



Office of the
Assistant Attorney General

Washington, D.C. 20530

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MEMORANDUM FOR JOHN J. KNAPP, GENERAL COUNSEL
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Re: First Amendment Issues Implicated in Section 202 Loans
and the Community Development Block Grant Program

This memorandum responds to your request for guidance on certain requirements and limitations that the Establishment Clause may impose on two programs administered by the Department of Housing and Urban Development (HUD). With respect to the loan program that provides housing and related facilities for elderly or handicapped families under § 202 of the Housing Act of 1959, Pub. L. No. 86-372, 73 Stat. 667 (codified as amended at 12 U.S.C. (& Supp. V) § 1701q), you posed three specific questions. First, you inquired whether it is constitutionally necessary to create a separate nonreligious entity to act as the borrower of federal funds if a religious organization sponsors such housing. We conclude that creation of a separate borrowing entity is constitutionally required. Accordingly, we need not address your subsidiary question whether such a requirement is administratively desirable, even if not constitutionally necessary, to avoid creating any risk of Church-State entanglement.

Second, you asked whether a nonprofit corporation whose articles of incorporation recite, in conformity with 26 U.S.C. § 501(c)(3), that it is created exclusively for "religious, charitable, scientific, . . . or educational purposes," is ineligible, as a constitutional matter, for a § 202 loan. We conclude that nothing in the Constitution bars this general group of tax-exempt entities automatically from eligibility for § 202 loans. However, as explained below, with respect to a portion of this group of tax-exempt entities -- nonprofit corporations organized exclusively, or in part, for religious purposes -- the analysis differs.

Third, you inquired whether an organization which is exempt from the prohibitions of the Fair Housing Title of the Civil Rights Act of 1968, Pub. L. No. 90-284, Title VIII, 82 Stat. 81 (codified as amended at 42 U.S.C. (& Supp. V) § 3601 et. seq.), because it is "operated, supervised or controlled by or in conjunction with a religious organization, association, or society, . . ." 42 U.S.C. § 3607, is ineligible, as a constitutional matter, for a § 202 loan. We conclude that an organization which operates so as to fall within the limited exemption under 42 U.S.C. § 3607 -- that is, grants preferences to persons based on creed -- would not be constitutionally eligible for a § 202 loan. However, as set forth below, mere status as an organization "operated, supervised or controlled by or in conjunction with a religious organization, . . ." is not necessarily determinative of eligibility for § 202 loans.

With respect to grants under Title I of the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (codified as amended at 42 U.S.C. (& Supp. V) § 5031 et. seq.), you questioned whether recipients of block grant funds can allocate such monies to religious or church-related organizations. We conclude that your existing policy, which prohibits block grant recipients from using any funds to rehabilitate, maintain or restore religious structures currently used for religious purposes, properly reflects constitutional requirements. The Constitution, in fact, prohibits government subsidies to any structure or facility used to promote religious interests. Whether allocating block grant funds to church-related organizations is constitutionally permissible will depend upon the specific factual circumstances. The character and purpose of the institution benefiting, the particular use, sectarian or secular, of the funds, the nature of the aid that the block grant recipient provides, and the resulting relationship between the government (State or federal) and the religious authority, will all be relevant factors in the constitutional analysis. We explain our conclusions in greater detail below.

I. Background

A. Section 202 Loan Program

Section 202 of the Housing Act of 1959, 12 U.S.C. (& Supp. V) § 1701q, authorizes the Secretary of HUD to make loans "to assist private nonprofit corporations, limited profit sponsors, consumer cooperatives, or public bodies or

agencies to provide housing and related facilities for elderly or handicapped families." 12 U.S.C. § 1701q(a)(1). The loans may not exceed the total development cost and shall be repaid within a period, not to exceed fifty years, determined by the Secretary. 12 U.S.C. § 1701q(a)(3). ^{1/} Congress further directed that the Secretary coordinate applications for § 202 project loans with applications under section 8 of the United States Housing Act of 1937, 42 U.S.C. (& Supp. IV) § 1437f, for lower-income housing assistance with respect to units in such projects. See 12 U.S.C. (& Supp. V) § 1701q(g). The Secretary, by regulation, has required that at least twenty percent of the units in any § 202 project receive section 8 housing assistance payments. See 24 C.F.R. § 885.210(a)(ii) (1982).

According to a HUD study, § 202 projects are "meant to provide moderate cost shelter plus the amenities and services which are appropriate to the needs of handicapped and elderly persons. . . ." See U.S. Dept. of Housing and Urban Development, "Housing for the Elderly and Handicapped: The Experience of the Section 202 Program from 1959 to 1977" at 53 (Jan. 1979) [hereinafter Housing Study]. Because the appropriate mix of functional shelter and amenities or services are left, within broad guidelines, to the discretion of the housing sponsor, § 202 projects range across a broad spectrum from nearly standard apartment rental units to projects with extensive service facilities. *Id.* at 53-58. Most § 202 projects had, at the time of the HUD evaluation, at least one multi-purpose room, a common area with kitchen facilities and a laundry room. *Id.* at 54. The HUD Housing Study also found that § 202 projects typically offered services that included recreational and social activities, meals, transportation and religious services. *Id.* at 55. In addition, members of sponsoring groups often volunteer their services, including legal and financial expertise and medical assistance, as well as donate rooms, appliances, mini-buses, furnishings and supplies. *Id.* at 46. The HUD study found that "[s]ome sponsors provide financial assistance on a regular basis through, for example, an annual Mothers' Day Church offering."

^{1/} The Secretary by regulation has determined that the mortgage shall be repayable during a term not to exceed forty years. See 24 C.F.R. § 885.410(i) (1982). But cf. 24 C.F.R. § 277.6 (1982) (§ 202 loans shall be repayable within fifty years if made prior to 1976).

Id. at 47. In one instance, several members of a church congregation even mortgaged their own homes to make donations to their church's § 202 project. See ibid.

