The Garn Act: The Death Knell for Due-on-Sale Controversies In Arizona?

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Due-on-sale clauses[1] are common features in mortgages and deeds of trust.[2] These provisions authorize a lender to declare the entire loan balance immediately due and payable if a borrower sells or transfers the encumbered property without the lender's consent.[3] Lenders use the due-on-sale clause to protect their security interest in the encumbered property. These clauses prevent the borrower from transferring the property to a less reliable third party without the lender's consent.[4]

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1. For the purpose of this Note, the term "due-on-sale clause" means a "contract provision which authorizes a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent. . . ." The Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 341(a)(1), 96 Stat. 1469, 1505 (1982) (to be codified at 12 U.S.C. § 1701j-3) [hereinafter cited as the Garn Act].

2. A 1970 Federal Home Loan Mortgage Corporation study of lenders found that over two-thirds of the conventional mortgages issued contained due-on-sale clauses. OFFICE OF POLICY DEV. AND RESEARCH, U.S. DEP'T OF HOUS. AND URBAN DEV., AN ECONOMIC ANALYSIS OF DUE-ON-SALE CLAUSES 19 (1981).

3. Uniform Covenant 17 of the Uniform Mortgage Instrument released by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) provides a standard due-on-sale clause. Uniform Covenant 17 provides, in pertinent part:

> Transfer of the Property; Assumption: If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this [mortgage], (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this [mortgage] to be immediately due and payable. 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 of transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this [mortgage] shall be at such reate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this [mortgage] and the Note.

Squires, *A Comprehensible Due-on-Sale Clause (with form)*, 27 PRAC. LAW., Apr. 15, 1981, at 67, 71-72. Paragraph 17, cited above, appeared in two deeds of trust at issue in Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141, 145, n.2 (1982).

4. Crane, *Wellenkamp v. Bank of America: A Victory for the Consumer?*, 31 HASTINGS L.J. 275, 275-76 (1979). *See, e.g.*, Bonnett, *Enforceability of a Real Estate Financier's Contractual Right to Increase the Interest Rate When Non-Residential Property Is Transferred by the Borrower*, 17

During recent periods of rising interest rates, the enforceability of due-on-sale clauses has become more important.[5] Mortgage lenders, particularly savings and loan institutions, traditionally have relied upon passbook accounts as a source of funds.[6] At the same time, these institutional lenders have invested mainly in long-term real estate mortgages at fixed interest rates.[7] Thus, during recent periods of rising interest rates, lenders have found themselves paying higher rates of interest to their depositors than they could collect on the relatively low interest rate mortgages.[8] Consequently, institutional lenders have begun enforcing due-on-sale clauses as a means of adjusting their loan portfolios up to current interest levels.[9] By accelerating the debt on a mortgage, lenders have found that they can retire the old low interest mortgage, and then loan the money at current market rates.[10] Some lenders have opted to forego acceleration if the borrower agrees to pay a higher rate of interest.[11] The interests of lenders in maximizing the return on mortgage loans, however, have conflicted with the interests of borrowers who want to transfer or sell their property with the low interest rate intact.[12]

This conflict between lenders and borrowers concerning the enforceability of due-on-sale clauses engendered lawsuits.[13] The tension between mortgage lenders and borrowers continued to rise until Congress intervened. The 97th Congress enacted the Garn-St. Germain Depository Institutions Act of 1982[14] (The Garn Act), which became effective on October 15, 1982. The Garn Act significantly affected the law regarding the enforceability of due-on-sale clauses.[15]

This Note considers the ramifications of the Garn Act on Arizona law. To lay the groundwork for an appreciation of the complexities of the Garn Act, this Note first reviews the development of Arizona law regarding due-on-sale clauses prior to the Garn Act. Next, it reviews the federal preemption of due-on-sale clauses, which culminated in the enactment of the Garn Act. The Note then discusses the provisions, legislative history and implications of the Garn Act and finally, examines the effects the Garn Act has had on Arizona law.

ARIZ. B.J. 8, 8-9 (Aug. 1981); Bartke & Tagaropulos, *Michigan's Looking Glass World of Due-on-Sale Clauses*, 24 WAYNE L. REV. 971, 979 (1978).

5. Bonnett, *supra* note 4, at 8.

6. Bartke & Tagaropulos, *supra* note 4, at 978.

7. *Id.*

8. *Id.*

9. *See supra* note 4.

10. *Id.*

11. *See supra* note 3. The Uniform Mortgage Instrument Covenant 17 cited therein provides that a lender may waive the option to accelerate if the interest payable on the mortgage is raised to a rate acceptable to the lender.

12. Clark, *Epilogue to the Due-on-Sale Storm*, 54 OKLA. B.J. 875 (1983).

13. *See* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978); Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *appeal denied*, 108 Ariz. 192, 494 P.2d 1322 (1972); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1979); Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

14. The Garn Act, Pub. L. No. 97-320, § 341, 96 Stat. 1469, 1505-07 (1982).

15. *See* Sanders, *Congress Legislates on "Due-on-Sale" Mortgage Clauses*, 57 FLA. B.J. 53 (1983).

I. HISTORY OF THE DUE-ON-SALE CLAUSE IN ARIZONA

Prior to 1971, no Arizona court directly ruled upon the validity of due-on-sale clauses.[16] In 1971, however, the Arizona Court of Appeals drastically limited the enforceability of such clauses.[17] In *Baltimore Life Insurance Co. v. Harn*,[18] the court determined whether a due-on-sale clause in a mortgage could be enforced upon the sale of the mortgaged property.[19]

The Harns borrowed $180,000 from Baltimore Life Insurance Company's predecessor in interest.[20] A promissory note and a mortgage on a piece of commercial real estate secured the loan.[21] The note and the mortgage both contained a due-on-sale clause.[22] The Harns subsequently entered into an agreement to sell the commercial real estate. Upon learning of the sale, Baltimore Life sued to foreclose and to recover the entire balance of the loan plus a prepayment penalty and attorneys' fees pursuant to the provisions of the due-on-sale clause.[23]

Though the *Harn* court recognized the general validity of due-on-sale clauses,[24] it held that an arbitrary exercise of a due-on-sale clause unreasonably restrained alienation of the debtor's property.[25] The court stated that the exercise of a due-on-sale provision "must be based on grounds that are reasonable on their face."[26] The court's opinion suggests that it would consider the grounds reasonable if they were bargained-for elements of the mortgage contract.[27] Furthermore, the court held that the lender must prove the transfer would jeopardize its security. Otherwise, the due-on-sale provision would be unenforceable.[28]

Also, in 1971, the Arizona Court of Appeals reaffirmed *Harn* in *Lane*

16. *See* Baker v. Leight, 91 Ariz. 112, 116, 370 P.2d 268, 271 (1962), in which the Arizona Supreme Court ruled that while the due-on-sale clause involved apparently gave the mortgagee the right to accelerate the debt, the court did not find it necessary to determine whether the right was enforceable in all events.

17. Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *appeal denied*, 108 Ariz. 192, 494 P.2d 1322 (1972).

18. *Id.*

19. *Id.* at 80, 486 P.2d at 192.

20. The *Harn* facts are characteristic of the basic fact pattern of other Arizona cases discussed within this Note. In the basic fact situation, a borrower/mortgagor transfers mortgaged property to a third party. Upon transfer the lender/mortgagee, who wants to raise the interest rate on the instrument, invokes the due-on-sale clause contained in the deed of trust or mortgage. This fact pattern applies to all the cases discussed unless otherwise noted.

21. *Id.* at 79, 486 P.2d at 191.

22. *Id.* The due-on-sale clause of the note read:

> All sums due and payable under this Note and the mortgage or mortgages securing the same, . . . shall become due and payable without notice forthwith upon the conveyance of title to all or any portion of the mortgaged premises or property, or the vesting thereof in any other manner in, one other than to mortgagor named therein.

23. *Id.* at 80, 486 P.2d at 192.

24. *Id.*

25. *Id.* at 81, 486 P.2d at 193.

26. *Id.*

27. *See* Bonnett, *supra* note 4, at 10.

