–108 (segregation leads to increased housing costs, commuting costs, decreased economic success, increased crime, and increased taxes).

[74] This program was undertaken as part of a settlement in the lawsuit Gautreaux v. Romney, 448 F2d 731 (7th Cir. 1971), aff'd sub nom. Hills v. Gautreaux, 425 US 284 (1976). Hartnett, supra note 60, at 108.

[75] Hartnett, supra note 60, at 108–109.

ment in favor of segregation should it occur "naturally,"[76] that there are economic benefits to be gained by integration.

Federal Antidiscriminatory Laws and Equity Financing

What, then, will the move away from debt financing mean for development? Can the developer act upon its own discriminatory impulses? If you accept the point that people make choices after considering economic and noneconomic factors,[77] nothing prevents the developer, like the loan officer, from discriminating. Both the developer and the loan officer have a financial stake in the development. Both face risks if demand is oversupplied.[78]

Considering only economic factors, the developer would not intentionally discriminate. Keeping in mind that discrimination entails making decisions based on such factors as race and gender, these factors are not currently factored *directly* into a decision model.[79] The company with equity is driven instead by profits and cash flow.[80]

[76] Other studies suggest that segregation may occur only because of discrimination. See Stanley P. Stocker–Edwards, "Black Housing 1860–1980: The Development, Perpetuation, and Attempts to Eradicate the Dual Housing Market in America," 5 Harv. Blackletter J. 50, 69–70, 77 (1988).

[77] See supra note 48.

[78] See supra notes 47 and accompanying text.

[79] For example, see supra notes 18, 21–23. They may, however, have an indirect impact in these models. See supra note 27 and accompanying text.

[80] The pressure on the management of a public company is to keep stock prices up. The basic formula for valuing stock is $P_0 = \frac{D_0(1+g)}{k-g}$, where P_0 is the stock value, D_0 is the current dividend, g is the expected growth rate of the dividend, and K is the required rate of return on the stock. Brigham and Gapenski, supra note 11, at 238. The required rate of return can be found by the formula $k = r_f + (r_m - r_f)\,\beta$, where r_f is the risk–free rate (usually the T–bill rate), r_m is the market return, and β is the beta of the stock. Id. at 143. Beta is in turn calculated by dividing the covariance between the stock and the market by the variance of the market returns. Id. at 152. From the P_0 formula, we see that stock price is highly dependent on dividends. Assuming a 10 percent required rate of return and a 5 percent growth rate, a company with a $3.00 dividend will have a stock price of $63. If the dividend were to drop $.25, the stock would fall to $57.50. REITs are particularly susceptible to this dividend pressure, since their dividends are directly related to their net income. See supra note 33. In this respect, REITs are similar to a pass-through security, such as an MBS. See supra note 16.

As noted, lower–, medium– and upper–income housing provide both in differing weights.[81] By merely meeting demand, developers will keep the market balanced, and discrimination in the form of a shortage, due to nonmarket forces, will not occur.[82]

However, it is a fair assumption that people make decisions using noneconomic criteria.[83] When funds were sourced from lenders, the lending agents were in control.[84] With funds being sourced from equity, the shareholders, indirectly through the market, exercise some degree of control.[85] If the company's stock performs below expectations or below comparable stock, stockholders will sell. This selling pressure in turn drives down the stock value. Assuming management holds a substantial amount of its own stock, behavior that causes the company's stock to fall will directly affect the management financially.[86] Discrimination in the decision of what types of structures to build can, as in the Property Trust example, lead to a market retribution.[87]

[81] See supra notes 59–63.

[82] Discrimination in the form of using substandard building materials and other unequal treatment of low–income housing may, however, occur under the economic scheme. See infra note 102. If a developer looks at the savings from cutting corners and the expected costs of future lawsuits, understanding that low–income individuals do not have the financial or political resources to litigate such issues, and the benefits outweigh the costs, then this would result in a discrimination that goes against the equality paradigm. Relying on cost, though, shrouds the decision in rationality. However, the author prefers to focus on discrimination connected with the choice to build, not how to build.

[83] See supra note 64–67 and accompanying text.

[84] See supra note 47.

