NOTES

THE DUE-ON-SALE CONTROVERSY: BENEFICIAL EFFECTS OF THE GARN-ST. GERMAIN DEPOSITORY INSTITUTION ACT OF 1982

The recent federal preemption of state restrictions on the enforceability of due-on-sale clauses, accomplished by section 341 of the Garn-St. Germain Depository Institution Act of 1982 (the Garn Act),[1] came amid considerable controversy. In recent years, the due-on-sale clause, a contract provision permitting a lender to declare a mortgage loan immediately due and payable if the real property securing the loan is transferred without the lender's consent,[2] has been criticized by legal commentators and invalidated by both courts and legislatures.[3]

The Garn Act essentially authorizes blanket use and routine enforcement of due-on-sale clauses.[4] It preempts state invalidations of

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1. Pub. L. No. 97-320, 96 Stat. 1469, 1505 (codified at 12 U.S.C. § 1701j-3(a) to -3(g) (1982)).

2. In some contexts, the term due-ou-sale has been used loosely to refer to a provision that triggers acceleration upon any transaction affecting the title of the securing property, such as the imposition of a subordinate lien. Throughout this note, the term due-on-sale will refer only to provisions concerning the actual transfer of the securing property. The use of due-on-encumbrance provisions has declined considerably in recent years, Thornburg, *The Due-on-Sale Clause: Current Legislative Actions and Probable Trends*, 9 FLA. ST. U.L. REV. 645, 646 (1981), and their enforceability is no longer a particularly important issue. For an example of the judicial treatment afforded such due-on-encumbrance clauses, see La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 869, 489 P.2d 1113, 1115, 97 Cal. Rptr. 849, 851 (1971)(clause held to be invalid as an unreasonable restraint on alienation unless exercised solely to protect the lender's security).

3. *See infra* notes 36, 46, 86, 87 and accompanying text.

4. The Garn Act's authorization applies equally to all lenders and to virtually all types of loan instruments secured by real property. *See* 12 U.S.C. § 1701j-3(a)(2) to (3) (1982). The Act does place some restrictions on the use of the due-on-sale clause. The clause may not be exercised, regardless of when or by whom the loan may have been originated, in any of the following situations:

> (1) the creation of a lien or other encumbrance subordinate to the lender's security interest which does not relate to a transfer of rights of occupancy in the property;
> (2) the creation of a purchase money security interest for household appliances;
> (3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;
> (4) the granting of a leasehold interest of three years or less not containing an option to purchase;
> (5) a transfer to a relative resulting from the death of a borrower;

the clause and frees lenders from almost all restrictions on the use of due-on-sale clauses except in the narrow class of mortgages originated or assumed after the relevant state invalidated the clause and outstanding when Congress passed the Act. To protect the expectations of borrowers who in good faith believed that the due-on-sale clauses in such mortgage contracts were unenforceable, the Act provides that its preemptive provisions need not apply for the full term of loans made during a specified "window period." The window period began on the date on which the state invalidated due-on-sale clauses and ended October 15, 1982, the effective date of the Garn Act.[5] Under the provisions of the Garn Act, this moratorium on enforcement of the due-on-sale clauses of window period loans lasts only three years, until October 15, 1985.[6] State legislatures, however, retain the power during that three year period to extend the moratorium for the full term of window period loans, and the appropriate federal agencies retain the same power with regard to federal lending institutions.[7]

Although legislatures in states that prior to the enactment of the Garn Act restricted the use of due-on-sale clauses may reinstitute those prohibitions with regard to window period loans, this note advises against any extension of the Act's three year moratorium. Permitting lenders to enforce due-on-sale clauses is the more reasonable position to adopt, from both legal and economic perspectives. By extending the length of the Garn Act's window period exception, a state would only perpetuate the distortions that the due-on-sale restrictions created.[8] Part I of this note examines the development of the controversy

(6) a transfer where the spouse or children of the borrower become an owner of the property;

(7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a trustee of rights of occupancy in the property; or

(9) any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.

12 U.S.C. § 1701j-3(d) (1982). Congress included this section to prevent unconscionable or inequitable exercise of the due-on-sale clause. S. REP. No. 536, 97th Cong., 2d Sess. 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3078-79 [hereinafter cited as SENATE REPORT].

5. 12 U.S.C. § 1701j-3(c)(1) (1982).

6. *Id.*

7. *Id.*. The Senate Report on the Garn Act indicates clearly that a state that had already imposed restrictions on the use of due-on-sale clauses could "lengthen the time that State due-on-sale restrictions would apply to window period loans." SENATE REPORT, *supra* note 4, at 3077. Clearly, then, such a state could extend that time long enough to reimpose its restrictions for the full term of window period loans. A state may not extend the scope of its restrictions, however. *Id.* A state is also free to shorten the length of the moratorium, or to reduce the scope of its restrictions. *Id.*

8. *See infra* text accompanying notes 32-33.

surrounding the use of due-on-sale clauses.[9] Part II assesses the arguments for and against enforcing such clauses,[10] and concludes that decisions denying enforcement represent an emotional rather than reasoned response to a perceived "burden" on borrowers.[11] Courts refusing to enforce the clauses seem to oppose any "contract which provides a benefit to an institutional, deep pocket party, on the basis that all benefits should somehow flow to the consumer."[12] Yet, enforcing due-on-sale clauses benefits not only lenders, but also the greatest number of borrowers and potential borrowers.[13] Part III reviews the post-Garn Act status of the due-on-sale clause, and discusses its likely future.[14]

I. The Due-on-Sale Clause Before the Garn Act

Historically, lenders employed due-on-sale provisions in loan agreements to protect their security interests.[15] Although lenders normally satisfy themselves with the creditworthiness of the original borrower, they have no assurance that an assignee of the mortgage would be equally creditworthy if the mortgage were freely assumable. To protect themselves from "specific risk," that is, the risk of loss associated with defaults by mortgage assumers who do not satisfy the lenders' credit requirements, lenders began including an acceleration provision in their mortgage contracts that allowed the lender to declare the mortgage due and payable in full upon a transfer by the mortgagor of the securing property. The due-on-sale clause is usually drafted in general terms with no mention of its specific purpose.[16] As a result, lenders began to condition their consent to a particular transfer of the securing

9. *See infra* text accompanying notes 15-30.