Religious organizations are the most frequent "sponsors" 2/ of § 202 projects. See id. at 45 ("two out of three § 202 projects . . . sponsored by religious institutions"). We are informed that most nonprofit corporate religious sponsors are churches, while others, such as the Salvation Army, B'nai B'rith and the Young Men's Christian Association "are fundamentally religious organizations and presumably do not want to eliminate references to their religious purposes in their own articles of incorporation." Letter to Theodore B. Olson, Assistant Attorney General, Office of Legal Counsel from John J. Knapp, General Counsel, Department of Housing and Urban Development at 2 (Jan. 7, 1983). To enable these religious organizations to sponsor § 202 projects consistent with First Amendment principles, HUD regulations permit private nonprofit sponsors to establish a private, secular nonprofit borrower corporation, "which will obtain a section 202 loan and execute a mortgage in connection therewith as the legal owner of the project." 24 C.F.R. § 885.5 (1982). 3/ In parallel fashion, in

2/ According to HUD regulations,

Sponsor means any private nonprofit entity, no part of the net earnings of which inures to the benefit of any private shareholder, contributor or individual, which entity is not controlled by, or under the direction of persons or firms seeking to derive profit or gain therefrom, and which is approved by the Field Office Director as to administrative and financial capacity and responsibility. "Sponsor" does not mean a public body or the instrumentality of a public body.

24 C.F.R. § 885.5 (1982).

3/ The applicable regulation states in full:

Borrower means a private nonprofit corporation or a nonprofit consumer cooperative which may be established by the Sponsor, which will obtain a Section 202 loan and execute a mortgage in connection

(Footnote continued on next page)

order to avoid any First Amendment difficulties created by the provision of federal funds to religious organizations, HUD policy has prohibited, since the beginning of the § 202 program in 1959, direct loans to corporations whose articles empower them to operate Christian (or other religious) homes. See Memorandum to Harry J. McNerney, Chief Counsel, CFA, Housing and Home Finance Agency, Re: Housing for the Elderly--Operation of a Christian Home (July 13, 1961). Thus, the annual notice announcing fund availability for § 202 loans for FY 1983 specifies:

(3) Religious bodies may serve as Sponsors of Section 202 projects, but the Borrower corporation must be a separate legal entity in order to comply with Constitutional requirements for separation of Church and State. No religious purpose may be included in the Articles of Incorporation or By-laws, etc., of the Borrower corporation.

48 Fed. Reg. 17397 (April 22, 1983).

Opinions of HUD's General Counsel further refine this requirement. Borrowers are precluded from distributing their assets to religious corporations on dissolution. Sponsoring religious corporations may not retain direct control over the borrower. However, a religious sponsor may designate the members or directors on the borrower's board. See Memorandum to Lawrence B. Simons, Assistant Secretary for Housing, Re:

(Footnote continued)

therewith as the legal owner of the project. "Borrower" does not mean a public body or the instrumentality of any public body. The purposes of the Borrower must include the promotion of the welfare of elderly and/or handicapped families. No part of the net earnings of the Borrower may inure to the benefit of any private shareholder, contributor or individual and the Borrower may not be controlled by or under the direction of person or firms seeking to derive profit or gain therefrom.

24 C.F.R. § 885.5 (1982).

Section 202 Program, Sponsorship by Religious Organizations (Sept. 24, 1979); Memorandum to William L. Warfield, Special Assistant to the Assistant Secretary-Commissioner, Re: Section 202 Request No. 736, The Salvation Army (March 26, 1976).

We further note that some HUD field office personnel believe that the kinds of locations, sponsors, and even names given to § 202 projects often create an image of privately-owned, unsubsidized apartment buildings, which deters otherwise eligible persons from considering applying for admission. See Housing Study, supra, at 34. As the HUD Housing Study notes, "[m]any projects are named after the sponsoring organization such as Quaker Retirement Home, Beth Shalom House, Rotary Club Home, First Christian Church Apartments, Lutheran Home, and Teamsters Housing, and this may give the false impression that they are only for members of that group." Id. at 34 n.15. There is also evidence that a few § 202 project managers impose some of their values on the projects, although the sponsors' values are not necessarily those of the tenants. "[A] manager stated that he felt it more important to feed souls than bodies and, consequently, he refused to allow a food service into the project because it would have conflicted with a schedule of daily religious services that were held in the building." Id. at 51. 4/

HUD previously had a practice of excluding from eligibility for § 202 loans nonprofit corporate borrowers whose articles of incorporation simply quoted the Internal Revenue Code exemption to establish their status as a corporation "operated exclusively for religious, charitable, scientific, . . . literary or educational purposes, . . ." 26 U.S.C. § 501(c)(3). 5/ We are informed that HUD observed this practice

4/ We assume that HUD regulations and policies do not sanction or support such practices. In any event, we are not suggesting that such practices conform to First Amendment principles.

5/ HUD regulations require a borrower to provide evidence of its legal status as a nonprofit corporation. See 24 C.F.R. § 885.210(a)(9)(1982). Borrowers may qualify as tax-exempt corporations under 26 U.S.C. § 501(c)(3) or § 501(c)(4). However, if an organization has a § 501(c)(3) exemption, charitable contributions made to that organization are deductible. See 26 U.S.C. § 170(c)(2).

even with regard to borrowers established by sponsors that are not religious organizations. However, beginning with the Announcement of Fund Availability covering FY 1983, HUD has altered this practice. Agency policy now provides that "the mere recital in a Borrower's Articles of Incorporation that it is organized exclusively for religious charitable, scientific, literary or education purposes within the meaning of section 501(c)(3) of the Internal Revenue Code will not by itself make a Borrower ineligible." 48 Fed. Reg. 17397 (April 22, 1983).

HUD employs one final criterion to define the class of organizations eligible for § 202 loans. An organization may not receive a § 202 loan if it falls within the exemption from the Civil Rights Act of 1968 which permits a "religious organization, . . . or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, . . ." to limit the "sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, . . ." or to give "preference to such persons, . . ." 42 U.S.C. § 3607 6/. HUD has further required that a borrower in the § 202 program be neither "a religious organization, association, or society," nor "any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, . . ." as defined in 42 U.S.C. § 3607. See Memorandum for Lawrence B. Simons, Assistant Secretary for Housing-Federal

6/ 42 U.S.C. § 3607 reads in full:

"Nothing in this title shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preference to such persons, unless membership in such religion is restricted on account of race, color, or natural origin."