[85] See supra note 80. It is possible for shareholders to exert direct control by voting in a board of directors with common goals. With REITs, shareholders may not be too dispersed to exert such control without difficulty. See supra note 31. Conversely, a small number of people, probably running the REIT, can hold a substantial percentage of stock. In this situation, management could then act on their desires without too much threat from direct action by other shareholders. There remains, however, the influence of the market, which the author believes, though it may not prevent discrimination from occurring, does place limits on the extent of such discrimination. See supra notes 80, 85–87 and accompanying text.

[86] In an indirect way, then, it is possible for management to pay for discriminating. See Bell, supra note 60. See also note 60 on payments under current state law.

[87] See supra notes 59–63.

It may be argued that one developer could discriminate, leaving a void to be filled by nondiscriminating developers. If one assumes building low–income properties to be a profitable venture,[88] another developer would build where others fail to for discriminatory reasons. This argument, however, did not hold true with debt financing, as the Property Trust example demonstrated.[89] Economists reply that this was merely a short-term market failure that will be corrected over the long run—they consider a five–year market failure to be short term. Even so, Congress has passed laws to correct market failures in the past. The entire antitrust regime is premised on the belief that certain anticompetitive activities, which would not occur in a pure competitive market, take place in real life because the market is imperfect.[90] In this vein, antidiscrimination laws can be thought of as attempting to correct a social failure.[91]

Assuming, however, that the single developer can discriminate in his development choices, and other developers fill the void left by the discriminating developer, is this discrimination illegal? Some laws, if they reached this activity otherwise, would not apply because the funds are not sourced from the government or a federally insured institution.[92] Title VI of the Civil Rights Act of 1964, for example, states that no person shall be subject to discrimination "under any program or action receiving federal financial assistance."[93] Because the SEC acts only as an information conduit,[94] there is no federal money provided to the company selling equity.[95] If there were, this

[88] They are profitable and provide a very reliable cash flow. See supra notes 50–51.

[89] Id.

[90] Eleanor M. Fox and Lawrence A. Sullivan, Cases and Materials on Antitrust 1-11 (1989).

[91] In essence, I believe this is what Professor Taibi argues. The structural defect he identifies, however, is that the current legal structure is not equipped to properly handle discrimination. See Taibi, supra note 48.

[92] The receipt of Section 8 funds is one way to trigger coverage. See 24 CFR Pt. 8, App. A (1994). However, if the developer is discriminating, it is not making housing for people who would be using section 8 certificates.

[93] 42 USCA § 2000d (1988).

[94] See supra note 4.

[95] As a matter of clarification, the statute requires federal financial assistance. If the federal government bought securities in a REIT, the REIT would have federal money, but not federal financial assistance. See Soberal–Perez v. Heckler, 717 F2d 36 (2d Cir. 1983), cert. denied, 466 US 929 (1983) (Title VI only meant to

statute may have been broad enough to reach the developer's actions. Most of the other antidiscrimination laws are equally inapplicable. The ECOA,[96] the Home Mortgage Disclosure Act[97] and the Community Reinvestment Act[98] target creditors. Although these laws reach the developer who loans money to tenants or purchasers,[99] they do not reach activities prior to the lending stage, such as the decision to construct particular strata of housing.[100]

The most probable federal law for coverage is the Fair Housing Act.[101] This act states that it is the policy of the United States "to provide . . . for fair housing throughout the United States."[102] Most of the FHA applies to the sale or rental of housing[103] or actions incident to such sale or rental.[104] Presumably, the developer or its successor

cover situations where funding is given to a nonfederal entity that, in turn, provides financial assistance to a beneficiary).

[96] 15 USCA §§ 1691–1691f (1989 and Supp. 1994).

[97] 12 USCA §§ 2801–2810 (1989 and Supp. 1994).

[98] 12 USCA §§ 2901–2907 (1989 and Supp. 1994).