10. *See infra* text accompanying notes 31-74.

11. One critic of the due-on-sale clause went so far as to characterize it as a "sword of Damocles" hanging over the head of a borrower contemplating a transfer of the securing property. Bonanno, *Due on Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives*, 6 U.S.F.L. REV. 267, 285 (1972).

12. Subcomm. on "Due-on" Clauses of the Comm. on Real Estate Financing, *Enforcement of Due-on-Transfer Clauses—A Review and Commentary of the State of the Law on Enforceability of Acceleration Provisions in Mortgages and Deeds of Trust by Reason of Transfer of an Interest in Security*, 13 REAL PROP. PROB. & TR. J. 891, 935 (1978) [hereinafter cited as *Subcomm. Report*].

13. *See infra* notes 52-53, 62-63 and accompanying text.

14. *See infra* text accompanying notes 75-93.

15. Bonanno, *supra* note 11, at 271.

16. The clause used by the lender in Northwestern Fed. Sav. & Loan Ass'n v. Ternes, 315 N.W.2d 296, 298 (N.D. 1982) is typical:

> If any sale or conveyance of said property is made by the mortgagor, his executors, administrators, successors or assigns, without the written consent of the mortgagee, its successors or assigns, and without an agreement in the instrument of conveyance under which the grantee assumes and agrees to pay the indebtedness, then in either event the mortgagee may at its option and without notice declare the entire amount of the mort-

property on the purchaser's agreeing to an increase in the interest rate on the loan. If the purchaser did not agree to pay a higher rate of interest, the lender simply called the loan due and used the funds to make new loans at prevailing, and presumably higher, interest rates. Thus, the due-on-sale clause allowed lenders to protect themselves from "portfolio risk," that is, the risk of loss resulting from holding long term assets with fixed rates of return while financing the portfolio with short term liabilities during periods of rising interest rates.[17]

For the past several decades, rising interest rates increasingly prompted lenders to enforce due-on-sale provisions even when the proposed assumption of the mortgage posed no threat to the lender's security interest.[18] This practice led to strident protests from borrowers and legal commentators, and ultimately to varying degrees of judicial and legislative response.[19] Some courts and legislatures forbade enforcement of due-on-sale clauses, either as an unreasonable restraint on alienation of property or as an inequitable or unconscionable contract provision;[20] other courts and legislatures upheld enforcement of these clauses.[21] A few states merely restricted the amount by which a lender could increase the interest rate, upon assumption, under threat of acceleration.[22]

The federal government first entered the fray in 1976, when the Federal Home Loan Bank Board (FHLBB) issued a regulation authorizing the use of due-on-sale clauses by federally chartered savings and loan associations.[23] This authorization created competitive disparities between state and federally chartered lenders. In a state that otherwise

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gage indebtedness immediately due and payable and may foreclose the mortgage as prescribed by law.

17. *See* Comment, *Due-on-Sale Clauses: The Economic and Legal Issues*, 43 U. PITT. L. REV. 441, 443 (1982); *see also infra* note 70 and accompanying text.

18. *See* Bonanno, *supra* note 11, at 278.

19. *Id.* at 278-79.

20. Some courts have refused to enforce the clause absent a showing that the lender's security interest would be jeopardized by the transfer. *See, e.g.,* Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 948, 587 P.2d 970, 975, 148 Cal. Rptr. 379, 385-86 (1978); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 166, 250 N.W.2d 804, 806 (1977); Sanders v. Hicks, 317 So. 2d 61, 64 (Miss. 1975). For a complete list of state restrictions on the enforceability of due-on-sale clauses, see *infra* notes 86-87.

21. These courts have found nothing wrong with the unconditional enforcement of the due-on-sale clause as written. *See, e.g.,* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 301, 509 P.2d 1240, 1242 (1983); *In re* Foreclosure of Deed of Trust Executed by Bonder, 306 N.C. 451, 459, 293 S.E.2d 798, 803 (1982); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 812 (Tex. 1982).

22. *See* COLO. REV. STAT. § 38-60-165 (1982); GA. CODE ANN. § 44-15-5(b) (1982); MINN. STAT. ANN. § 47.20 (Supp. 1984); *see also infra* note 87.

23. This regulation is now codified at Contract Provisions for Real Estate Loans, 12 C.F.R. § 545.8-3(f) (1983).

clauses.[29] It was in this context of unequal treatment of lenders with regard to the enforceability of due-on-sale clauses that Congress enacted section 341 of the Garn Act. In opting for general enforceability, Congress was attempting both to remove the advantages enjoyed by some lenders and to resolve the longstanding debate between borrowers and lenders in a matter most beneficial to the long term health of the mortgage industry and to the greatest number of borrowers.[30]

II. Enforcement of the Due-on-Sale Clause: An Assessment

When states invalidated due-on-sale clauses prior to the Garn Act, despite the FHLBB's preemption of those restrictions for federal lenders, they not only placed lenders chartered by that state at a competitive disadvantage,[31] but also created macroeconomic distortions in the national flow of funds within and to the mortgage market. The absence of a due-on-sale clause makes a mortgage relatively less attractive on the secondary market. In particular, the Government National Mortgage Association, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation, which together represent ten percent of the secondary market, require due-on-sale clauses in the mortgages that they purchase.[32] Lenders in states restricting the use of the clause are forced to sell their loans at a discount, which puts them at a disadvantage in bidding for those funds available to the mortgage market as a whole, and may ultimately direct mortgage funds away from those states that would not enforce the clause. Congress could have addressed this problem by invalidating due-on-sale clauses across the board, as this would have eliminated any preference that might be enjoyed by due-on-sale states in the secondary market. But by doing so, Congress would also have rendered mortgage

29. Past periods of interest rate increases have been followed by relative calm, notably in the early 1960's and 1970's, and the due-on-sale controversy has waxed and waned with interest rates. *See* Bonanno, *supra* note 11, at 279-80. This perhaps explains why only a small number of state legislatures have taken any action to restrict the enforceability of due-on-sale clauses, given the inevitable lag between the time a particular issue is brought to the legislature's attention and the time that legislation is actually passed. If interest rates level or decline during that lag period, so that lenders are no longer exercising their rights under due-on-sale clauses, the legislature may consider the issue moot and turn its attention to more pressing issues. Indeed, it is surely no coincidence that Congress did not act until interest rate volatility was recognized as a continuing phenomenon.