Housing Commissioner, Re: Section 202 Program, Applicability of 42 U.S.C. § 3607 at 3 (Dec. 26, 1978). According to this HUD interpretative policy, mere status as a nonprofit institution, supervised or controlled by a religious organization, would render a borrower ineligible for a § 202 loan, regardless whether the nonprofit institution actually limited occupancy to persons of the same religion.

Your questions regarding the § 202 loan program all focus on whether these existing policies and practices which function to define the class of organizations eligible for § 202 loans are constitutionally required.

B. Title I Block Grants

Title I of the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (codified as amended at 42 U.S.C. (& Supp. V) § 5301 et. seq.), authorizes the Secretary of HUD to make grants on a formula basis to States and units of general local government ^{7/}, with particular emphasis on metropolitan areas. See 42 U.S.C. §§ 5303, 5306. The Act's primary objective "is the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income." 42 U.S.C. § 5301(c). We are informed that recipients of these grants often ask HUD whether the monies may be used to maintain or restore churches, many of which have historical significance. HUD's current policy prohibits the cities, counties, and States who are direct block grant recipients from using any funds to rehabilitate, maintain, or restore religious structures, notwithstanding designation as an historic property, if actively used for religious purposes. See Memorandum for Robert C. Embry, Jr., Assistant Secretary for Community Planning and Development, Re: Letter Agreeing with ACLU that Use of Block Grants Funds for Property Rehabilitation Grant to Calvary Baptist Church is Unconstitutional (Aug. 3, 1979). You have requested this Office to review the constitutional

^{7/} "The term 'unit of general local government' means any city, county, town, township, parish, village, or other general purpose political subdivision of a State; . . ." 42 U.S.C. (Supp V) § 5302(a)(1). The statutory definition has other specific meanings, e.g. Guam, the District of Columbia, not generally relevant for present purposes.

propriety of existing policy and to provide legal guidance on any First Amendment requirements applicable to religiously affiliated institutions.

II. Analysis

A. Section 202 Loan Program

1. Is a religious sponsor of § 202 housing required constitutionally to create a separate borrower corporation to serve as the legal owner of the housing project?

While the First Amendment to the Constitution 8/ requires both the Federal and State governments 9/ to observe a scrupulous neutrality among religions 10/ as well as between religious and other activities 11/, the Supreme Court has never read

8/ In relevant part, the First Amendment reads: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; . . ." U.S. Const., Amend. I.

9/ The Supreme Court first stated that the First Amendment guarantees of free speech and free press were applicable to the States in Gitlow v. New York, 268 U.S. 652, 666 (1925). Not until 1940 did the Court apply the First Amendment ban on governmental interference with the free exercise of religion to the States. See Cantwell v. Connecticut, 310 U.S. 296, 303 (1940). In Everson v. Board of Education, 330 U.S. 1 (1947), the Court finally ruled that the States were barred from passing laws respecting an establishment of religion.

10/ See McGowan v. Maryland, 366 U.S. 420, 431, 443, 448 (1961); Zorach v. Clauson, 343 U.S. 306, 313 (1952); cf. Larson v. Valente 456 U.S. 228, 247, 252 (1982) (imposing strict scrutiny standard of review rather than three-part "Lemon test" in judging constitutionality of state law granting a denominational preference).

11/ See Board of Education v. Allen, 392 U.S. 236 (1968) (State loans textbooks on equal terms to students attending public and church-related elementary schools); Everson v. Bd. of Education, 330 U.S. 1 (1947) (State supplies bus transportation for children to and from church-related as well as public schools).

that Amendment to mandate the absolute separation of Church and State. See Roemer v. Maryland Public Works Bd., 426 U.S. 736, 746 (1976) (plurality opinion). Thus, not every law that confers an "indirect," "remote," or "incidental" benefit upon religious institutions is per se unconstitutional. See Committee for Public Education v. Nyquist, 413 U.S. 756, 771 (1973); Walz v. Tax Comm'n, 397 U.S. 664, 671-72, 674-75 (1970). It is equally clear, however, that a law may impermissibly be one "respecting an establishment of religion" even though it does not promote a "state religion," Lemon v. Kurtzman, 403 U.S. 602, 612 (1971), but merely benefits all religions alike. See Everson v. Board of Education, 330 U.S. 1, 15 (1947).

To determine whether establishing a separate borrower corporation is necessary, one must ask the related question: whether HUD constitutionally could provide § 202 loans to religious organizations directly. The Supreme Court has developed a three-prong test to analyze whether such a construction of this statute authorizing federal housing assistance would pass muster under the Establishment Clause of the First Amendment. See Meek v. Pittenger, 421 U.S. 349, 358 (1974). First, the statute must reflect a clearly secular legislative purpose. See, e.g., Epperson v. Arkansas, 393 U.S. 97, 107-09 (1968). Second, the statute must have a primary effect that neither advances nor inhibits religion. See, e.g., School Dist. of Abington Township v. Schempp, 374 U.S. 203, 218-22 (1963). Third, the statute and its administration must avoid excessive government entanglement with religion. See, e.g., Walz v. Tax Comm'n, supra. See generally, Wolman v. Walter, 433 U.S. 229, 236 (1977); Committee for Public Education v. Nyquist, 413 U.S. at 773; Lemon v. Kurtzman, 403 U.S. at 612-13. These three criteria measure, albeit imprecisely, whether the statute furthers any of the evils against which the Establishment Clause protects. Primary among those evils, as revealed by our history and the discussions of the Framers, are the "sponsorship, financial support, and active involvement of the sovereign in religious activity." Walz v. Tax Comm'n, 397 U.S. at 668; see Meek v. Pittenger, 421 U.S. at 359; Lemon v. Kurtzman, 403 U.S. at 612.