[99] The ECOA makes it unlawful for a creditor to discriminate against protected class applicants with respect to any aspect of the credit transaction. 15 USCA § 1691(a) (1989 and Supp. 1994). "Creditor" is defined as any person who regularly extends, renews or continues credit. Id at § 1691a(d). "Creditor" has been treated broadly by the courts. E.g., United States v. American Future Sys., 571 F. Supp. 551 (DC Pa. 1982) aff'd 743 F2d 169 (3d Cir. 1984) (CEO with 97 percent stock holding who regularly participated in policy determinations for extension of credit is a creditor); In re Brazil, 21 BR 333 (Ohio 1982) (natural gas company that regularly provided gas to customers before being paid is a creditor). So long as a developer "regularly" extends loans, which is the likely scenario, then the developer will come under the ECOA. The FHA would also reach this activity as a real estate–related transaction. 42 USCA § 3605 (1977 and Supp. 1994).

[100] See, e.g., 12 CFR Pt. 202, Supp. I (1994).

[101] 42 USCA §§ 3601–3619, 3631 (1977 and Supp. 1994).

[102] 42 USCA § 3601 (1977). The wording here is purposefully crafted. The statute does not read that the nation will provide housing, but that it will provide for fair housing. In other words, people are entitled to be free from any impediment or conduct by others who, for discriminatory reasons, deny them housing. See Jaimes v. Toledo Metro. Hous. Auth., 758 F2d 1086 (6th Cir. 1985). The *Jaimes* court also held that there is no constitutional right to be furnished with safe, sanitary, and decent housing. Id. at 1101–1102. Accord Lindsey v. Normet, 405 US 56, 74 (1972).

[103] 42 USCA § 3604(a) (1977 and Supp. 1994).

[104] Id. at §§ 3604(b)–(f), 3605, 3606, and 3617.

will sell the units, so this action is covered.[105] But the status of the actual choice of what to develop is arguably not covered.

The FHA covers dwellings, a term which includes both a structure designed or intended for residential use and vacant land offered for sale for the construction of such a structure.[106] A developer who intends to discriminate in its choice of what to develop will not, it seems, be caught under the FHA because of vacant land purchased for that purpose. The FHA does not appear to reach back to the land purchase as grounds for a breach in its eventual use. The only way to bring the FHA into the decision not to build low–income housing is to read the phrase "or otherwise make unavailable . . . a dwelling"[107] to include failing to build a dwelling.

Although there are not many cases that address this aspect of the FHA, those that have done so are in agreement. One early case found no duty of the government—federal, state, or local—to construct low-income housing for families, even after it provides low–income housing for senior citizens.[108] A more recent case did not find a country's failure to assume leases as "otherwise making unavailable" dwellings under the FHA.[109] The FHA was designed to affect those who could deny housing, not those who could step in and provide it.[110] Because the FHA[111] does not extend a duty on government to provide housing, the same analysis should apply to private developers.[112]

[105] Since the beginning of 1969, all dwellings, except those exempted in Section 3603(b), are covered by the FHA. 42 USCA § 3603(a)(2) (1977). Before that date, coverage depended on the source of funds, under which companies with pure equity financing were impliedly exempt. Id. at (a)(1). Other exemptions apply, of course, but are not applicable here. Id. at 3607.

[106] 42 USCA § 3602(b) (1977 and Supp. 1994).

[107] The wording of the statute is as follows:

> it shall be unlawful—
>
> (a) To 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.

42 USCA § 3604(a) (1977 and Supp. 1994).

[108] Acevedo v. Nassau County, 500 F2d 1078, 1081–1082 (2d Cir. 1974).

[109] Growth Horizons v. Delaware City, 983 F2d 1277 (3d Cir. 1993).

[110] Id. at 1282–1283.

[111] *Growth Horizons* also addressed the Fourteenth Amendment and concluded that it did not contain the duty to provide housing, at least in situations where one group—the elderly—is provided for and others are not. Id. at 1280–1282.

[112] This conclusion is consistent with general tort law, also. See Restatement (Second) of Torts § 314 (1965) ("The fact that the actor realizes or should realize that action on his part is necessary for another's aid . . . does not itself impose upon him a duty to take such action.").