30. Senate Report, *supra* note 4, at 3075.

31. *See supra* note 24 and accompanying text.

32. Thornburg, *supra* note 2, at 650; *see also* Senate Report, *supra* note 4, at 3075. Of course, the clause cannot be required in those jurisdictions that prohibit it. In lieu of the due-on-sale clause, Fannie Mae requires the loan to contain a seven year call option. HUD Report, *supra* note 26, at 29.

loans less attractive as a class of investment, and would likely have driven some funds out of the mortgage market altogether, again creating macroeconomic distortions.[33]

To the extent that states choose to extend the moratorium on preemption for window period loans, these distortions, unlike the microeconomic distortions discussed below,[34] threaten to persist. Lenders in a state such as Arizona, where the window period is eleven years,[35] have a significant percentage of loans with unenforceable due-on-sale clauses in their portfolios. As long as the due-on-sale provisions in such loans remain unenforceable, the loans will continue to be unattractive on the secondary market and mortgage funds will be directed to federally chartered lenders or to lenders in nonrestricting states. If the moratorium were extended indefinitely on window period loans, it would take twenty to thirty years for this distortion to dissipate completely.

Nonetheless, most of the controversy surrounding the enforceability of due-on-sale clauses focuses on microeconomic relationships between particular borrowers and lenders. Those who support the invalidation of due-on-sale clauses argue either that such clauses should be void as unreasonable restraints on alienation of property or that they should be unenforceable as inequitable or unconscionable. Neither of these arguments withstands scrutiny, however. The costs of invalidating the clause exceed the benefits.

A. *The Due-on-Sale Clause and the Unconscionability Doctrine.*

Unconscionability arguments rely on characterizing the borrower as an economic underdog: "These clauses afford the potential not only for great profits but also for frequent abuses. They place borrowers at the mercy of the savings institutions."[36] But where is the abuse? One court suggested that a lender attempting to impose a greater-than-market rate upon assumption would be flirting with unconscionability;[37] yet the court neglected to observe that the lender wonld be unsuccessful

33. The New Mexico legislature cited this problem as justification for its decision to permit a limited interest rate increase upon assumption for its window period loans. N.M. STAT. ANN. §§ 48-7-15 to -19; *see also infra* note 89 and accompanying text.

34. *See infra* text accompanying note 73.

35. The Arizona Supreme Court has determined that the window period began there on July 8, 1971. Scappaticci v. Southwest Ass'n, 135 Ariz. 456, 461, 662 P.2d 131, 136 (1983); *see also infra* note 86.

36. Note, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1124 (1975).

37. Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 304, 509 P.2d 1240, 1245 (1983).

because the prospective purchaser could always obtain financing elsewhere, presumably at market rates. Similarly, fears that lenders will impose usurious rates on the party assuming the mortgage are unfounded because federal law has lifted most state interest rate limitations from first-mortgage loans.[38] Unfortunately, discussion of the subject of interest rates often becomes distorted by emotion;[39] personal sympathies for respective plights of borrowers and lenders aside, however, there appears to be no basis in usury law for finding a due-on-sale clause to be an unconscionable contract provision.[40]

The due-on-sale clause has also been said to be unconscionable because it amounts to a "sleeper" clause; the borrower may be unaware at the time the contract is made that the lender will condition his consent to a mortgage assumption not simply on the creditworthiness of the prospective purchaser, but also on his willingness to agree to an increased rate of interest.[41] There may be some merit to this contention given a generally worded due-on-sale provision;[42] a borrower could well be surprised to learn of the lender's motive in enforcing the clause. But what should his expectations be?[43] The language of the typical

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38. Section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 161-63 (codified as a note to 12 U.S.C. § 1735f-7 (1982)), provides that state laws "limiting the rate or amount of interest, discount points, [or finance] charges" shall not apply to any loan, mortgage, credit sale, or advance that is "secured by a first lien on residential real property." Although a number of states have acted to override that federal preemption, most of them do not impose any interest rate ceiling in first-mortgage loans as a matter of state law. *See, e.g.,* WIS. STAT. § 138.052(11) (1983).

39. The Tennessee Supreme Court, in holding that the use of a due-on-sale clause to increase the interest rate on the loan was not unconscionable, noted the unfortunate tendency of some to "savor the subject of interest with a grimace." Gunther v. White, 489 S.W.2d 529, 531 (Tenn. 1973).

40. *See id.*; Malouff v. Midland Sav. & Loan Ass'n, 181 Colo. 294, 304, 509 P.2d 1240, 1245 (1983); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982).

41. *See* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 167, 250 N.W.2d 804, 808 (1977); Holiday Acres No. 3 v. Midwest Federal Sav. & Loan Ass'n, 308 N.W.2d 471, 481 (Minn. 1981); *see also* Thornburg, *supra* note 2, at 653-54; Note, *supra* note 36, at 1124.

42. *See, e.g., supra* note 16.

43. The Minnesota Supreme Court argued that because the historical purpose of the due-on-sale clause was to protect the lender from specific risk, the borrower could reasonably assume that he was bargaining for enforcement of the clause only if assumption represented a credit risk. Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 481 (Minn. 1981). A borrower sophisticated enough to appreciate the historical rationale for the due-on-sale clause, however, would seem to be just as likely to appreciate the modern portfolio risk rationale, and, according to this argument, would therefore have bargained with that in mind as well. Most likely, the average borrower has no idea at the time he enters into the loan contract why the due-on-sale clause is valued by the lender, although it might become painfully obvious when he tries to assign the mortgage. On the other hand, a borrower obtaining legal advice in connection with the transaction, as is often the case, could reasonably be expected to be informed of the effect of the due-on-sale clause. In either case, the borrower has no reason to assume that the clause will be enforced only to protect the lender from specific risk.

clause describes the borrower's rights and duties unambiguously; he may repay the loan on a periodic basis only as long as he owns the securing property. Understanding the lender's motives does not alter the borrower's obligations under the contract.

The inadequate disclosure argument in recent years has, however, been losing whatever merit it may have had. First, the clauses increasingly include language that explicitly sets forth the lender's intention to exercise the clause in order to protect itself from portfolio risk.[44] In addition, the escalation of the controversy to the federal level has increased general awareness of the existence of the due-on-sale clause and of the purposes that the clause serves.