Assuming then, that HUD loans were to be made directly to religious organizations, there is no difficulty with the first prong of the test. Section 202 of the Housing Act of 1959 clearly reflects Congress' legitimate, secular "purpose" to provide housing to elderly and handicapped persons by assisting nonprofit corporations with loans to cover development

costs. See 12 U.S.C. § 1701q. Rather, the analytical difficulty lies with the "primary effect" and "entanglement" criteria. See also Wolman v. Walter, 433 U.S. at 236.

The "primary effect" inquiry focuses on what private activities may be supported by, in this instance, federal funds. To achieve a permissible "primary effect" requires (1) "that no [government] aid at all go to institutions that are so 'pervasively sectarian' that secular activities cannot be separated from sectarian ones, and (2) that if secular activities can be separated out, they alone may be funded." Roemer v. Maryland Public Works Bd., 426 U.S. at 755; Hunt v. McNair, 413 U.S. 734, 743 (1973). As noted above, most non-profit corporate religious sponsors are churches, while others, such as the Salvation Army, B'nai B'rith and the Young Men's Christian Association are fundamentally religious organizations that presumably do not want to eliminate references to their religious purposes in their own articles of incorporation. Unquestionably, churches are "pervasively sectarian" organizations. We also believe that the nonchurch religious organizations in issue here should be characterized as "pervasively sectarian." That is, analogizing to the available Supreme Court precedent in this area, these religious institutions conform more to the "profile" of a sectarian or substantially religious institution defined in Committee for Public Education v. Nyquist than they resemble the character of the "essentially secular," although church-related, higher education institutions at issue in Tilton v. Richardson, 403 U.S. 672 (1971) (plurality opinion). Compare Nyquist, 413 U.S. at 767-68 (factors: institution may place religious restriction on admissions; is integral part of the religious mission of the sponsoring church; has religious indoctrination as a substantial purpose) with Tilton, 403 U.S. at 686-87 (factors: atmosphere of academic freedom and critical inquiry; open admissions; predominant mission is provision of secular service, e.g., education; no required attendance at religious services). This is not to suggest that, as a theoretical matter, a church receiving a § 202 loan could not provide a secular housing service that is functionally independent of the church's religious mission. Nevertheless, were § 202 loans given directly to churches or other fundamentally religious organizations, the principle "that no aid at all go to institutions that are so 'pervasively sectarian' that secular activities cannot be separated from sectarian ones, see Roemer v. Maryland Public Works, Bd., 426 U.S. at 755, would by definition be violated. Moreover, as a practical matter, we note that church sponsors are genuinely motivated to aid

the handicapped and elderly and often contribute their own resources to the housing project. See Housing Study, supra, at 46-47. The probable commingling of church and government monies were § 202 loans made directly to churches and the possibility that the borrowing churches' values would infuse the housing project aptly illustrate the Supreme Court's admonition that, "[i]n the absence of an effective means of insuring that public funds will be used exclusively for secular, neutral, and nonideological purposes, it is clear . . . that direct aid in whatever form is invalid." See Nyquist, 413 U.S. at 780.

Although the primary difficulty in granting § 202 loans to churches or fundamentally religious organizations is that loans would go directly to "pervasively sectarian" institutions rather than separate, although church-related institutions, government aid found not to have the "primary effect" of advancing religion differs in another critical respect from direct federal grants for housing costs to churches and fundamentally religious organizations. General legislation may make available to all citizens services such as bus transportation, school lunches or secular textbooks. Even though the resources of a religious institution are thereby freed for use in other sectarian ends, such incidental and indirect benefits, neutrally available to all ^{12/}, do not offend the Establishment Clause. See Everson v. Bd. of Education, supra. But the substantial aid that § 202 loans would directly provide churches or church-related organizations is neither indirect nor incidental. See Meek v. Pittenger, 421 U.S. at 365. As the Supreme Court has explained, at some point State aid becomes so substantial that "[e]ven though earmarked for secular purposes, 'when it flows to an institution in which religion is so pervasive that a substantial portion of its functions are subsumed in the religious mission,' state aid has the impermissible primary effect of advancing religion." Meek v. Pittenger, 421 U.S. at 347-48 (quoting Hunt v. McNair, 413 U.S. at 743). The effect of such substantial loans made

^{12/} This is not to suggest that HUD monies are not neutrally available to all. By requiring that loan recipients comply with Title VIII of the Civil Rights Act of 1968, which prohibits discrimination in housing on account of race, color, religion or national origin, HUD regulations ensure that federal aid under § 202 be neutrally available. See 24 C.F.R. § 885.210 (7) (1982).

directly to pervasively sectarian institutions would tend inevitably to subsidize and advance the religious mission of such organizations.

Finally, § 202 loans to religious organizations would amount to an affirmative government involvement with religion that differs markedly from the passive State involvement that characterized the real estate tax exemption for churches at issue in Walz v. Tax Comm'n, 397 U.S. at 374-75, the one other instance in which what is arguably government aid went directly to churches. As the Court noted in Walz, the grant of a tax exemption does not constitute sponsorship or have the primary effect of advancing religion "since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state." Walz v. Tax Comm'n, 397 U.S. at 675; id. at 690-91 (Brennan J., concurring) ("In other words, '[i]n the case of direct subsidy, the state forcibly diverts the income of both believers and nonbelievers to churches,' while '[i]n the case of an exemption, the state merely refrains from diverting to its own uses income independently generated by the churches through voluntary contributions.'") (quoting Giannella, "Religious Liberty, Nonestablishment and Doctrinal Development, pt. II," 81 Harv. L. Rev. 513, 553 (1968)).

Thus, if churches and B'nai B'rith-like organizations directly borrowed § 202 loans, the pervasively sectarian character of the organizations that would receive the funds and the substantial size of the grants make it impossible to guarantee as a practical matter that secular and sectarian activities could be separated so as to avoid government advancement of religion.