28. *Harn* at 81, 486 P.2d at 193. The court's holding did not distinguish between federal and state-chartered lenders, not did it distinguish between commercial and residential loans. The court's reasoning, however, would apply to all types of loans and lenders.

v. Bisceglia.[29] A mortgagee refused a proposed mortgage assumption unless the interest rate was increased three-quarters of one percent.[30] Citing *Harn* the court held that the mortgagee did not have the right to conditionally approve the assumption at a higher interest rate absent a provision in the due-on-sale clause permitting this.[31]

Later in 1971, the Arizona legislature enacted a comprehensive set of statutes which significantly affected the enforcement of certain due-on-sale clauses.[32] The statutes provided for the creation and administration of deeds of trust.[33] The legislature enacted the statutes to avoid costly and time-consuming judicial mortgage foreclosure procedures.[34]

Section 33-806.01 of the Arizona Revised Statutes specifically affects the enforcement of due-on-sale provisions in deeds of trust.[35] This section applies only to residential trust property of two and one-half acres or less which is used for four or fewer single-family dwelling units.[36] It provides that when a trustor transfers his interest in the trust property, the trustee may not increase the interest rate on the obligation unless the trustor is

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29. 15 Ariz. App. 269, 488 P.2d 474 (1971).

30. *Id.* at 269, 488 P.2d at 474. *See* Bonnett, *supra* note 4, at 10.

31. 15 Ariz. App. at 271, 486 P.2d at 476. The court discussed the mortgagee's rights in the following terms:

> We find that the mortgage company only had the apparent right, *Baltimore Life Insurance Co. v. Harn*, 15 Ariz. App. 78, 486 P.2d 190 (1971), to approve or reject the assumption and had no right to conditionally approve the assumption at a greater rate of interest.
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> This conclusion is reached by examining the wording of the mortgage. Clause 5 thereof specifically entitled the lender to alter the interest rate of the note when further advances are made to the borrower. Such language is not present in clause 13. Thus, clause 13 merely permits the lender to approve or disapprove the transfer and contains no authority entitling the mortgagee to vary the interest rate.

Id. at 271, 486 P.2d at 476.

32. ARIZ. REV. STAT. ANN. §§ 33-801 to -821 (1974).

33. Under a deed of trust, the borrower/trustor conveys title of property to a trustee to hold in trust to secure payment of the debt to the lender/beneficiary. If the borrower defaults on the loan, the trustee has the authority to sell the property without going through formal judicial proceedings. J. DUKEMINIER & J. KRIER, PROPERTY 621 (1981). *See also* Fry, *The Deed of Trust: A New Device in Arizona Real Estate Financing*, 7 ARIZ. B.J. No. 3 at 5 (1972) (providing a discussion of the separate sections of Arizona's deeds of trust statutes).

34. *See* ARIZ. REV. STAT. ANN. § 33-807 (1974), which outlines the sale of trust property, powers of the trustee and foreclosure of a trust deed. *See also* Fry, *supra* note 33; Comment, *Due-on-Sale Clauses in Deeds of Trust: State Regulation or Preemption?*, ARIZ. ST. L.J. 367, 374 (1979).

35. ARIZ. REV. STAT. ANN. § 33-806.01 (1974). The provisions of this section are as follows:

> A. Nothing in this article shall be construed to prevent or limit the right of a trustor to transfer his interest in the trust property, or authorize a beneficiary or trustee to arbitrarily withhold his consent to a transfer of the trustor of the trustor of his interest in the trust property.
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> B. When a trustor transfers his interest in the trust property, no beneficiary or trustee shall charge a fee on the transfer of more than one hundred dollars or one percent of the balance due on the obligation secured by the trust deed, whichever is greater.
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> C. When a trustor transfers his interest in the trust property, no beneficiary or trustee shall increase the interest rate on the obligation secured by such trust deed unless the transferring trustor is released from all liability thereon and in no event shall the amount of such increase exceed one-half of one percent per annum more than the interest rate paid by the transferring trustor.
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> D. This section shall be applicable only to trust property of two and one-half acres or less which is not used for commercial purposes and which is limited to and utilized for dwelling units, not to exceed four single-family units.

36. ARIZ. REV. STAT. ANN. § 33-806.01(D) (1974). See *supra* note 35 for the text of the statute.

released from all liability.[37] Moreover, the interest rate increase may not exceed "one-half of one percent per annum more than the interest rate paid by the transferring trustor."[38] Furthermore, this section limits the fee a trustee can charge the trustor on the transfer to "one hundred dollars or one per cent of the balance due on the obligation secured by the trust deed, whichever is greater."[39]

The Arizona courts first considered the validity of due-on-sale provisions in deeds of trust in *Patton v. First Federal Savings and Loan Association of Phoenix*.[40] In *Patton*, the Arizona Supreme Court considered whether a due-on-sale clause in a deed of trust was an unlawful restraint on alienation. The facts in *Patton* were similar to those in *Harn*,[41] in that the trustor sought to transfer secured property to a third party.[42] Upon learning of the transaction, the trustee threatened to enforce the due-on-sale clause[43] contained in the deed of trust unless the trustor agreed to an interest rate increase.[44] *Patton* differs from *Harn*, however, in at least two respects. First, the due-on-sale clause in *Patton* was in a deed of trust rather than a mortgage. Second, under the transfer agreement, the trustor was to remain obligated to the beneficiary for the loan.[45]

Since *Patton* was the first Arizona case involving a due-on-sale provision under a deed of trust, the court noted that mortgages and deeds of

37. ARIZ. REV. STAT. ANN. § 32-806.01(D) (1974). See *supra* note 35 for the text of the statute.

38. *Id.*

39. ARIZ. REV. STAT. ANN. § 33-806.01(B)(1974). See *supra* note 35 for the text of the statute.

40. 118 Ariz. 473, 578 P.2d 152 (1978). See also Comment, *Enforcement of Due-on-Sale Clauses in Secured Real Estate Transactions*, 22 ARIZ. L. REV. 311 (1980).

41. *See supra* notes 20-23 and accompanying text.

42. *Patton*, 118 Ariz. at 475, 578 P.2d at 154.

43. *Id.* at 475, 578 P.2d at 154. The due-on-sale provision in First Federal's deed of trust provided that in the event of a voluntary or involuntary conveyance or further encumbrance of the property:

> without the written consent of Beneficiary, all indebtedness secured by this Deed of Trust, irrespective of the maturity date of said indebtedness, and without regard to the adequacy or inadequacy of the security, or solvency or insolvency of Trustor, shall, at the option of the Beneficiary, become immediately due and payable without demand or notice. Beneficiary shall have the contractual right to withhold its consent to a transfer under the provisions of this paragraph in any instance where the security upon reevaluation, the financial responsibility of the purchaser, or the physical condition of the premises does not warrant that consent, or the existing interest rate of this loan is less than the current interest rate being charged on loans to purchasers of properties similar in value to the secured property.

Id. at 477, 578 P.2d at 156.

44. *Id.* at 475, 578 P.2d at 154. The beneficiary, First Federal, tried to force the trustor Mrs. Patton, to pay a transfer fee and a one-half of one percent interest increase on the loan in exchange for not enforcing the due-on-sale clause. Although Mrs. Patton refused to pay the transfer fee or the increased interest rate, she continued to make her payments without default. *Id.* First Federal refused to accept Mrs. Patton's payments and arranged for a trustee's sale of the property. *Id.* at 475-76, 578 P.2d at 154-55.

45. Under the terms of the agreement of sale, the loan from First Federal remained Mrs. Patton's obligation, and she would pay off the loan before Mr. Toy, the purchaser, made his last payment on the installment purchase contract. Mrs. Patton instructed the title company collecting Mr. Toy's installment payments to make the payments on her First Federal loan. *Id.* at 478, 578 P.2d at 157. Upon Mr. Toy's final payment under the purchase contract, title to the property would pass to him. *Id.* at 475, 578 P.2d at 154.

trust are analogous for purposes of due-on-sale provisions.[46] In a holding similar to the *Harn* court's, the supreme court held that, absent the beneficiary's showing that the transfer of the property jeopardized its security, enforcement of its due-on-sale provision was an unlawful restraint on alienation prohibited by the deed of trust statutes.[47]

The *Patton* court considered two factors in assessing whether the beneficiary's security was jeopardized. First, it considered whether the third-party transferee was credit-worthy. Noting that the transferee had a strong interest in maintaining the property, the court stated that the addition of the transferee to the transaction probably improved the beneficiary's security.[48]

Second, and more importantly, the court examined the trustor's financial status and responsibility. The court pointed out that the trustor did not ask the trustee to be relieved from liability on the loan; the court then ruled that the beneficiary's security interest remained unchanged.[49] Furthermore, since Arizona's deed of trust statutes[50] prohibit a lender from increasing the interest rate on an obligation absent the transferring trustor's release from liability, the court held that the beneficiary could not increase the interest rate in this situation.[51]

The aforementioned cases have dealt with the validity of due-on-sale clauses and the restrictions placed upon the enforcement of such clauses by Arizona courts.[52] The issue of federal preemption of state law concerning due-on-sale provisions has not been discussed. The next section will consider the doctrine of federal preemption of due-on-sale provisions prior to the enactment of the Garn Act.