B. *The Due-on-Sale Clause as a Restraint on Alienation.*

The case against enforcement of due-on-sale clauses as unreasonable restraints on alienation stumbles at the first step. The *Restatement of Property* describes a restraint on alienation as

> an attempt by an otherwise effective conveyance or contract to cause a later conveyance:
> (a) to be void; or
> (b) to impose contractual liability on the one who makes the later conveyance when such liability results from a breach of an agreement not to convey; or
> (c) to terminate or subject to termination all or part of the property interest conveyed.[45]

A due-on-sale clause fits this definition, if at all, only under subsection (b), referred to by the *Restatement* as "promissory restraint."[46] But the due-on-sale clause is a poor fit even as a promissory restraint. No "contractual liability" actually results from the borrower's unauthorized transfer of the securing property in the sense that the borrower is thereby liable for damages for a breach; the borrower simply must repay the entire loan in accordance with the explicit terms of the mort-

44. Thornburg, *supra* note 2, at 653-54. Note that the due-on-sale clause currently used in the uniform mortgage instruments developed by Fannie Mae, known as paragraph 17, contains the following language:

> Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to the Lender and that *the interest payable on the sums secured by this Deed of Trust shall be at such rate as Lender shall request*.

Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 145 n.2 (1983)(emphasis added). Paragraph 17 is used in many loan instruments. *Id.*

45. RESTATEMENT OF PROPERTY § 404(1) (1944).

46. *Id.* § 404(3); *see also* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 165, 250 N.W.2d 804, 805 (1977); Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 774 & n.114 (1973).

gage contract. Consequently, the due-on-sale clause does not amount to a direct restraint on alienation.[47]

Some courts characterize the due-on-sale clause as an "indirect" restraint.[48] The California Supreme Court in *Wellenkamp v. Bank of America*[49] set out the "indirect" restraint argument: Assume a prospective purchaser of the property is willing to pay the asking price of the seller, but only if he can assume that seller's existing mortgage. If the lender refuses to permit the assumption, or conditions the assumption on the purchaser's agreeing to an increased interest rate, the purchaser may be unable to afford the property with the higher financing costs unless the seller agrees to a lower sale price. If the seller is unwilling to sell at a lower price, the entire transaction will fail. Thus, according to this argument, the due-on-sale clause has the effect of rendering that property inalienable, at least with respect to these specific parties.[50]

The argument that a due-on-sale clause is inherently a restraint on alienation because its operation may eliminate a few property transactions at the margin treads on treacherous ground, however. First, note the assumptions about the borrower and seller that are required to reach the restraint result. Both parties must be inflexible with regard to the selling price; this characterization is, however, often unrealistic. Few real estate transactions are consummated without any bargaining over the ultimate sale price. Of course, if the difference between the interest rate on the seller's existing mortgage and the market rate is great, the amount by which the seller would be required to lower his price might well discourage a sale. That disincentive is reduced as the spread between the two rates decreases, a point that the *Wellenkamp* analysis failed to consider.[51] Indeed, the absence of an enforceable

47. *See In re* Foreclosure of Deed of Trust Executed by Bonder, 306 N.C. 451, 456, 293 S.E.2d 798, 801 (1982); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 813-15 (Tex. 1982)(citing to *Restatement*); *see also,* Comment, *supra* note 17, at 444. Even one of the more vehement critics of the clause conceded that "arguing that the due-on-sale clause is, under the restraints doctrine, per se invalid is a futile gesture." Volkmer, *supra* note 46, at 804 n.*.

48. *See, e.g.,* Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 950-51, 582 P.2d 970, 973-74, 148 Cal. Rptr. 379, 383 (1978); Redd v. Western Sav. & Loan Co., 646 P.2d 761, 764 (Utah 1982). Other courts, in refusing to enforce due-on-sale clauses, have foregone any inquiry into what kind of a restraint such clauses represent, simply taking the fact they they are restraints as given. *See, e.g.,* Sanders v. Hicks, 317 So. 2d 61, 63 (Miss. 1975); *see also Subcomm. Report*, *supra* note 12, at 901.

49. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

50. *Id.* at 951, 582 P.2d at 973-75, 148 Cal. Rptr. at 384. A number of critics have embraced this argument. *See, e.g.,* Bonanno, *supra* note 11, at 284; Volkmer, *supra* note 46, at 748-49; Note, *supra* note 24, at 285-86; Note, *supra* note 36, at 1112.

51. The court in *Wellenkamp* discussed weighing the "quantum of restraint" of the clause against its justifications in determining its reasonableness, but ultimately concluded that *all* due-on-sale clauses require a "significant showing" of justification to be enforced, not simply those

due-on-sale clause is like any other attribute of the property in that it affects the property's value. A seller of property subject to a mortgage with such a clause cannot offer prospective purchasers financing at below-market rates. In that sense, the property is less valuable than an identical property with advantageous financing. But the seller is hardly in a position to protest, because he bargained for the less attractive asset, the mortgage subject to acceleration on sale. Presumably he paid less to obtain a mortgage with such a clause, precisely because of the decreased resale value.

Second, the assertion that a due-on-sale clause qualifies as an indirect restraint is undermined by an examination of the effect that invalidation of such clauses has on other segments of the market for real property. A loan with an unenforceable due-on-sale clause, in effect a fixed-rate mortgage loan with an expected maturity of perhaps thirty years, is a riskier asset for a lender than a loan with an expected maturity of six or seven years.[52] The risk is particularly acute for a lender relying on short term liabilities for its funds. To compensate for this increased risk, a lender must charge a higher interest rate on a fixed-rate loan on which he cannot exercise his rights under a due-on-sale clause.[53] Consider then the prospective purchaser who wants to finance the purchase of property that is not subject to an existing mortgage. This purchaser must pay the prevailing rate on a mortgage loan, and that rate will be higher than a lender would charge for a loan subject to an enforceable due-on-sale clause. This buyer may be unable to afford that particular property at the higher rate of interest, whereas he may have been able to afford it at the lower rate, which would have been available if the lender were able to enforce a due-on-sale clause. As a result, invalidation of due-on-sale clauses operates as a restraint on alienation of property just as does the enforcement of the clause. Thus, it is incongruous to disregard an otherwise valid contract term in the name of preserving alienation of property, when the effect of such disregard is to restrain alienation of property somewhere else in the market.