Alternatively, even assuming that direct loans to churches could be administered to ensure their use for solely sectarian purposes, such administrative oversight would necessarily involve an excessive government entanglement with religion. The Supreme Court has held that the third part of the test, that of "excessive government entanglement," involves a consideration of three factors: "(1) the character and purposes of the benefited institutions, (2) the nature of the aid provided, and (3) the resulting relationship between the State and the religious authority." Roemer v. Maryland Public Works Bd., 426 U.S. at 748. Again, because the churches and religious organizations are characterized by substantial religious activity and purpose, and because the aid involved is massive, requires considerable supervision in its administration,

see 24 C.F.R. § 885 (1982), and the exercise of some discretion in disbursement, see 48 Fed. Reg. 17397 (Apr. 22, 1983), the resulting relationship between the institutions and the government would entail an impermissible degree of entanglement. Indeed, in upholding the tax exemption for churches in Walz v. Tax Comm'n, the Court cautioned that, in contrast to an "indirect" or "passive" exemption, "a direct money subsidy would be a relationship pregnant with involvement and, as with most governmental grant programs, could encompass sustained and detailed administrative relationships for enforcement of statutory or administrative standards. . . ." 397 U.S. at 675. Unlike the "one-time, single-purpose" construction grants in Tilton which entailed "no continuing financial relationships or dependencies, no annual audits, and no government analysis of an institution's expenditures on secular as distinguished from religious services," Tilton, 403 U.S. at 688, a § 202 loan to a church would require a government audit to ensure the segregation of housing monies from other church funds and would entail a forty-year involvement to oversee repayment of the loan. In addition, the Secretary's authority to enter into contracts with housing owners (hypothetically, the church borrower) to make low-income housing assistance payments to lower-income families occupying certain of the units further complicates the government's financial involvement with the church. See 42 U.S.C. § 437f. 13/ Moreover, whereas on-site government inspection of the federally financed libraries and other college buildings in Tilton involved only a "minimal contact," government surveillance of § 202 housing projects to ensure the absence of church-sponsored religious services or religious

13/ In Hunt v. McNair, 413 U.S. 734 (1973), the Supreme Court did uphold a State statute which established a State authority to assist, through the issuance of revenue bonds (secured by a conveyance and lease back of property), State colleges in constructing buildings, excluding facilities for sectarian uses. There, however, the institutions had a primarily secular purpose and it was possible to ensure that funding aided only secular activities. Most importantly, although the State authority's powers to fix, revise and collect rents and fees for use of the projects posed significant entanglement problems, see id. at 747, the Court deferred to the State court's narrow construction of these financial oversight powers. We have no such narrow interpretation of the Secretary's powers here.

symbols in rooms would be far more intrusive given the substantial privacy interests involved.

Lastly, the Supreme Court considers the factor of political divisiveness to determine in a broader sense whether the entanglement is constitutionally impermissible. The Court, however, has cautioned that the prospect of such divisiveness may not alone warrant the invalidation of laws that otherwise survive constitutional scrutiny. See Nyquist, 413 U.S. at 798; Lemon v. Kurtzman, 403 U.S. at 625. Indeed, if political divisiveness provided a sufficient basis for invalidating a statute on First Amendment grounds, then all statutes remotely affecting religion would presumably fail to pass constitutional muster.

On the one hand, a federally administered program such as the § 202 housing loans would present a lesser potential for political divisiveness than a State aid program that contemplates aid to parochial schools and tends to cause States and communities to divide along religious lines. See Tilton, 403 U.S. at 689 (potential for divisiveness inherent in the essentially local problems of primary and secondary schools is significantly less with respect to institutions whose constituency is diverse and more widely dispersed). On the other hand, there is some potential for divisiveness in the § 202 program insofar as two-thirds of all projects have religious sponsors, although not all applications are accepted. Cf. Roemer v. Maryland Public Works Bd., 426 U.S. at 765 ("political divisiveness is diminished by the fact that the aid is extended to private colleges generally, more than two-thirds of which have no religious affiliation; this is in sharp contrast to Nyquist, . . . where 95% of the aided schools were Roman Catholic parochial schools"); Lemon v. Kurtzman, 403 U.S. at 623 (potential for political divisiveness in permanent annual appropriations for schools that benefit relatively few religious groups is aggravated by need for continuing annual appropriations and likelihood of larger demands as costs and populations grow). While this potential for divisiveness is by no means dispositive for our analysis, it is nevertheless a "warning signal" not to be ignored." Nyquist, 413 U.S. at 798.

Cumulatively then, because of the pervasively sectarian character of the religious organizations that would want to borrow § 202 funds, because of the long-term, substantial nature of the aid provided, because a fair degree of administrative supervision would be necessary and because of the

potential for political divisiveness in a program which benefits religious institutions in large part, the resulting Church-State entanglement would be unconstitutional were § 202 loans made directly to such religious entities. Accordingly, churches and other fundamentally religious organizations must establish a separate borrower to receive and administer § 202 loans to avoid constitutional prohibitions on the advancement of religion and excessive government entanglement with religion. See discussion at II, A.2 infra. Such an institutional arrangement is essentially similar to that in Tilton v. Richardson, where the colleges, although separate institutions, were "governed by Catholic religious organizations," 403 U.S. at 686, and that in Roemer v. Maryland Public Works Bd., where the colleges had a high degree of institutional autonomy but were formally affiliated with the Catholic church, which also was represented on their governing boards. See 426 U.S. at 755. We further note that our conclusion that fundamentally religious organizations are constitutionally required to establish separate borrowing entities to obtain and administer § 202 loans accords with HUD's consistent administrative practice with respect to these loans. Consequently, any possible reluctance we might entertain in determining, solely on the basis of a hypothetical understanding of how churches might handle borrowed funds for arguably segregable activities, is removed by the agency's practical experience with the difficulties encountered in ensuring that federal funds not be used to support religious activities.

2. Is a nonprofit corporate borrower whose articles of incorporation state that it is "operated exclusively for religious, charitable, scientific, . . . literary or educational purposes, . . ." 26 U.S.C. § 501(c)(3), ineligible, as a constitutional matter, for a § 202 loan?