II. FEDERAL PREEMPTION PRIOR TO THE GARN ACT

Federal law invalidates state law whenever Congress has expressly or impliedly intended that federal law shall govern or whenever federal and state laws irreconcilably conflict.[53] Federal preemption of state law regarding the enforcement of due-on-sale clauses began with regulations affecting only federal savings and loan institutions.[54] Federal preemption has expanded to exclude the operation of state law regarding the enforcement of acceleration clauses by any lending institution, whether state or

46. *Id.* at 477, 578 P.2d at 156.

47. *Id.* at 479, 578 P.2d at 158. In its decision, the court relied on the reasoning in Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 2d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974); *See also* ARIZ. REV. STAT. ANN. § 33-806.01(A)(1974). *See supra* note 35 for the text of the statute.

48. *Patton*, 118 Ariz. at 478, 578 P.2d at 157.

49. *Id.*

50. ARIZ. REV. STAT. ANN. § 33-806.01(C) (1974). *See supra* note 35 for the text of the statute.

51. *Patton*, 118 Ariz. at 478, 578 P.2d at 157.

52. *See* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978); Lane v. Bisceglia, 15 Ariz. App. 269, 488 P.2d 474 (1971); Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *appeal denied*, 108 Ariz. 192, 494 P.2d 1322 (1972).

53. Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141, 152-53 (1982). *See generally* Note, *It's Due Time: Federal Preemption of Due-on-Sale Controversies*, 24 ARIZ. L. REV. 371, 373 (1982); Comment, *Due-on-Sale Clauses in Deeds of Trust: State Regulation or Preemption?*, 1979 ARIZ. ST. L.J. 367, 377 (1979).

54. *See* 12 C.F.R. § 545.8-3(f)(1983). *See infra* note 61, for the text of the regulation.

federally chartered.[55]

A. *Regulation of Federal Savings and Loan Due-on-Sale Clauses*

All federal savings and loan associations (FSLs) are organized, chartered and operated under the Home Owners Loan Act (HOLA) of 1933.[56] The HOLA authorizes the Federal Home Loan Bank Board (FHLBB), an independent federal regulatory agency, "under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as 'Federal Savings and Loan Associations.' "[57] Pursuant to this authorization, the FHLBB has promulgated extensive regulations.[58]

In 1976 the FHLBB issued the first regulation making specific reference to due-on-sale clauses.[59] In response to the growing controversy over the authority of FSLs to enforce due-on-sale provisions,[60] the FHLBB regulation specifically allowed FSLs to include such provisions in their loan agreements.[61] According to this regulation, only the terms of the loan contract limited the exercise of due-on-sale clauses,[62] with certain specific limitations.[63]

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55. The Garn Act, Pub. L. No. 97-320, § 341, 96 Stat. 1469, 1505-07 (1982).

56. 12 U.S.C. §§ 1461 to 1470 (1982).

57. 12 U.S.C. § 1464(a) (1982).

58. *See* People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

59. 12 C.F.R. § 545.803(1983) (originally codified at 12 C.F.R. § 545.6-11(f) (1976)). *See* 44 Fed. Reg. 39108, 39149 (1979). *See infra* note 61 for the text of this regulation.

60. *See* 12 C.F.R. § 545.8-3(f) (1983). The FHLBB enacted this regulation based upon its concern that restrictions upon a savings and loan association's ability to accelerate a loan upon the transfer of its security interest would lead to several adverse effects: (1) that "the financial security and stability of federal associations would be endangered if . . . the security property is transferred to a person whose ability to repay the loan and properly maintain the property is inadequate"; (2) that "elimination of the due-on-sale clause will cause a substantial reduction of the cash flow and net income of Federal associations, and that to offset such losses it is likely that the associations will be forced to charge higher interest rates and loan charges on home loans generally"; and (3) that "elimination of the due-on-sale clause will restrict and impair the ability of Federal associations to sell their home loans in the secondary mortgage market, by making such loans unsalable or causing them to be sold at reduced prices, thereby reducing the flow of new funds for residential loans, which otherwise would be available." 41 Fed. Reg. 6283, 6285 (1976). The FHLBB concluded that "elimination of the due-on-sale clause will benefit only a limited number of home sellers, but generally will cause economic hardship to the majority of home buyers and potential home buyers." *Id.*

61. 12 C.F.R. § 545.8-3(f) (1983) states:

> (f) Due-on-Sale Clauses. An association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. . . . [The] exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association shall be fixed and governed by that contract.

62. 12 C.F.R. § 545.8-3(f) (1983). *See supra* note 61 for the text of the regulation.

63. 12 C.F.R. § 545.8-3(g) (1983) states the limitations as follows:

> (g) Limitations on the exercise of due-on-sale clauses. With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association:
>
> (1) shall not exercise a due-on-sale clause because of (i) creation of a lien or other encumbrance subordinate to the association's security instrument, (ii) creation of a purchase money security interest for household appliances; (iii) transfer by devise, descent, or operation of law on the death of a joint tenant; or (iv) granting of a leasehold

The 1976 FHLBB regulation did not mandate preemption of state law.[64] In 1981, however, the FHLBB amended the 1976 regulation to provide that FHLBB regulations exclusively were to govern due-on-sale practices for FSLs.[65] The amendment expressly preempted state law limitations on the exercise or inclusion of due-on-sale provisions, including state prohibitions based upon restraints on alienation.[66]

B. *The* de la Cuesta *Decision*

While the FHLBB clearly intended to preempt the application of state law regarding the inclusion and exercise of due-on-sale provisions by FSLs, the courts ultimately had to determine whether the FHLBB regulation actually preempted state law in this area. Both state and federal courts reached conflicting conclusions.[67] The United States Supreme Court finally resolved the issue in *Fidelity Federal Savings and Loan Association v. de la Cuesta.*[68]

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interest of three years or less not containing an option to purchase; (2) shall not impose a prepayment charge or equivalent fee for acceleration of the loan by exercise of a due-on-sale clause; and (3) waives its option to exercise a due-on-sale clause as to a specific transfer if, before the transfer, the association and the person to whom the property is to be sold or transferred (the existing borrower's successor in interest) agree in writing that the person's credit is satisfactory to the association and that interest on sums secured by the association's security interest will be payable at a rate the association shall request. Upon such agreement and resultant waiver the association shall release the existing borrower from all obligations under the loan instruments, and the association is deemed to have made a new loan to the existing borrower's successor in interest.

64. 12 C.F.R. § 545.8-3(f) (1983). *See supra* note 61 for the text of the regulation. The regulation's preamble, however, stated that federal law exclusively should govern the due-on-sale practices of FSLs.

65. Preamble, 12 C.F.R. § 545.6-11 (1983). *See also* 41 Fed. Reg. 18,286-18,287 (1976).

66. 12 C.F.R. § 556.9(f)(1983) was amended by adding the following new paragraph (f): (f)-(2) Paragraph (f) of § 545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses, subject only to the express limitations contained in § 545.8-3(g). Due-on-sale practices of Federal associations shall be governed exclusively by the Board's regulations in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers.

This section has since been removed in 48 Fed. Reg. 21,554, 21,560 (1983) (to be codified at 12 C.F.R. § 556).

67. A number of courts concluded that the FHLBB regulation preempted state law. *See, e.g.*, First Fed. Sav. and Loan Ass'n v. Dev. & Management Enters., Civ. 79-880 PHX-EHC (D. Ariz. 1981) (holding that the FHLBB preempted regulatory control over FSLs, the district court allowed enforcement of a FSL due-on-sale clause without a showing of jeopardized security); Price v. Florida Fed. Sav. & Loan Ass'n., 524 F. Supp. 175, 178 (M.D. Fla. 1981) (§ 545.8-3(f) preempted any state regulation); First Fed. Sav. & Loan Ass'n v. Peterson, 516 F.Supp. 732, 740 (N.D. Fla. 1981) (§ 545.8-3(f) preempted state due-on-sale restrictions); Dantus v. First Fed. Sav. & Loan Ass'n, 502 F.Supp. 658, 661 (D. Colo. 1980) (analogous ruling with respect to Colorado law); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F.Supp. 1139, 1141 (C.D. Ill. 1979) (§ 545.8-3(f) forecloses any state regulation of due-on-sale practices of federal savings and loans), *appeal dismissed*, 636 F.2d 1221 (7th Cir. 1980). On the other hand, several courts have found that state contract and property law principles determine the enforceability of due-on-sale clauses. *See, e.g.*, Smart v. First Fed. Sav. & Loan Ass'n, 500 F.Supp. 1147 (E.D. Mich. 1980); Panko v. Pan Am. Fed. Sav. & Loan Ass'n, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981) (dual compliance not impossible between state and federal law governing due-on-sale clauses).