Even if a court characterizes the due-on-sale clause as a restraint, it should not hold the clause unenforceable unless it is also unreasona-

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clauses sought to be enforced where the interest spread exceeds a certain threshold amount. 21 Cal. 3d at 948-49, 582 P.2d at 973, 148 Cal. Rptr. at 382-83.

52. The average time between sales of residential real property in California, for example, is seven years. Note, *supra* note 24, at 276.

53. *See infra* note 70 and accompanying text.

ble.[54] Most courts determine the reasonableness of a restraint through a balancing test, weighing the justifications for its use—in this case, promotion of freedom of contract and equitable and efficient allocation of risk—against its disadvantages.[55] According to Herbert Bernhard, the practice of voiding restraints is designed to address five "evils": (1) obstruction of commerce, (2) concentration of wealth, (3) survival of the least fit, (4) abuse of creditors, and (5) dead hand control.[56] Enforcement of a due-on-sale clause does not implicate the second, third, or fifth "evil" to any significant extent.[57] Furthermore, enforcement of a due-on-sale clause does not obstruct commerce in property to an extent greater than does invalidation of such a clause.[58] Only the concern for abuse of creditors remains. The fear is that individuals will represent that they are good credit risks because of their real property holdings when, in fact, restraints on the alienation of their property may substantially reduce its actual value.[59] In the case of due-on-sale clauses, however, invalidation works to the detriment of creditors. Therefore, neither the concern for obstruction of commerce nor the

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54. *See* Finch, *supra* note 24, at 309-11 (discussing the development of the reasonableness test); *see, e.g.,* Wellenkamp v. Bank of Am., 21 Cal.3d 943, 953, 582 P.2d 970, 976-77, 148 Cal. Rptr. 379, 385-86 (1978).

55. *See, e.g.,* Wellenkamp v. Bank of Am., 21 Cal.3d 943, 948-49, 582 P.2d 970, 973, 148 Cal. Rptr. 379, 382 (1978); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 166, 250 N.W.2d 804, 806 (1977); First Fed. Sav. & Loan Ass'n v. Loekwood, 385 So. 2d 156, 158-59 (Fla. Dist. Ct. App. 1980); Malouff v. Midland Sav. & Loan Ass'n, 181 Colo. 294, 298, 509 P.2d 1240, 1243 (1973).

The balancing test results in a determination of the desirability of permitting lenders to avoid portfolio risk through due-on-sale accelerations, because even those courts that have held that protection from portfolio risk is not a reasonable justification have held that protection from specific risk is reasonable enough to warrant the restraint. *See, e.g.,* First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156, 159 (Fla. Dist. Ct. App. 1980); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 166, 250 N.W.2d 804, 806 (1977).

It is interesting to note that the Illinois Supreme Court, finding that specific risk protection was a reasonable justification for the restraint, ultimately declared that the due-on-sale clause was per se reasonable. The court did so in the interest of avoiding uncertainty about a contract provision; such uncertainty, if found, could be resolved only through litigation. Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 126, 333 N.E.2d 1, 5 (1975).

56. Bernhard, *The Minority Doctrine Concerning Direct Restraints on Alienation*, 57 MICH. L. REV. 1173, 1180 (1957).

57. These evils arise principally in the case of a direct prohibition against alienation, which, it was feared, would concentrate wealth in the hands of those who owned property of which they could not dispose, would encourage the incompetent or unproductive management of property, and would in effect allow a remote and often deceased grantor to exercise control over the property. *See* Bernhard, *supra* note 56, at 1180. Because the enforcement of a due-on-sale clause does not absolutely prevent the alienation of the property involved, it does not give rise to these concerns.

58. *See supra* text accompanying notes 48-54.

59. Bernhard, *supra* note 56, at 1180. In fact, Bernhard contends that this fourth "evil" is the most compelling modern reason for invalidating restraints. *Id.* at 1181.

concern for abuse of creditors amounts to an important "evil" in determining whether due-on-sale clauses, if considered restraints on alienation, are reasonable.

Moreover, enforcement of the clauses is justified by the important benefits of freedom of contract and optimal risk allocation. The due-on-sale clause represents a useful contracting option in the mortgage market, and the freedom of individuals to make contracts enjoys a generally favored position in American jurisprudence.[60] The economic justification for freedom of contract is that the legal enforcement of contracts facilitates a system of voluntary exchange, which in turn permits the efficient allocation of resources.[61] When persons seek to enter into a contract that would have the effect of restricting another person's freedom to contract sometime in the future, however, allocative efficiency arguments for enforcing that contract dissipate; the positive effects of permitting the original contract will be offset by the negative future effects of the restriction. A sales contract containing an absolute prohibition against alienation of property poses an example. Any benefit resulting from the initial transfer is offset by inefficiencies that will result if the new owner values the property less than some subsequent potential purchaser, but cannot transfer it. On the other hand, if the restrictive contract is not enforced, the net effect to society cannot be negative; the seller may refuse to sell, effecting no change in resource allocation, or he may find a buyer willing to pay a higher price to compensate him for not being able to restrict future alienation, in which case the allocational benefits of free transfer are achieved.

Due-on-sale clauses should be denied enforcement and an exception to the freedom of contract rule should be tolerated, therefore, only if invalidation has a positive effect on allocative efficiency. In fact, disregard of a due-on-sale clause may result in a net societal loss. Although the net effect on total alienability resulting from invalidation of the clause is unclear and probably relatively small,[62] certain borrowers and lenders will be left less well off. Consider the borrower who does

60. *See* A. CORBIN, CONTRACTS § 1376 (1952).

61. *See* R. POSNER, ECONOMIC ANALYSIS OF LAW 11, 41-42 (1972). Posner cited the example of individual A who owns a piece of property with which he believes he can earn an income stream equal to a present value of $1000. Individual B believes that he can earn an income stream equal to a present value of $1500 from that property. If A sells the property to B for $1250, both will be better off and, assuming that their expectations are generally correct, the property will be put to more efficient use by B. *Id.* at 11.