This criterion of ineligibility is clearly overbroad as a constitutional matter and, as you implied in your letter, ill-tailored from an administrative perspective, for determining eligibility for § 202 loans. Use of this criterion would eliminate from eligibility for a § 202 loan not only a nonprofit religious sponsor associated with a nonprofit religious borrower, but also a religious sponsor with a nonsectarian corporate borrower and even a nonsectarian sponsor with a nonsectarian corporate borrower. Because a secular charitable sponsor with a secular charitable corporate borrower clearly would be constitutionally eligible for a § 202 loan, this requirement is not necessary as a constitutional matter.

Moreover, a religious sponsor with a borrower incorporated for, e.g., "exclusively . . . charitable" purposes would be constitutionally eligible for a § 202 loan, although barred by the above administrative requirement. The Supreme Court has continued to adhere to the principle established in Bradfield v. Roberts, 175 U.S. 291 (1899), that the government may finance a religious order to perform a wholly secular task. See Roemer v. Maryland Public Works Bd., 426 U.S. at 746; Hunt v. McNair, 413 U.S. at 742-43; Tilton v. Richardson, 403 U.S. at 679 ("simplistic argument that every form of financial aid to church-sponsored activity violates the Religion Clauses was rejected long ago in Bradfield"). In Bradfield v. Roberts the Court upheld a federal construction grant to a corporation which, although allegedly composed entirely of members of a Roman Catholic sisterhood acting "under the auspices of said church," 175 U.S. at 297, was limited by its corporate charter to the secular purpose of operating a charitable hospital open to all. The legal character of the hospital in Bradfield -- a private, eleemosynary corporation under the auspices of the Roman Catholic Church but "managed pursuant to the [secular corporate] law of its being (175 U.S. at 298)" -- is analogous to the legal status of nonsectarian corporate borrowers that HUD regulations and policies require religious sponsors to establish in order to be eligible for § 202 loans. See 24 C.F.R. § 885.5 (1982); 48 Fed. Reg. 17397 (April 22, 1983) 14/. Therefore, at least

14/ The private eleemosynary corporation in Bradfield v. Roberts, 175 U.S. 291 (1899), had:

1. no mention of religion or the religious faith of its incorporators in the act of incorporation, id. at 297;
2. a secular purpose -- the provision of care for any sick or invalid persons, id. at 296-97, 299;
3. power to hold property only by and for itself, id. at 298-99;
4. a Board whose members belonged to a sisterhood of the Roman Catholic Church, id. at 297-98.

(Footnote continued on next page)

with respect to borrower corporations operated for charitable purposes, and whose legal status resembles the hospital in Bradfield, eligibility for a § 501(c)(3) exemption and for a § 202 loan is constitutionally permissible.

Equally clearly, if a religious corporation were to establish a separate nonprofit corporate borrower organized and operated exclusively for religious purposes, then a § 501(c)(3) exemption would be available but a § 202 loan would violate the constitutional prohibition respecting an establishment of religion. Because of the pervasively sectarian character of such a borrower, it would be difficult, if not impossible, to ensure that federal funds were supporting solely secular activities. Consequently, the aid would have the primary effect of advancing religion and would involve an excessive entanglement with religion. See Sec. II, A.1., supra.

There may, however, be an intermediate, more complex category of borrower corporations that qualify for § 501(c)(3) status because they are organized and operated exclusively for, e.g., religious and educational and charitable purposes, but whose eligibility for § 202 loans will depend on the specific facts involved. If the borrowing organization's primary purpose is educational or charitable, then, like the colleges that received aid in Tilton and Roemer, it might be possible to separate out secular and sectarian activities, and ensure that secular activities alone benefit from § 202 loans. But if the organization is pervasively sectarian, then the size and nature of the § 202 loan would create a constitutionally impermissible relationship between the government and the religious borrowing organization. At most then, tax-exempt status as a § 501(c)(3) organization serves

(Footnote continued).

The opinions of HUD's General Counsel, reasoning from these characteristics, prohibit, with respect to § 202 borrowers, (1) any reference to religion in their corporate charter and bylaws, (2) distribution of assets to a religious corporation on dissolution and (3) direct control over the borrower by a religious corporation. HUD does, however, permit a sponsoring religious corporation to designate the borrower's members or directors. See Memorandum to Lawrence B. Simons, supra; Memorandum to William L. Warfield, supra; Memorandum to Harry J. McNerney, supra.

only as a rough indicator. It defines a broad category of corporations, many of whom may be eligible for § 202 loans and some of whom may not be. In no way does status as a § 501(c)(3) corporation necessarily entail ineligibility, as a constitutional matter, for a § 202 loan.

3. Is exemption from the prohibitions of the Fair Housing Act as an organization "operated, supervised or controlled by or in conjunction with a religious organization, association, or society, . . ." 42 U.S.C. § 3607, inconsistent, as a constitutional matter, with eligibility for a Section 202 loan?

One must keep clearly in mind two independent aspects of the exemption for religious organizations in the Fair Housing Act of 1968 set forth in 42 U.S.C. § 3607. First the statutory exemption covers "a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, . . ." Second, the statutory provision permits such organizations, for noncommercial purposes, to limit the sale or rental of dwellings to persons of the same religion or to grant preferences in housing based on religious belief.

Were a religious or church-affiliated organization to limit dwelling occupancy to persons of a particular faith, then it would be ineligible for § 202 funds. An institution that grants preferences to members of a particular creed would by definition be a pervasively sectarian organization. Compare Tilton, 403 U.S. at 686 (non-Catholics admitted along with Catholics in an institution deemed not pervasively sectarian) with Nyquist, 413 U.S. at 756 (profile of sectarian schools includes institutions that impose religious restrictions on admissions). Moreover, given the substantial, long-term nature of the § 202 loan, the effect of such aid would be to advance religion in contravention of First Amendment principles. See Lemon v. Kurtzman, 403 U.S. at 633 (Douglas, J., concurring) ("government may, of course, finance a hospital though it is run by a religious order, provided it is open to people of all races and creeds").