68. 458 U.S. 141 (1982). The facts in this case conform to the basic pattern set forth at note 20 and accompanying text.

The Supreme Court held that the FHLBB's due-on-sale regulation[69] preempted conflicting state restrictions concerning the due-on-sale practices of FSLs.[70] Therefore, the Court barred the application of California's restriction limiting the exercise of such clauses to situations which jeopardized the lender's security interest[71] because the California restriction directly conflicted[72] with the FHLBB regulation.[73] After *de la Cuesta*, the question of preemption concerning the enforcement of due-on-sale provisions by all other lenders remained until Congress acted to answer it.

III. THE GARN ACT

Congress concluded that *de la Cuesta* significantly disadvantaged state chartered savings and loans and other lenders and that it created uncertainty among homebuyers and sellers regarding the enforceability of due-on-sale provisions.[74] Therefore, Congress enacted the Garn Act.[75] Pursuant to the authority vested in it by the Garn Act,[76] the FHLBB, in consultation with the Comptroller of the Currency[77] and the National Credit Union Administration Board, issued a final regulation governing the implementation of the Garn Act.[78] The following discussion sets forth relevant sections of the Garn Act, the legislative history of the Act and the subsequent agency regulations implementing the Act.

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69. *See supra* notes 61-66 and accompanying text.

70. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. at 139. The Court found that the FHLBB had acted reasonably within its statutorily delegated authority in promulgating the 1976 regulation. *Id.* at 159-70. Furthermore, the Court held that the importance of real property law as an area of special state concern did not render the preemption doctrine inapplicable. *Id.* at 153.

71. In Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978), the California Supreme Court held that a FSL's exercise of a due-on-sale clause violated California's prohibition against unreasonable restraints on alienation, CAL. CIV. CODE ANN. § 711 (West 1954), "unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." 21 Cal.3d at 953, 582 P.2d at 977, 148 Cal. Rptr. at 386. The Arizona court relied on *Wellenkamp* in *Patton v. First Fed. Sav. & Loan Ass'n*, *see supra* notes 40-51 and accompanying text.

72. In *de la Cuesta* the Court noted, at footnote 14, that since an actual conflict between federal and state law existed, it need not decide whether the HOLA or the FHLBB's regulations occupied the field of due-on-sale law or the entire field of FSL regulation. 458 U.S. at 159.

73. *Id.* at 154-159.

74. S. REP. No. 536, 97th Cong., 2d Sess. 1, 20-21, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3074-75. The House bill was passed in lieu of the Senate bill after amending its language to contain much of the text of the Senate bill. The House accepted the Senate provision on federal preemption with two additional amendments. S. CONF. R. No. 641, 97th Cong. 2d Sess. 85, 89, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3128, 3132.

75. The Garn Act, Pub. L. No. 97-320, § 341, 96 Stat. 1469, 1505-07 (1982).

76. The Garn Act, Pub. L. No. 97-320, § 341(e)(1) provides:

> The Federal Home Loan Bank Board, in consultation with the Comptroller of the Currency and the National Credit Union Administration Board, is authorized to issue rules and regulations and to publish interpretations governing the implementation of this section.

77. The Comptroller of the Currency has issued a regulation to confirm the congressional validation and revalidation of due-on-sale clauses in real estate loans originated or acquired by national banks. Comptroller of the Currency—Real Estate Loans Made by National Banks; Validation and Enforcement of Due-on-Sale Clauses, 48 Fed. Reg. 51,283 (1983) (to be codified at 12 C.F.R. Part 30) [hereinafter cited as Comptroller's Regulation].

78. FHLBB Preemption of State Due-on-Sale Laws, 48 Fed. Reg. 21,554 (1983) (to be codified at 12 C.F.R. Parts 556, 590 and 591) [hereinafter cited as FHLBB Regulations].

A. *Federal Preemption of State Laws Restricting Enforcement of Due-on-Sale Clauses by Any Lender*

Section 341(b)(1) of the Garn Act provides for the federal preemption of state laws and judicial decisions which restrict enforcement of due-on-sale provisions[79] by any lender,[80] except for loans originated during a "window period."[81] In a loan not subject to a window-period exception, the terms of the loan contract exclusively[82] govern a lender's right to enforce a due-on-sale provision.[83] The FHLBB regulation does not prohibit a lender from imposing any noncontractual term as a condition of waiving a due-on-sale clause, as long as state contract law permits such an option.[84]

The Garn Act encourages the lender who exercises rights pursuant to a due-on-sale clause to negotiate assumption of the existing mortgage at the original contract rate or at a blended interest rate.[85] A blended interest rate is a rate between the lower contract rate and the higher current market rate for new loans.[86] The legislative history of the Garn Act states that a blended interest rate benefits lenders, home sellers and home buyers, espe-

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79. The Garn Act, Pub. L. No. 97-320 § 341(a)(1). Section 341(a) of the Garn Act provides the definition of due-on-sale clause as follows:

> For the purpose of this section—
> (1) the term "due-on-sale clause" means a contract provision which authorizes a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent.

In its final regulation the FHLBB modified the definition of "due-on-sale" in § 591.2(b) to clarify the scope of what constitutes a "sale or transfer" of property for the purpose of enforcing a due-on-sale clause. FHLBB Regulation, 48 Fed. Reg. at 21,561 (to be codified at 12 C.F.R. § 591.2(b)).

80. The Garn Act, Pub. L. No. 97-320, § 341(a)(2). Section 341(a)(2) defines "lender" as follows: "the term lender means a person or government agency making a real property loan or any assignee or transferee, in whole or in part, of such a person or agency." The FHLBB has expanded the statutory definition of lender to include federal and state chartered credit unions and insurance companies. The list of entities is representative, not exclusive. FHLBB Regulation, *supra* note 78, 48 Fed. Reg. at 21,555 and 21,561 (to be codified at 12 C.F.R. § 591.2(g)).

81. The Garn Act, Pub. L. No. 97-320, § 341(b)(1). For an explanation and discussion of "window period," *see infra* notes 96-120 and accompanying text.

82. The Garn Act, Pub. L. No. 96-320, § 341(b)(2), provides that the terms of the loan contract exclusively govern a lender's right to enforce a due-on-sale clause except as provided in § 341(d) of the Act, which provides nine exceptions to the enforcement of such provisions; *see* FHLBB Regulation, 48 Fed. Reg. at 21,558 and 21,562 (to be codified at 12 C.F.R. § 591.3(b)).

83. The Garn Act, Pub. L. No. 97-320, § 341(b)(2), provides as follows:

> (b)(2) Except as otherwise provided in subsection (d), the exercise by the lender of its option pursuant to such a clause shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the lender and the borrower shall be fixed and governed by the contract.

See also S. REP. No. 536, 97th Cong., 2d Sess. 1, 21, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3075.

84. FHLBB regulation, 48 Fed. Reg. at 21,558. For example, a lender can make a later agreement with the borrower or transferee that he will agree to waive the due-on-sale provision, for payment of a fee.

85. The Garn Act, Pub. L. No. 97-320, § 341(b)(3). This section provides as follows:

> In the exercise of its option under a due-on-sale clause, a lender is encouraged to permit an assumption of a real property loan at the existing contract rate or at a rate which is at or below the average between the contract and market rates, and nothing in this section shall be interpreted to prohibit any such assumption.