62. *See supra* notes 48-53 and accompanying text. It might be argued that the effect of voiding even strict restraints on alienation produces only a negligible net effect on alienability of property, because a property owner might simply refuse to convey property if he cannot prevent the grantee thereafter from reconveying it. Yet there is an inevitable limit to how long a given piece of property can remain in one person's possession, and those taking after such a person's death

not place much value on the ability freely to assign his mortgage, because, for example, he intends to retain the securing property for an extended period of time. If a lender cannot offer this borrower a mortgage with an enforceable due-on-sale clause, the borrower is faced with the choice of either purchasing a feature he does not want at the price of a higher interest rate, or foregoing the transaction entirely, in which case both lenders and sellers lose a prospective customer. If a lender can offer a mortgage with a valid due-on-sale clause, all borrowers would be able to make an optimal choice, because those who value an assumption feature would still be free to bargain for it.[63] With the net effect on allocative efficiency unclear, the policy favoring freedom of contract suggests that enforcement is reasonable.

Enforcement of a due-on-sale clause is also reasonable because it provides the most equitable and efficient allocation of the risks that are unavoidably associated with the lending of money. The due-on-sale clause imposes the costs of that risk on the respective participants in the mortgage lending market to the extent that their market preferences entail a desire to assume such risk; whereas the prohibition of the use of the due-on-sale clause effectively requires certain borrowers to give up more risk than they would prefer at the given interest cost, while bestowing a windfall of reduced risk on a limited class of current borrowers.

This analysis is best demonstrated by segregating the short-term and long-term effects of invalidating the due-on-sale clause. In the short term, lenders will suffer an immediate loss on the value of their loan portfolios, and in the long term, borrowers will suffer a loss to the extent that they can no longer fit the available mortgage products to their risk preferences. A borrower already holding a mortgage benefits immediately from a nullification of the clause because such a ruling relieves him of any interest rate risk. The borrower is always able to avoid the downside risk, because he is free to refinance his mortgage if interest rates fall. Although prepayment penalties can undermine the borrower's advantage,[64] many states prohibit or severely limit such penalties.[65] Even in a jurisdiction where prepayment penalties are un-

may well be more inclined to part with the property. Hence, the net effect ultimately is to promote the alienability of property.

63. *See* HUD REPORT, *supra* note 26, at 17.

64. Note, *supra* note 36, at 1126.

65. For example, prepayment penalties are prohibited in Minnesota, MINN. STAT. ANN. § 47.20(5) (West Supp. 1984), and Maryland, MD. COM. LAW CODE ANN. § 12-1009(e) (West Supp. 1983), and they are restricted in Wisconsin, WIS. STAT. ANN. § 138.052(2)(a) (West Supp. 1983)(no penalty after five years, and otherwise limited to 60 days interest on that part of the prepayment in excess of 20% of the amount of the loan), and in California, CAL. BUS. & PROF.

restricted, however, the penalty would have to be quite high to offset the savings that the borrower would realize from a refinancing if interest rates drop significantly.[66] If a court renders the due-on-sale clause unenforceable, the borrower enjoys the advantage of interest rate increases because he can transfer his below-market-rate mortgage at a premium.[67] The borrower is thus in a no-lose situation when a court refuses to enforce due-on-sale clauses in outstanding mortgages. In contrast, enforcement of such clauses would allocate the risk associated with interest rate uncertainty roughly equally between the borrower and lender, as the parties anticipated at the time they struck their bargain.[68]

Faced with the situation of losing regardless of movement in interest rates, a lender will increase the interest rate it charges on its fixed-rate loans, or stop making fixed-rate loans altogether.[69] Assuming that the mortgage lending industry is competitive, the previous rate will have been sufficiently high to cover the lenders' costs, including return on capital, to account for expected changes in the rate of inflation, and to compensate for the level of specific and portfolio risk associated with the borrower and the debt instrument. The invalidation of the due-on-sale clause increases the portfolio risk associated with the fixed-rate mortgage,[70] and the lender will not be able to cover his total lending costs unless he increases the interest rate on these loans.

CODE § 10242.6 (West 1984)(no penalty after seven years, and otherwise subject to the same limits as in Wisconsin). This list is not exhaustive. Also, federally chartered savings and loan associations are prohibited from imposing prepayment penalties in conjunction with a due-on-sale clause acceleration. Contract Provisions for Real Estate Loans, 12 C.F.R. § 545.8-3(g)(2) (1983).

66. For example, assume borrower B takes out a $100,000, 20 year mortgage at 15%. Assume also that all interest calculations will be performed on a simple, annual basis. B's monthly payment under that mortgage is $1331.35. Assume that after five years, market rates drop to 10%, and B wants to refinance his loan. He will have paid $6582.14 of the principal, so he will have to borrow $93,417.86 to repay the original lender. His monthly payment on the new mortgage, assuming a 10% rate and a 15-year term, will be $1023.50, $307.85 less than on the 15% mortgage. That savings has a present value, at 10% annual interest, of $20,593.30.

67. *See* Gunther v. White, 489 S.W.2d 529, 532 (Tenn. 1973).

68. Of course, it is not necessarily inequitable for the lender to shoulder all of the interest risk, as long as it is being duly compensated for doing so. But, as is demonstrated, *infra* at text accompanying notes 69-71, the lender would have charged a higher interest rate had it known the due-on-sale clause would be unenforceable. Every borrower already indebted under a mortgage containing a due-on-sale clause receives a benefit at the expense of the lender as an immediate result of the court's decision to invalidate the clause, in the form of a valuable assumability option for which the borrower paid nothing.

69. *See* SENATE REPORT, *supra* note 4, at 3075; HUD REPORT, *supra* note 26, at 2; Note, *supra* note 24, at 305.