However, not all organizations "operated, supervised or controlled by or in conjunction with a religious organization, . . .," 42 U.S.C. § 3607, necessarily grant preferences based on religious belief in the homes or dwellings they own or operate. Assuming that such a religiously-affiliated organization

were to make housing available to all, the question whether such an organization would be eligible for a § 202 loan is an entirely separate issue. If a religiously-affiliated organization were governed by a corporate charter that conformed with existing HUD requirements, it would clearly be eligible for a § 202 loan. Thus, while limiting occupancy in a dwelling based on religious affiliation would render an organization ineligible for a § 202 loan, mere status as an organization "operated, supervised or controlled by or in conjunction with a religious organization," as defined in 42 U.S.C. § 3607, is not necessarily determinative of § 202 loan eligibility.

Indeed, it is not clear to us that 42 U.S.C. § 3607 is at all relevant for purposes of defining what organizations may receive § 202 loans without violating the Establishment Clause prohibition in the First Amendment. Section 3607 addresses an entirely different question: it defines the narrow realm of private activity that Congress, to avoid violating the Free Exercise Clause, excepted from its broad power under the Thirteenth Amendment to regulate fair housing.^{15/} Thus, it is unlikely that Congress had First Amendment Establishment issues in mind when delimiting the scope of exempted, religiously affiliated organizations in § 3607, because government aid to such organizations was not at all in issue. See also Fair Housing Act of 1967, Hearings on S. 1358, S. 2114 and S. 2280 before the Subcomm. on Housing and Urban Affairs of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 169, 365 (1967) (discussing exemption for religious institutions maintained through private religious charitable funds). Moreover, even if government involvement or support had been

^{15/} The few courts that have explicitly addressed the issue have determined that Congress was exercising its power under the Thirteenth Amendment in enacting the Fair Housing Act, 42 U.S.C. § 3601 et. seq. See United States v. Hunter, 459 F.2d 205, 214 (4th Cir.) cert. denied, 409 U.S. 934 (1972); United States v. Parma, 494 F. Supp. 1049, 1052 (N.D. Ohio 1980), appeal dismissed, 633 F.2d 218 (6th Cir. 1980). The legislative hearings make several references to Congress' power to enact fair housing legislation under the Fourteenth Amendment and the Commerce Clause. See Fair Housing Act of 1967, Hearings on S. 1358, S. 2114, and 2280 before the Subcomm. on Housing and Urban Affairs of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. at 7 (1967) (remarks of Sen. Mondale); id. at 8-14 (statements of Attorney General Clark).

a relevant factor, Congress was confronting the permissibility of such support primarily in the context of racial discrimination, rather than in the admittedly different context of religious promotion. Not insignificantly, the government has greater leeway to aid sectarian organizations than it has to support, in any manner, discriminatory institutions. See Norwood v. Harrison, 413 U.S. 455, 464 n. 7 (1973) (State may loan textbooks to private sectarian schools but not to private schools that discriminate racially).

We therefore conclude that the statutory terms in 42 U.S.C. § 3607 describing organizations "operated, supervised or controlled by or in conjunction with a religious organization, . . ." should not, standing alone, serve as a limiting definition of organizations ineligible for § 202 housing loans. Frequently, institutions operated in conjunction with a religious organization or supervised by a religious organization receive government funds without violating the Establishment Clause, because it is possible to ensure funding for the institutions' secular activities alone. See Roemer v. Board of Public Works of Maryland, *supra* (funding for colleges affiliated with the Roman Catholic Church); Hunt v. McNair, *supra* (State revenue bonds fund construction at Baptist-controlled college); Tilton v. Richardson, *supra* (federal construction grant for colleges governed by Catholic religious organizations); Bradfield v. Roberts, *supra* (construction grant for hospital governed by members of Roman Catholic sisterhood). Although the extent to which an organization is operated, supervised or controlled by a religious institution is undeniably relevant to any Establishment Clause inquiry, other factors, such as whether secular activities can be separated out for funding purposes, the nature of the aid provided, and the resulting relationship between the State and the religious authority are also decisive. Cf. Roemer v. Maryland Public Works Bd., 426 U.S. at 764-66 (character-of-institution distinctions may be more significant than form-of-aid distinctions). Because constitutional analysis for purposes of discerning Establishment Clause violations is highly dependent on the specific facts of each situation, we believe that an abstract definition of organizations "operated . . . in conjunction with a religious institution" as a priori ineligible for federal funds under § 202 is unduly restrictive. Accordingly, to the extent that the December 26, 1979 Memorandum to Assistant Secretary for Housing Lawrence B. Simons requires that § 202 borrowers not be an "institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association or society," we conclude that this is a constitutionally unnecessary requirement.

B. Use of Block Grants under the Housing and Community Development Act

1. Use of Block Grant Funds for Churches or Structures Used for Religious Purposes

In light of the principles articulated above with respect to § 202 housing loans, analysis of whether block grant funds can be used to restore or maintain active churches or other structures in which religious activities are conducted is relatively straightforward. Indeed, the decisions in Committee for Public Education v. Nyquist, supra, and Tilton v. Richardson, supra, expressly prohibit government assistance for religious buildings or structures used to promote religious interests. In Tilton v. Richardson, the Court held that federal construction grants to sectarian colleges were constitutional precisely because the authorizing statute specifically prohibited use of the federally funded facilities for sectarian instruction, religious worship or department of divinity programs. See 403 U.S. at 679-82, 689. Further, the Court held that the statute violated the Establishment Clause to the extent that the prohibition on religious use was limited to twenty years. After that period, were the building converted to a chapel or used for any religious purposes, the original federal grant would have the impermissible effect of advancing religion. See Tilton v. Richardson, 403 U.S. at 683. Similarly, in Nyquist the Court held that a state statute authorizing "maintenance and repair" payments to nonpublic, primarily Catholic, elementary and secondary schools, unconstitutionally advanced religion because the statute did not restrict permissible expenditures to the upkeep of facilities used exclusively for secular purposes. The Court did not believe it was possible to guarantee exclusively secular use of the State funds in the context of such "religion-oriented institutions." 413 U.S. at 774. Therefore, the Court, extrapolating from Tilton, concluded: "If tax-raised funds may not be granted to institutions of higher learning where the possibility exists that those funds will be used to construct a facility utilized for sectarian activities 20 years hence, a fortiori they may not be distributed to elementary and secondary sectarian schools for the maintenance and repair of facilities without any limitations on their use." 413 U.S. at 776-77. The Court noted, perhaps inevitably, that "[i]f the State may not erect buildings in which religious activities are to take place, it may not maintain such buildings or renovate them when they fall into disrepair." 413 U.S. at 776-77. The analogy to constitutionally permissible and impermissible

uses of federal block grant funds for maintenance and repair is evident.