86. S. REP. No. 536, 97th Cong., 2d Sess. 1, 21, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3075.

cially during periods of high interest rates.[87] Congress asserts that during these periods a blended rate mortgage would aid lenders by increasing interest income on older loans, would benefit home sellers by facilitating the sale of a home, and would aid home buyers by providing below-market financing.[88] The use of a blended interest rate is within the lender's discretion; the lender is under no obligation to offer a blended rate.[89]

B. *The "Window-Period" Exception*

1. *Purpose and Statement of the Exception*

Recognizing that a blanket federal preemption of state restrictions would have an unfair impact on homeowners who had relied on state due-on-sale restrictions, Congress carved out a "window-period" exception to the preemptive provision.[90] The "window-period" exception provides that due-on-sale clauses in real property loans[91] made or assumed[92] during the period beginning on the date a state prohibited[93] the exercise of such provisions and ending on the enactment date of the Garn Act[94] are not subject to preemption, until three years after the enactment of the Garn Act.[95]

2. *Definitions and Scope of the Exception*

To provide an understanding of the impact of the "window-period" exception, certain terms need definition and clarification. The first is the term "window-period loan." Since the Garn Act does not specifically[96]

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87. *Id.*

88. *Id.*

89. FHLBB Regulation, 48 Fed. Reg. at 21558; *see infra* note 138 and accompanying text for instances in which the use of a blended rate is mandatory.

90. S. REP. No. 536, 97th Cong., 2d Sess. 1, 22, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3076.

91. The Garn Act, Pub. L. No. 97-320, § 341(a)(3), defines the term "real property loan" as follows: "a loan, mortgage, advance, or credit sale secured by a lien on real property, the stock allocated to a dwelling unit in a cooperative housing corporation, or a residential manufactured home, whether real or personal property." *See also* FHLBB Regulation, 48 Fed. Reg. at 21,561 (to be codified at 12 C.F.R. § 591.2(1)).

92. The term "assumed" includes transfers of the liened property by installment land contracts, assumptions, wrap-around loans, contracts for deed and transfers subject to the mortgage or lien. S. REP. No. 536, 97th Cong., 2d Sess. 1, 22, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3076. *See also* FHLBB Regulation, 48 Fed. Reg. 21,561 (to be codified at 12 C.F.R. § 591.2(a)).

93. See *infra* notes 108-11, and accompanying text for an interpretation of the term "prohibited."

94. The Garn Act was enacted on October 15, 1982. Pub. L. No. 97-320, 96 Stat. 1469 (1982).

95. The Garn Act, Pub. L. No. 97-320, § 341(c)(1), sets forth the "window-period" exception:

> (c)(1) In the case of a contract involving a real property loan which was made or assumed, including a transfer of the liened property subject to the real property loan, during the period beginning on the date a State adopted a constitutional provision or statute prohibiting the exercise of due-on-sale clauses, or the date on which the highest court of such State has rendered a decision (or if the highest court has not so decided, the date on which the next highest appellate court has rendered a decision resulting in a final judgment if such decision applies statewide) prohibiting such exercise, and ending on the date of enactment of this section, the provisions of subsection (b) shall apply only in the case of a transfer which occurs on or after the expiration of 3 years after the date of enactment of this Act. . . .

96. While the meaning of the term "window-period loan" may be inferred from § 341(c)(1) of the Garn Act, it is not specifically defined therein. *See* Pub. L. No. 97-320, § 341(c)(1).

define the term, the FHLBB regulation provides a definition.[97]

The FHLBB regulation sets forth the requirements a loan must meet to qualify as a window-period loan. The loan must be a real property loan,[98] which was made or assumed[99] during a state window period[100] and which was not originated by a federal association.[101] The loan must have been recorded before October 15, 1982 or within sixty days thereafter.[102] In addition, the FHLBB regulation provides that a loan is a window-period loan only if it falls within the specific category of loans the state intended to protect by prohibiting the unrestricted exercise of due-on-sale clauses.[103]

The regulation also clarifies the beginning and ending dates of a state's window period. Section 341(c) (1) of the Garn Act provides that the window period begins on the date a state "prohibited" the exercise of due-on-sale clauses[104] either by judicial decision,[105] statute[106] or constitutional provision.[107] Because of ambiguous language in the statute, the FHLBB regulation defines certain terms specifically. First, in view of probable

97. FHLBB Regulation, 48 Fed. Reg. 21,554 (to be codified at 12 C.F.R. Parts 556, 590 and 591).

98. *Id.* at 21,561 (to be codified at 12 C.F.R. § 591.2(1)), provides a definition of a real property loan. *See also supra* note 91.

99. 48 Fed. Reg. at 21,561 (to be codified at 12 C.F.R. § 591.2(a)) provides a definition of "assumed." *See also supra* note 92.

100. 48 Fed. Reg. at 21,561 (to be codified at 12 C.F.R. § 591.2(p)(1)).

> A "window-period loan" is a real property loan, not originated by a Federal association, which was made or assumed during a window period created by state law and subject to that law, which loan was recorded, at the time of origination or assumption, before October 15, 1982, or within 60 days thereafter (December 14, 1982).

101. FHLBB Regulation, 48 Fed. Reg. at 21,561 (to be codified at 12 C.F.R. § 591.2(c)) defines a federal association. A FSL cannot make a window-period loan because FSL's are not subject to the window-period exception. *See* the Garn Act, Pub. L. No. 97-320, § 341(c)(2)(C); *see also infra* notes 155-56 and accompanying text.

102. 48 Fed. Reg. at 21,561. The FHLBB incorporated a "sunset date" of sixty days to prevent fraudulent backdating or nonrecordation of transfer documents. *Id.* at 21,557. *See supra* note 100.

103. 48 Fed. Reg. at 21,561. This requirement is codified in § 591.2(p)(1), referring to window-period loans as those "subject to" the state law creating the window period. *See supra* note 100 for the text of § 591.2(p)(1).

104. The legislative history of the Garn Act defines the beginning of a window period as the date state law prohibited " 'the unrestricted exercise of due-on-sale clauses upon outright transfers of the property.' " S. REP. No. 536, 97th Cong. 2d Sess. 1, 22, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3076 (citing Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 170 n.24 (1982)).

105. The legislative history of the Garn Act notes that the highest court in Arizona imposed restrictions on the enforcement of due-on-sale clauses in 1978. S. REP. No. 536, 97th Cong. 2d Sess. 1, 22 n.2, *reprinted in* 1982 U.S. CODE CONG. & AD NEWS 3054, 3076 n.3 (citing Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978)). The Arizona Supreme Court has since held differently. *See infra* notes 171-81 and accompanying text. Other states in which the highest courts have placed restrictions on the exercise of due-on-sale provisions are: Arkansas, in 1972; California, in 1978; and Michigan, in 1977. S. REP. No. 536, 97th Cong., 2d Sess. 1, 22, n.2 *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3076 n.3.

106. The legislative history of the Garn Act further notes that, at the time of its writing, the following states had enacted legislation restricting the enforcement of due-on-sale clauses: Colorado, in 1975; Iowa, in 1979; New Mexico, in 1978; and Utah, in 1981. S. REP. No. 536, 97th Cong., 2d Sess. 1, 22, n.2, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3076, n.2.

107. The Garn Act, Pub. L. No. 97-320, § 341(c)(1). *See supra* note 95, for the text of section 341(c)(1).

congressional intent[108] and practical realities,[109] the FHLBB regulation modifies the term "prohibited." Although the Garn Act states that the window period starts on the date state law "prohibited the exercise of due-on-sale clauses,"[110] the regulation clarifies that the period begins on the date a state "prohibited the unrestricted exercise of due-on-sale clauses."[111]

Second, if a state statute restricts the enforcement of due-on-sale clauses, the FHLBB regulation specifies that the window period commences on the later of the date the statute is adopted or the date it becomes effective.[112] This modification clarifies the commencement date where the state has a delayed effective date for the statute.[113] Using a similar method, the regulation provides that a window period ends on the earlier of October 15, 1982 or the date a state law rescinded a prior statutory or judicial restriction on the enforcement of due-on-sale clauses.[114]

To determine the beginning and ending dates of a state's window period requires one to read the statute and the regulation together. If a state restricts the enforcement of due-on-sale clauses upon outright transfers of property by means of a constitutional provision or statute, then the window period begins on the later of the date the provision is adopted or the date it becomes effective.[115] Alternatively, if a state restricts the enforcement of due-on-sale clauses by a judicial decision,[116] then the window period begins on the date the state court renders the decision.[117] Irrespective of how a window period begins, a state window period ends on the earlier

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108. *See supra* note 104, for the congressional intent.

109. The FHLBB found that, if it adopted an absolute prohibition approach in defining the window period, it would effectively eliminate all window periods since no states absolutely prohibited the exercise of due-on-sale clauses. FHLBB Regulation, 48 Fed. Reg. at 21,557.