70. The lender will not enjoy the benefits of holding a long-term fixed-rate asset during periods of falling rates, because borrowers will refinance at the lower rates. *See supra* text accompanying notes 64-66. When allowed to exercise its rights under a due-on-sale clause, the lender can update its portfolio during periods of rising rates. In this way the lender's portfolio return fluctuates around the market rate, above the market rate until borrowers can refinance and below it

The lender's only real concern with invalidation of due-on-sale clauses is the short term loss associated with the mortgages it holds at the time of invalidation because it can avoid future losses, once it knows the clause is unenforceable, by increasing the rate on its fixed-rate loans.[71] The long term effect of invalidating due-on-sale clauses involves a different sort of risk misallocation, however. Once the mortgage with a due-on-sale clause is no longer an option, all borrowers must pay the interest premium for an assumable mortgage regardless of their desire for the assumption feature. Therefore, although the borrower otherwise would not opt to pay for the assumption feature, he nonetheless must pay because he represents increased portfolio risk to the lender. The borrower is less well off because the assumption feature is not worth the premium he must pay.[72]

The Garn Act has effectively remedied these microeconomic problems with respect to prospective loans. The converse problems may be aggravated, however, when the preemption becomes effective with regard to window period loans. To the extent that lenders had increased the interest rate on these loans, assuming that these mortgage contracts continued to contain due-on-sale clauses, to compensate for the increased portfolio risk, they will receive a benefit at the expense of those borrowers whose loans will no longer be freely assumable.[73] This concern alone should not encourage states to extend the window period moratorium, however, because that benefit will at most offset the loss that those lenders suffered upon invalidation of the clause in the first instance. In fact, if the states allow a moratorium of any length on the federal preemption the lenders will not recoup all of their earlier losses.[74]

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until properties are sold and the lender can raise the interest rate. Invalidation of the due-on-sale clause inhibits the lender's ability to update its portfolio, by extending the expected interval between interest increases on any particular loan from 6 or 7 years to 25 or 30 years; the borrower's ability to refinance is unimpaired, however. That represents the increased portfolio risk. *See* HUD REPORT, *supra* note 26, at 12.

71. HUD REPORT, *supra* note 26, at 17.

72. *See id.* at 23.

73. *See supra* note 68 and accompanying text.

74. Assuming that the size of the average lender's portfolio has not changed significantly from the beginning of the window period to the end, its loss on resale of mortgages made assumable by the state restriction would be offset by the premium it will receive on resale of loans made unassumable by the Garn Act preemption. The lender stands to gain on the same percentage of its post-window period portfolio that it was forced to sell at a loss from its pre-window period portfolio. Any loans held through the window period will be restored to their original value. If a lender sells a loan during a moratorium period, it will not receive a premium for the nonassumability featnre to offset an earlier loss, and its net position as a result of the restriction and the preemption will be negative.

In summary, the due-on-sale clause cannot properly be invalidated as unconscionable or as an unreasonable restraint on alienation. To the contrary, it should contribute economic benefit to borrower and lender alike, at least in the long run. Further, enforcement of the clause is consistent with the general policy of freedom of contract. Hence, the Garn Act represents a positive development in the law of mortgages and states should not dilute its beneficial effects by extending the moratorium on preemption for window period loans.

III. CURRENT STATUS OF THE DUE-ON-SALE CLAUSE AND TRENDS FOR THE FUTURE

Federally chartered savings and loan associations were exempt from state restrictions on due-on-sale clauses even before the Garn Act, by virtue of the FHLBB's regulation authorizing the use of the clause,[75] and the subsequent decision by the Supreme Court in *Fidelity Federal Savings & Loan Association v. de la Cuesta*[76] that the regulation preempted state law. Furthermore, the Garn Act, and the final regulations promulgated under the Act by the FHLBB, specifically exempt loans originated by federal savings and loan associations from the window period requirements.[77] As a result, due-on-sale clauses are enforceable in federal savings and loan mortgage instruments, regardless of the date the mortgage was executed.

Clauses in loans originated by national banks or federal credit unions during the window period are subject to invalidation in those states that imposed restrictions on due-on-sale clauses before the Garn Act, until October 15, 1985.[78] The moratorium may be altered, however, by appropriate rules promulgated before October 15, 1985 by the Office of the Comptroller of the Currency, in the case of national banks, or by the National Credit Union Administration Board, in the case of federal credit unions.[79] The Office of the Comptroller of the Currency has issued final regulations shortening the moratorium on preemption to April 15, 1984; after that time, the clauses are fully en-

75. *See supra* note 23 and accompanying text. For additional material on the effect of the Garn Act preemption on federally chartered lenders, see generally Geier, *Due-on-Sale Clauses Under the Garn-St. Germain Depository Institutions Act of 1982*, 17 U.S.F.L. REV. 1355 (1983).

76. 458 U.S. 141, 170 (1983); *see also supra* note 25.

77. 12 U.S.C. § 1701j-3(c)(2)(C) (1982); Preemption of State Due-on-Sale Laws, 48 Fed. Reg. 21,561, 21,562 (1983). Recall that the Act generally provides that loans originated or assumed during the window period continue to be subject to pre-Garn Act state law until October 15, 1985. *See supra* notes 5-6 and accompanying text.

78. 12 U.S.C. § 1701j-3(c)(1) (1982); Preemption of State Due-on-Sale Laws, 48 Fed. Reg. 21,561, 21,562 (1983).

79. 12 U.S.C. § 1701j-3(c)(1) (1982).

forceable on all loans subject to its regulations regardless of state law.[80] Also, although national banks may not enforce due-on-sale clauses on window period loans before that date, they are permitted to condition assumption on the assumer's agreeing to an increase in the loan rate to a blended rate, the average of the existing contract rate and the market rate at assumption.[81] Such restrictions apply only to residential real property, however; due-on-sale clauses are enforceable on loans secured by commercial property without restriction.[82] The final regulations of the National Credit Union Administration Board shortened the moratorium on preemption for window period loans to November 18, 1982.[83]

State banks and savings and loan associations must continue to abide by pre-Garn Act state law concerning due-on-sale clauses for all window period loans until October 15, 1985.[84] In most states, there will be no window period restriction because there was no state restriction on the use of due-on-sale clauses. Lenders in those states may make use of due-on-sale clauses subject to the narrow restrictions of the Garn Act.[85] Prior to the Garn Act, however, the enforcement of due-on-sale clauses had been restricted by courts in six states,[86] and by legislatures

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80. Real Estate Loans Made by National Banks, Validation and Enforcement of Due-on-Sale Clauses, 48 Fed. Reg. 51,283, 51,286 (1983).

81. *Id.*

82. *Id.*

83. Regulation of Due-on-Sale for Window Period Loans, 47 Fed. Reg. 54,424, 54,428 (1982) (to be codified at 12 C.F.R. § 701.21-6).

84. See *supra* notes 5-6 and accompanying text for a description of the window period exception.

85. *See supra* note 4.