Unquestionably then, the First Amendment prohibits direct block grant recipients from extending any funds to maintain or repair religious structures currently used for religious purposes. We find that your present policy as articulated in the August 3, 1979 Memorandum, correctly embodies these First Amendment principles. However, it is equally clear that any structure used to promote religious interests, regardless whether constructed for educational, charitable or whatever purposes, may not, consistent with the Establishment Clause, receive federal assistance. A conceivably minor exception to this bar against State support of religious activities would be the provision of a public benefit, e.g., sidewalks, neutrally available to all, pursuant to general legislation. See Everson v. Bd. of Education, 330 U.S. at 17-18 (Establishment Clause does not mean that state must discriminate against religious activities by failing to provide police and fire protection or public sidewalk maintenance that would otherwise be available).

2. Use of Block Grant Funds for Religiously Affiliated Organizations

Similar to the analysis regarding § 202 loans, the difficulty is not whether the Community Development Act reflects a secular, legislative purpose -- it clearly does -- but whether federal support of certain private activities would have the constitutionally prohibited effect of advancing religion or would occasion the equally proscribed entanglement of the State with religion. On the one hand, federal aid to church-related institutions that are so pervasively sectarian that secular activities cannot be isolated from sectarian ones would violate the Establishment Clause. On the other hand, federal aid to religiously affiliated institutions in which secular activities can be separated out and exclusively funded may be constitutional. See Roemer v. Maryland Public Works Bd., 426 U.S. at 755. Because such determinations are highly dependent on the facts specific to each church-related institution, it may be difficult to formulate precise guidelines to govern the use of block grant funds in such situations.

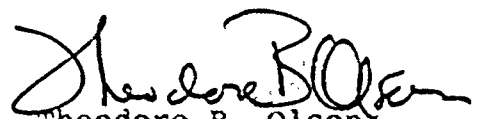
Moreover, assuming that the secular activities of a religiously affiliated organization can be separately funded, the nature of the aid provided (one-time grant or annual funding process) and the resulting relationship between the

organization and the State authority (detailed audits and frequent inspections) may constitute an unconstitutional government entanglement with religion. See Hunt v. McNair, 413 U.S. at 739-40, 745-49. Again, beyond general guidelines, it may be difficult to pinpoint in advance whether any particular aid envisaged will meet the critical aspects of nonadvancement and nonentanglement: "the ability of the state to identify and subsidize separate secular functions carried out at the [organization], without on-the-site inspections being necessary to prevent diversion of the funds to sectarian purposes." Roemer v. Maryland Public Works Bd., 426 U.S. at 765. It is clear, however, that the State authority or block grant recipients may not rely on statistical judgments or the good faith of persons involved in a particular program to guarantee that funds will not be used to finance religious activities. See Nyquist, 413 U.S. at 777-79 (statute limiting repair grants for nonpublic schools to 50% of the amount expended for comparable services in the public schools is insufficient to ensure that funds will not support sectarian activities); Lemon v. Kurtzman, 403 U.S. at 618-619 (even assuming that teachers attempt in good faith to segregate religious beliefs from secular educational responsibilities, the continuing state surveillance required to ensure observance of the First Amendment would involve excessive entanglement between church and state).

We also caution that the potential for political divisiveness, a factor related to the entanglement inquiry, may be exacerbated in the instance of the block grant program, which Congress designed to increase local decisionmaking and decrease federal involvement with respect to funding approval for various community development activities. See Letter to Thomas W. Ramsbey from Stephen J. Bollinger, Assistant Secretary, HUD (April 1, 1982); S. Rep. 139, 97th Cong., 1st Sess. 226 (1981) (amendments to Community Development Block Grant program contained in Omnibus Budget Reconciliation Act of 1981 reflected "purpose to lessen significantly this improper Federal intervention in the local decisionmaking process"). According to the Supreme Court, political divisiveness over religious issues may be aggravated when funding decisions affect local communities rather than a diverse, widely dispersed constituency. See Tilton v. Richardson, 403 U.S. at 688-89. As noted above, the potential for political divisiveness is heightened by "the need for continuing annual appropriations and the likelihood of larger and larger demands as populations and costs grow." Lemon v. Kurtzman, 403 U.S. at 623. In addition, political divisiveness is aggravated when only a

narrow class of primarily religiously affiliated organizations benefits from the State aid. See Nyquist, 413 U.S. at 795-98; Lemon v. Kurtzman, 403 U.S. at 623. Although we are not sufficiently informed about the specifics of the proposed or intended uses of block grants to reach any definite conclusions, it is possible that various proposed uses of the funds suffer from the above infirmities. Nevertheless, we emphasize that the "potential for entanglement in the broader sense of continuing political strife over aid to religion," Nyquist, supra, 413 U.S. at 794, does not alone warrant invalidation of certain block grant programs. Rather, it is another factor relevant to the somewhat inexact determination of whether a particular use of government funds constitutes a constitutionally "excessive entanglement" with religion.

In conclusion, we believe all of the above factors should be employed to illuminate whether a specific use of block grant funds for church-related organizations effects an impermissible advancement of religion or entails an excessive entanglement. We are reluctant to attempt, absent more specific information, to formulate more precise guidelines to govern the use of block grant funds with respect to religiously affiliated organizations.



Theodore B. Olson
Assistant Attorney General
Office of Legal Counsel