110. The Garn Act, Pub. L. No. 97-320, § 341(c)(1), uses similar language. *See supra* note 95 for the text of section 341(c)(1).

111. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.2 (p)(2)). *See infra* note 115 for the text of this section.

112. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.2(p)(2)(i)). *See infra* note 115 for the text of section 591.2(p)(2).

113. 48 Fed. Reg. at 21,557.

114. *Id.* at 21,562 (to be codified at 12 C.F.R. § 591.2(p)(ii)). *See infra* note 115 for the text of section 591.2(p)(2).

115. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.2(p)(2), which reads as follows:

> The window-period begins on:
>
> (i) The date a state adopted a law (by means of a constitutional provision or statute) prohibiting the unrestricted exercise of due-on-sale clauses upon outright transfers of property securing loans subject to the state law creating the window-period, or the effective date of a constitutional or statutory provision so adopted, whichever is later; or
>
> (ii) The date on which the highest court of the state rendered a decision prohibiting such unrestricted exercise (or if the highest court has not so decided, the date in which the next highest appellate court rendered a decision resulting in a final judgment which applies statewide), and ends on the earlier of the date such state law prohibition ended or October 15, 1982.

116. A judicial restriction on the enforcement of due-on-sale clauses must be rendered by the state's highest court or by the next highest appellate court whose judgment applies statewide. *See supra* notes 95 and 115. The FHLBB regulation also requires that the judicial decision include language expressly holding a due-on-sale clause unenforceable, and not merely comment on unenforceability in dicta. FHLBB Regulation, 48 Fed. Reg. at 21,557.

117. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.2(p)(2)(ii). *See supra* note for the text of section 591.2(p)(2)(ii).

of date the state law prohibition terminates or October 15, 1982.[118]

Finally, the nature of the state law prohibition must be examined to determine if a window period exists. Since the Garn Act is not specific, the FHLBB regulation sets forth the two types of state prohibition which trigger a window period.[119] The regulation provides that a window period exists where a statute or judicial decision permits the lender to exercise a due-on-sale clause only if: 1) the lender's security interest is impaired; or 2) the lender is required to accept an assumption without an interest rate change or with an interest rate change below the current market rate.[120] Consequently, a state may not have a window period.

3. *Exceptions to and Limitations of the "Window-Period" Exception*

Section 341(c) of the Garn Act provides for several statutory limitations on the use of the window-period exception.[121] The Act gives states and the Comptroller of the Currency the right to limit the window-period exception.[122] The Act also imposes a statutory limitation where a transferee of the borrower fails to meet a lender's customary credit standards.[123] Finally, the window-period exception does not apply to loans originated by FSLs.[124] This section discusses each of these limitations and exceptions.

a. *States—Loans Originated by State Chartered Lenders*

Window-period loans originated by non-federally chartered lenders are subject to applicable state law for a three year grace period from the date of enactment of the Garn Act, unless a state legislature acts within the three year period to regulate such loans in a different manner.[125] According to the Garn Act's legislative history, the three year grace period is intended to provide state legislatures in window-period states the

118. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.2(p)(2)).
119. *Id.*
120. *Id.* This section of the regulation states:
> Categories of state law which create window-periods by prohibiting the unrestricted exercise of due-on-sale clauses upon outright transfers of property securing loans subject to such state law restrictions include laws or judicial decisions which permit the lender to exercise its option under a due-on-sale clause only where:
> (i) The lender's security interest or the likelihood of repayment is impaired; or
> (ii) The lender is required to accept an assumption of the existing loan without an interest-rate change or with an interest-rate change below the market interest rate currently being offered by the lender on similar loans secured by similar property at the time of the transfer.

121. The Garn Act, Pub. L. No. 97-320, § 341(c).
122. The Garn Act, Pub. L. No. 97-320(c)(1)(A) & (B).
123. The Garn Act, Pub. L. No. 97-320, § 341(c)(2)(A).
124. The Garn Act, Pub. L. No. 97-320 § 341(c)(2)(C).
125. The Garn Act, Pub. L. No. 97-320, § 341(c)(1)(A), provides as follows:
> A State, by a State law enacted by legislature prior to the close of such 3-year period, with respect to real property loans originated in the State by lenders other than national banks, Federal savings and loan associations, Federal savings banks, and Federal credit unions, may otherwise regulate such contracts, in which case subsection (b) shall apply only if such State law so provides.

See S. REP. No. 536, 97th Cong., 2d Sess. 1, 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3077. *See also infra* note 183 for Arizona Statute.

opportunity to review the impact of the state's due-on-sale clause restrictions on non-federally chartered lenders.[126] The Act also encourages state legislatures to review the impact of such restrictions on consumers who rely on the validity of the state's restrictions when they receive assumable mortgages.[127] Therefore, a state may formulate an alternative to the treatment of window-period loans.[128] For example, a state could repeal existing due-on-sale restrictions or lengthen the time state due-on-sale restrictions would apply to window-period loans, or authorize blended rates for window-period loans.[129] A state legislature, however, cannot expand the types of loans to which the window period applies, nor can it retroactively extend the window period.[130] If a state fails to take action during this three year period, federal preemption becomes effective.[131]

b. *Comptroller of the Currency—Loans Originated by National Banks*

Analogous to the right given to states to otherwise regulate window-period loans is the right given to the Comptroller of the Currency. Section 341(c)(1)(B) of the Garn Act provides that window-period loans originated by national banks are subject to applicable state law for a period of three years after the enactment of the Garn Act. After this three year grace period, due-on-sale provisions in these loans are fully enforceable unless, during the three year period, the Comptroller of the Currency[132] acts to otherwise regulate such loan provisions.[133]

The Comptroller of the Currency has taken advantage of this option and has issued a regulation controlling window-period loans originated by national banks.[134] The general rule of the regulation is that all due-on-sale clauses in real property loans made or held by national banks are fully enforceable for transfers occuring after the effective date of the regulation.[135]

The regulation sets forth four exceptions to the general rule. First,

126. S. REP. No. 536, 97th Cong. 2d Sess. 1, 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3077.

127. *Id.*

128. *Id. See* FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(c)(1)).

129. S. REP. No. 536, 97th Cong., 2d Sess. 1, 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3077.

130. *Id. See also* FHLBB Regulation, 48 Fed. Reg. at 21,558.

131. S. REP. No. 536, 97th Cong., 2d Sess. 1, 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3077.

132. Section 341(c)(1)(B) of the Garn Act also gives the National Credit Union Administration Board the authority to otherwise regulate window-period loans originated by federally chartered credit unions. *See infra* note 133, for the text of section 341(c)(1)(B).

133. The Garn Act, Pub. L. No. 97-320, § 341(c)(1)(B), provides as follows:

> The Comptroller of the Currency with respect to real property loans originated by national banks or the National Credit Administration Board with respect to real property loans originated by Federal credit unions may, by regulation prescribed prior to the close of such period, otherwise regulate such contracts, in which case subsection (b) shall apply only if such regulation so provides.

134. Comptroller's Regulation, 48 Fed. Reg. at 51,283 (to be codified at 12 C.F.R. Part 30).

135. *Id.* at 51,285-51,286 (to be codified at 12 C.F.R. § 30.1(a)). The effective date of this regulation was December 8, 1983.

due-on-sale clauses in real property loans secured by liens on one- to four-family residential dwellings originated or assumed during a state window period[136] are not enforceable until after April 15, 1984.[137] Banks dealing with transfers of property prior to April 15, 1984 but subsequent to December 8, 1983 (the effective date of the regulation) must permit an assumption of the loan on the terms and conditions in the original loan contract, except that the interest rate may be increased to a blended rate.[138] This provision effectively excludes commercial mortgage loans originated by national banks from the window-period protection, thus making due-on-sale clauses in these loans fully enforceable as of December 8, 1983.[139]

Second, the regulation provides that a national bank or its transferee may require any successor of the borrower to meet its customary credit standards applicable to loans secured by similar property, or the lender may enforce the due-on-sale provision notwithstanding the window-period exception.[140]

Third, due-on-sale clauses are unenforceable in transfers described in section 341(d) of the Garn Act.[141] The fourth exception provides that in the case of due-on-sale clauses in window-periods loans purchased by national banks, due-on-sale clauses shall be enforceable only to the extent they would be enforceable by the original lender.[142]

c. *Customary Credit Standards*

Section 341(c)(2)(A) of the Garn Act permits lenders subject to window-period laws to exercise a due-on-sale clause if a transferee fails to meet the lender's "customary credit standards."[143] Both the FHLBB and the Comptroller of the Currency have incorporated this exception into their regulations.[144] The FHLBB regulation has clarified ambiguities in this exception as to what constitutes customary credit standards for differ-

136. 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. § 30.1(b)(3)) sets forth the window periods for purposes of national bank loans. Section 30.1(b)(3)(i) states Arizona's window period as July 8, 1971 to October 15, 1982. The Arizona Supreme Court, in Scappaticci v. Southwest Sav. and Loan Ass'n, 135 Ariz. 456, 662 P.2d 131 (1983), determined that Arizona's window period began on July 8, 1971, the date *Harn* was decided. *See supra* note 17 and *infra* notes 171-76.