86. Courts in the following states held prior to the Garn Act that a due-on-sale clause is unenforceable unless the lender's security interest is jeopardized by the transfer:

Arizona: Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 79, 81, 486 P.2d 152, 154 (1971), *cert. denied,* 108 Ariz. 192, 494 P.2d 1322 (1972). Although this case did not have statewide application, a later case with the same holding did. Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 478-79, 578 P.2d 152, 157-58 (1978). Nonetheless, in a post-*Harn* decision, the Arizona Supreme Court held that *Harn*, decided on July 8, 1971, marked the beginning of the window period of unenforceability in Arizona. Scappaticci v. Southwest Sav. & Loan Ass'n, 135 Ariz. 456, 461, 662 P.2d 131, 136 (1983).

Arkansas: Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 853, 481 S.W.2d 725, 728 (1972)(window period began June 19, 1972).

California: Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 953, 582 P.2d 970, 975, 148 Cal. Rptr. 379, 385-86 (1978)(window period began Aug. 25, 1978).

Michigan: Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 166, 250 N.W.2d 804, 806 (1977)(window period began Jan. 5, 1977).

Mississippi: Sanders v. Hicks, 317 So. 2d 61, 64 (Miss. 1975)(window period began July 21, 1975).

Washington: Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 441-42, 553 P.2d 1090, 1092 (1976)(window period began Aug. 19, 1976).

in six other states,[87] and those restrictions will apply for the duration of the moratorium to all window period loans issued by state chartered lenders.

The future of the due-on-sale clause under state law is less predictable than under federal law. So far, only one state, Arizona, has exercised its power under the Garn Act to extend the duration of the moratorium on the preemption of pre-Garn Act state law beyond the three years provided in the Act.[88] New Mexico, in contrast, has acted to permit state lenders to increase the rate on window period loans by as much as two percentage points, plus a one point assumption fee, in order to offset any advantage which the Garn Act preemption might have created for federal lenders.[89] Recently, several states acted to override the federal preemption of state usury restrictions pursuant to a power similar to that provided by the Garn Act,[90] giving perhaps some indication of the states' willingness to extend the moratorium. The states' desire to retain control over interest restrictions may prove to be more intense, however, than the desire to restrict the enforcement of due-on-sale clauses. The Iowa and Utah state legislatures had already

87. Enforcement of due-on-sale clauses has been restricted by statute to those instances where the lender's security interest is jeopardized by the transfer in the following states:

Iowa: IOWA CODE § 535.8(2)(c) (Supp. 1982)(effective July 1, 1979).

New Mexico: N.M. STAT. ANN. §§ 48-7-11 to -13 (Supp. 1983)(effective Mar. 15, 1979), *repealed by* N.M. STAT. ANN. §§ 48-7-15 to -19 (Cum. Supp. 1983).

Utah: UTAH CODE ANN. §§ 57-15-1 to -3 (Supp. 1983)(effective May 12, 1981). This statute overrules Utah's common law approval of due-on-sale clauses, which was announced in a later Utah Supreme Court case, Redd v. Western Sav. & Loan Co., 646 P.2d 761, 767 (Utah 1982)(although decided after the effective date of the statute, case arose before that date, and therefore turned on application of prior law).

Three other states have statutes limiting the amount by which an interest rate can be raised on any existing loan. COLO. REV. STAT. § 38-60-165 (1982)(effective July 1, 1975)(permits an increase of only one percent in the interest rate upon assumption); GA. CODE ANN. 44-14-5(b) (1982)(effective July 1, 1979)(permits an increase of only one percent in the interest rate upon assumption and only if the original borrower is released from liability); MINN. STAT. ANN. § 47.20 (Supp. 1984)(effective June 1, 1979)(prohibits any interest rate increase on any loans made before May 9, 1981). The Georgia and Minnesota statutes do not specifically preclude the enforcement of due-on-sale clauses, however, so a lender in one of these states might achieve its purpose of updating the rates on its portfolio by actually accelerating the loan pursuant to the clause, rather than conditioning assumption on a rate increase. Nonetheless, the *Senate Report* includes these states in its list of window period states. SENATE REPORT, *supra* note 4, at 3076 n.2. It is not clear whether these states can invalidate the clauses outright with respect to window period loans, but Congress did indicate a desire to limit the state's ability to increase the scope of their existing restrictions. *Id.* at 3077; *see supra* note 4.

88. The extension is to October 15, 1987. ARIZ. REV. STAT. ANN. § 33-1571 (Supp. 1983-84).

89. N.M. STAT. ANN. §§ 48-7-15 to -19 (Cum. Supp. 1983).

90. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 501, 94 Stat. 132, 161-63 (codified as a note to 12 U.S.C. § 1735f-7 (1982)). The only window period states that overrode that federal preemption are Colorado, COLO. REV. STAT. § 5-13-101 (Supp. 1983), and Georgia, GA. CODE ANN. § 7-4-20(1) (Supp. 1983).

demonstrated their policy choice against the enforcement of due-on-sale clauses prior to passage of the Garn Act.[91] The Utah legislature explicitly codified its findings; it considered the clause an unreasonable restraint on alienation "to the detriment of the public welfare."[92] These states, therefore, seem to be the most likely to extend the moratorium on preemption. The ultimate status of the due-on-sale clause will remain uncertain until the deadline for extending the moratorium has passed.

IV. Conclusion

The Garn Act, insofar as it removes restrictions on the enforcement of due-on-sale clauses, benefits both lenders and borrowers. Regardless of the historical purposes of the due-on-sale clause, use of the clause became prevalent because it is a useful mechanism for allocating risk between the participants in the mortgage industry. In fact, as Congress recognized,[93] enforcement of the clause is necessary to ensure the continued availability of the fixed-rate mortgage, a popular instrument from the borrower's perspective.

The states should refrain from exercising their power to extend the moratorium on the Garn Act preemption. By extending the prohibition of the enforcement of due-on-sale clauses for window period loans, a state might gain a little in terms of protection of borrowers' expectations, but it could lose significantly in terms of the decreased flow of funds to its mortgage market.

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91. *See supra* note 87.
92. UTAH CODE ANN. § 57-15-1 (Supp. 1983).
93. SENATE REPORT, *supra* note 4, at 3075.