Therefore, applied to the developer who is deciding what to build, the FHA does not cover the situation in which a builder decides to discriminate by constructing only upper–income housing. Once built, the developer need only not discriminate in connection with whom the units are sold to.[113] Depending on what other developers choose to do, this activity could result in continued underdevelopment of affordable housing and continued discrimination.[114]

State Antidiscriminatory Laws

If federal law does not reach the activity, state law may. In the Southeast, however, state law is largely patterned after the federal FHA.[115] Like the federal law, these state laws are aimed at providing people with the freedom to choose where they want to live without being impeded by discrimination.[116] Some states, like Florida, have set up programs to encourage the construction of affordable housing. The State Apartment Incentive Loan Program provides favorable loans to those developers who set aside certain percentages of their structures for very low–income persons.[117] Virginia mandates that its Housing Development Authority cannot finance housing development unless there is a shortage of decent, safe, sanitary housing at rentals low– and moderate–income families can afford and private enterprise is unwilling to provide because of profitability concerns.[118]

[113] Cf. Growth Horizons, 983 F2d at 1081 ("Of course, [the government] would have to operate that housing in a non–discriminatory fashion.").

[114] Professor Taibi recognizes that, under the current legal regime, discrimination continues. It merely is in less overt forms than existed prior to passage of federal laws. Taibi, supra note 48, at 1466.

[115] See, e.g., Ala. Code §§ 24–8–1 to 24-8-15 (1992); Fla. St. Ann. ch. 760.20 to 760.37 (Harrison 1994); O.C.G.A. §§ 8–3–200 to 8-3-215 (1989 and Supp. 1994); N.C. Gen. Stat. §§ 41A–1 to 41A-10 (1990); and Va. Code Ann. §§ 36–86 to 36-96.23 (Michie 1990 and Supp. 1994).

[116] E.g., O.C.G.A. § 8–3–200(b)(4) (1989 and Supp. 1994) (the state is interested in providing individuals with the freedom to take up residence wherever that individual chooses and in protecting personal dignity).

[117] Fla. Stat. Ann. ch. 420.5087 (Harrison 1990 and Supp. 1993). At least 20 percent of the units must be set aside for individuals who meet the program's requirements. Another 20 percent must be set aside for those with 50 percent or less of the state or local median income, whichever is higher. Id.

[118] Va. Code Ann. § 36–55.39 (Michie 1990). These economic justifications are further examples of how neoclassical economic thought pervades our legal structures. See supra notes 64–65.

A few other states have gone beyond incentive programs as seen in the Southeast and have passed laws giving local government the authority to place an affirmative duty on developers to dedicate a proportion of their development to housing for low-income families.[119] As mentioned earlier, however, some localities have watered down this mandate by providing in-lieu payments.[120] However, the existence of state laws that provide incentives or create duties to construct affordable housing imply two conclusions. First, federal law is not creating an environment that either encourages development or prevents development discrimination where it occurs. Second, the market forces economists rely on so fully are also not driving developers to meet this need. States, then, pressured by constituents, construction suppliers, or philanthropic impulses have had to step in to correct a problem that has otherwise continued despite current laws.[121]

If the federal laws fail to reach this activity and state law fails to reach it, merely providing incentives or allowing developers to pay their way out of providing affordable housing, the question remains of whether the federal government should address this problem. If you accept the existence of the social costs involved with segregation,[122] whether segregation occurs by economic choice or active discrimination, the decision is a resounding "yes." If you do not accept the social costs of segregation, there still seems scant reason to distinguish between this discrimination and other types covered by federal law. Both may be shrouded in economic rationale,[123] and both injure the individual who is victimized. The greatest difficulty, however, is in identifying when a developer is discriminating. If only one developer discriminates, the void will be filled by other developers. Thus, a discriminatory impact study will reveal nothing, but no harm results either. Only when a systematic failure exists will the effects of these discriminatory decisions be felt, and those effects may not develop until years have passed.[124] It is

[119] See supra note 60.

[120] Id. Without access to these local laws, it is unclear whether these payments are encumbered to subsidize affordable housing in some manner or used for other purposes.

[121] See supra note 114.

[122] See supra note 73.

[123] See Cartwright, 880 F2d at 912 (prohibition against denying loan because of the property's location does not require the lender to disregard its business interest and make investments that are not economically sound).

[124] See supra note 47 and accompanying text.

because of this possibility and the attending costs that the nation's antidiscrimination effort should reach the activity; otherwise no form of redress exists for those injured in this manner.