137. Comptroller's Regulation, 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. 30.1(b)(1)(i)).

138. 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. § 30.1(b)(1) (ii); this section provides a detailed definition of the blended rate to be used by national banks.

139. 48 Fed. Reg. at 51,285.

140. 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. § 30.1(b)(2)). *See infra* note 144 and accompanying text.

141. 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. 30.1(c)). *See infra* text accompanying notes 161-64 for a discussion of § 341(d) of the Garn Act.

142. Comptroller's Regulation, 48 Fed. Reg. at 51,286-51,287 (to be codified at 12 C.F.R. § 30.1(d)).

143. The Garn Act, Pub. L. No. 97-320, § 341(c)(2)(A), provides as follows:

> For any contract to which subsection (b) does not apply pursuant to this subsection, a lender may require any successor transferee of the borrower to meet customary credit standards applied to loans secured by similar property, and the lender may declare the loan due and payable pursuant to the terms of the contract upon transfer to any successor or transferee of the borrower who fails to meet such customary credit standards.

144. FHLBB Regulation, 48 Fed. Reg. at 21,554 (to be codified at 12 C.F.R. § 591.4(d); Comptroller's Regulation, 48 Fed. Reg. at 51,283 (to be codified at 12 C.F.R. § 30.1(b)(2)). *See supra* note 140 and accompanying text.

ent types of lenders, and whether credit standards customary at the time of the sale or at the time of the transfer should apply.[145] For a lender in the business of making real property loans, a customary credit standard is the standard applied by the lender at the date of sale or transfer to the lender's similar loans secured by similar property.[146] The customary credit standard for any lender not in the business of making loans is the standard customarily applied by other "similarly situated lenders or sellers in the geographic market within which the transaction occurs, for similar loans secured by similar property, prior to the lender's consent to the transfer."[147] The standards for both institutional and noninstitutional lenders are those in effect at the time of the transfer of the loan securing the real property.[148]

Furthermore, the FHLBB regulation has expanded the "customary credit standards" limitation in several respects. First, the FHLBB regulation creates a second branch to the limitation by allowing a lender to exercise a due-on-sale clause if a transferee or successor to the borrower fails to provide credit information requested by the lender to determine whether the transferee meets the lender's customary credit standards.[149] The transferee must provide the information within fifteen days after a written request by the lender.[150]

Second, to ensure that a lender responds in good faith to a transferee's credit application, the regulation provides that a lender must approve or disapprove the credit application and notify the applicant of its decision within thirty days of receiving the application.[151] A lender who fails to provide timely notice is precluded from exercising the due-on-sale clause upon the transfer.[152]

Finally, the FHLBB regulation indicates that the right to exercise a due-on-sale clause when the transferee fails to meet the lender's credit standards is not exclusive of other exceptions or qualifications currently available in window-period states.[153]

d. *Other Exceptions: Retroactive Enforcement and FSLs*

The final two exceptions to the window-period exception are: first, lenders who may be authorized to enforce due-on-sale clauses in window-period loans may not retroactively enforce such clauses for transfers which occur prior to the enactment of the Garn Act;[154] and second, the window-period provisions set forth in the Garn Act do not apply to loans

145. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 21 C.F.R. § 591.4(d)).
146. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(a)(1)(i)).
147. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(d)(1)(ii).
148. 48 Fed. Reg. at 21,558.
149. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(d)(2)).
150. *See* Comptroller's Regulation, 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. § 30.1(b)(2)(i)).
151. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(d)(3)).
152. *Id.*
153. 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(d)(4)).
154. The Garn Act, Pub. L. No. 97-320, § 341 (c)(2)(B). *See also* FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.4(c)(2)).

originated by FSLs and Federal Savings Banks.[155] The FHLBB has exclusive regulatory control over these institutions.[156]

C. *Absolute Restrictions on Exercise of Due-on-Sale Clauses*

To protect consumers from inequitable enforcement of due-on-sale clauses,[157] section 341(d) of the Garn Act delineates nine situations in which a lender may not enforce a due-on-sale clause under any circumstance.[158] This prohibition applies to all loans, including window-period loans, and to all lenders, including FSLs.[159] The only limitation on the prohibition is that the situations must occur with respect to a loan on the security of a home occupied or to be occupied by the borrower.[160] Accordingly, loans on all property other than borrower-occupied homes are not subject to the restrictions.

Section 341(d) of the Garn Act provides as follows:

> (d) With respect to a real property loan secured by a lien on residential real property containing less than five dwelling units, including a lien on the stock allocated to a dwelling unit in a cooperative housing corporation, or on a residential manufactured home, a lender may not exercise its option pursuant to a due-on-sale clause upon
> (1) the creation of a lien or other encumbrance subordiante to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property;[161]
> (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;[162]
> (5) a transfer to a relative resulting from the death of a borrower;
> (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

155. The Garn Act, Pub. L. No. 97-320, § 341(c)(2)(C).

156. FHLBB Regulation, 48 Fed. Reg. at 21,562 (1982) (to be codified at 12 C.F.R. § 591.3). This section controls the due-on-sale practices of federal associations.

157. See S. REP. No. 536, 97th Cong., 2d Sess. 1, 25, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3079.

158. The Garn Act, Pub. L. No. 97-320, § 341(d).

159. S. REP. No. 536, 97th Cong., 2d Sess. 1, 25, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3079.

160. FHLBB Regulation, 48 Fed. Reg. at 21,562 (to be codified at 12 C.F.R. § 591.5(b)).

161. *Id.* at 21,563 (to be codified at 12 C.F.R. § 591(b)(i)), which provides that this limitation does not include a transfer of the property pursuant to a contract for deed which would include contracts for conveyance of real property under Title 33 of the Arizona Revised Statutes.

162. 48 Fed. Reg. at at 21,563 (to be codified at 12 C.F.R. § 591.5(b)(iv)), which clarifies this provision by providing that a lease of more than three years or a lease with an option to purchase allows the exercise of a due-on-sale clause.

remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property;[163]

(9) any other transfer or disposition described in regulations prescribed by the Federal Home Loan Bank Board.[164]

The FHLBB has supplemented the Garn Act by adding two more restrictions. One restriction bans the imposition of a prepayment penalty in connection with the exercise of a due-on-sale clause in loans originated by federal associations after July 31, 1976 and prior to May 10, 1983.[165] If a lender meets certain requirements, it may impose a prepayment fee in connection with the exercise of a due-on-sale clause after May 10, 1983.[166] In imposing such a penalty, however, a lender must consult state law to determine the validity of the practice.[167] The FHLBB has determined that, by enacting section 341 of the Garn Act, Congress intended to preempt only state laws which interfered with a lender's effective enforcement of due-on-sale clauses at the time of the transfer as a means of increasing the yield on older low-interest mortgages in its portfolio. Therefore the lender's ability to impose a prepayment or equivalent fee upon acceleration of the loan is not essential to the effective use of the due-on-sale provision.[168]

The other FHLBB restriction provides that when a lender and a borrower's successor in interest enter into an agreement in which the latter agrees to be obligated under the terms of the loan, the lender waives its option to exercise a due-on-sale provision.[169] Such an agreement and waiver constitute a release of the original borrower from all contractual obligations. The lender is deemed to have made a new loan to the borrower's successor in interest.[170]

In summary, section 341 of the Garn-St. Germain Depository Institutions Act of 1982 has established a schedule to preempt state laws which restrict the right of any lender to enforce due-on-sale provisions in real property loans. Pursuant to authorization under this section, the FHLBB and the Comptroller of the Currency have implemented and clarified its provisions. Moreover, Arizona has considered and has acted upon the provisions set forth in section 341. The next section considers the effects the Garn Act has had upon Arizona law.

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163. *Id.* at 21,563 (to be codified at 12 C.F.R. § 591.5(b)(vi)), which provides that this limitation applies "unless, as a condition precedent to such transfer, the borrower refuses to provide the lender with reasonable means acceptable to the lender by which the lender will be assured of timely notice of any subsequent transfer of the beneficial interest or change in occupancy."

164. The Garn Act, Pub. L. No. 320, § 341(d) *amended by* Pub. L. No. 98-181, 97 Stat. 1153, 1237 (1983). See FHLBB Regulation, 48 Fed. Reg. at 21,563 (to be codified at 12 C.F.R. § 591.5(b)).

165. FHLBB Regulation, 48 Fed. Reg. at 21,563 (to be codified at 12 C.F.R. § 591.5(b)(2)(i) & (ii)).

166. *Id.*

167. *Id.* at 21,560.

168. *Id.*

169. *Id.* at 21,563 (to be codified at 12 C.F.R. § 591.5(b)(3)).

170. *Id.*

V. ARIZONA LAW SUBSEQUENT TO THE GARN ACT

A. *Consideration of the Garn Act by the Courts*

The Arizona Supreme Court first considered the provisions of section 341 of the Garn Act in *Scappaticci v. Southwest Savings and Loan Association*.[171] The court considered whether Arizona qualified as a window-period state, and if so, what act or judicial decision triggered the beginning date of the period.[172] The court cited *Baltimore Life Insurance Co. v. Harn*,[173] decided on July 8, 1971, in which the Arizona Court of Appeals restricted the enforcement of due-on-sale clauses to situations in which the lender's security was threatened or other reasonable situations.[174] The supreme court decided that the restrictions in *Harn* were substantial enough to cause borrowers to believe they had assumable loans; therefore, the court concluded that Arizona qualifies as a window-period state.[175]

Furthermore, the court concluded that the *Harn* decision triggered the window period.[176] The court refused to consider the appellant's argument that only a decision by the state's highest court could trigger the window period, thereby making the date of the 1978 supreme court decision in *Patton v. First Federal Savings and Loan Association*[177] the trigger date.[178] Holding that such a reading of the Garn Act was "unduly narrow and subvert[ed] the purpose of the window period exception,"[179] the court concluded that to immediately enforce due-on-sale clauses in mortgages made prior to *Patton* but after *Harn* would be unjust.[180]

According to *Scappaticci*, loans created or assumed between July 8, 1971 and October 15, 1982 are window-period loans and are subject to state law until October 15, 1985, at which time the provisions of section 341 of the Garn Act apply.[181] The Garn Act, however, provides that a state legislature may act to otherwise regulate window-period loans during the three year period from October 15, 1982 to October 13, 1985.[182]

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171. 135 Ariz. 456, 662 P.2d 131 (1983). The facts in this case substantially conform to the basic fact pattern set forth *supra* note 20.

172. *Id.* at 458, 662 P.2d at 133.

173. 15 Ariz. App. 78, 486 P.2d 190, *pet. for rev. den.*, 108 Ariz. 192, 494 P.2d 1322 (1972). *See supra* notes 17-28 and accompanying text.

174. *Scappaticci*, 135 Ariz. at 459, 662 P.2d at 134.

175. *Id.* at 460, 662 P.2d at 135.

176. *Id.*

177. 118 Ariz. 473, 578 P.2d 152 (1978). *See supra* notes 40-51 and accompanying text.

178. *Scappaticci*, 135 Ariz. at 460, 662 P.2d at 135. The court reasoned that a decision by the Arizona Court of Appeals has statewide application and that absent a contrary ruling by the Arizona Supreme Court, a decision by one division of the court of appeals is persuasive in the other division. *Id.* at 461, 662 P.2d at 136.

179. *Id.* at 460, 662 P.2d at 135.

180. *Id.* at 461, 662 P.2d at 136.

181. In Western Sav. & Loan Ass'n v. Booker, Civ-83-176-TUC-RMB (D. Ariz. Aug. 31, 1983), Western Savings filed suit against the defendants, the transferees, in order to enforce the terms of a due-on-sale clause in the mortgage. The district court applied *Scappaticci* to the facts and concluded that Arizona had restricted the enforcement of due-on-sale clauses since the *Harn* decision in 1971, therefore qualifying Arizona as a window-period state. The court concluded that the loan in question was a window-period loan under the Garn Act. Furthermore, the court found that since Western Savings failed to demonstrate that its security was jeopardized by the transfer, as required by state law, the due-on-sale clause was unenforceable.

182. The Garn Act, Pub. L. No. 97-320, § 341(c)(1)(A), *see supra* note 125 for text.

B. *Consideration of the Garn Act by the Arizona Legislature*

In May 1983, the Arizona legislature enacted a statute designed to regulate window-period loans.[183] The most important aspect of the new statute, section 33-1571 of the Arizona Revised Statutes, is the provision which extends the date after which a lender may enforce a due-on-sale clause in a residential window-period loan.[184] More specifically, the statute prohibits a lender from enforcing a due-on-sale clause upon the transfer of residential property consisting of one- to four-family units on two and one-half acres or less securing a window-period loan until October 14, 1987.[185]

Upon the transfer of such residential property prior to October 15, 1987, a lender may not increase the interest rate on the loan by more than one-half of one percent.[186] The lender must also comply with the other limitations set forth in section 33-806.01 of the Arizona Revised Statutes.[187] Further, with regard to all loans other than residential window-period loans, the statute provides that section 341 of the Garn Act applies in accordance with its terms.[188]

C. *Current Status of Arizona Law*

The Arizona legislature intended to clarify the regulation of window-period loans in the state. At least one issue remains unclear in the wake of

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183. ARIZ. REV. STAT. ANN. § 33-1571 (West Supp. 1983). This statute provides as follows:

> Notwithstanding any provision of Title 6 to the contrary, as provided by the Thrift Institutions Act, P.L. 97-320, Section 341, Subsection (c)(1)(A) the real property loans defined and described therein are regulated as follows:
>
> 1. From and after October 14, 1987, and not before, P.L. 97-320, section 341, subsection (b) applies to real property loans that were made or assumed, including transfers of liened property subject to real property loans, between July 8, 1971, and October 15, 1982, and that are secured by one to four family units utilized for residential purposes of two and one-half acres or less. Prior to October 15, 1987, upon a transfer of interest in such property, the interest rate on such loans shall not be increased by more than one-half of one-percent, and all other limitations provided in section 33.806.01 shall apply.
>
> 2. P.L. 97-320, section 341, applies in accordance with its terms to all real property loans other than those described in paragraph 1 of this section.

184. *Id.* The Arizona legislature probably had the authority to extend the grace period for residential window-period loans pursuant to § 341(c)(1)(A) of the Garn Act. The Garn Act, Pub. L. No. 97-320, § 341(c)(1)(A). The legislative history provides that a state may lengthen the time that state due-on-sale restrictions apply to window-period loans. S. REP. No. 536, 97th Cong., 2d Sess. 1, 23, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3077.

It may be argued, however, that the language of the FHLBB regulation prohibits the extension of the grace period. FHLBB Regulation, 48 Fed. Reg. at 21,554 (to be codified at 12 C.F.R. Parts 556, 590 and 591). The FHLBB regulation, which refers to the window period as the three year grace period, provides that a state may not retroactively extend the window period. *Id.* at 21,558. This provision probably means that once a state has determined the beginning date of its window period, it cannot retroactively decide that a prior (or an earlier) date should have been used. For example, once July 8, 1971 was established as the beginning date of Arizona's window period, the state could not by legislation provide that the beginning date was earlier so as to expand the window period. It is possible, however, from the FHLBB use of the term "window period" that the regulation meant to prohibit the extension of the grace period—October 15, 1982 to October 15, 1985.

185. ARIZ. REV. STAT. ANN. § 33-1571 (1) (West Supp. 1983).

186. *Id.*

187. *Id. See supra* note 35 for text of this statute.

188. ARIZ. REV. STAT. ANN. § 33-1571(2) (West Supp. 1983).

the above decisions and legislation: When are due-on-sale clauses in commercial loans enforceable in Arizona?

Section 33-1571 of the Arizona Revised Statute does not clarify or resolve the issue. The statute extends the grace period of residential window-period loans but not for commercial loans.[189] One can interpret the statute in two ways. First, commercial loans fall within the Garn Act window-period exception, but since Arizona did not act to extend the grace period for such loans, they are fully enforceable after October 15, 1985.[190] Second, if commercial loans are not window-period loans under the Garn Act, then they are fully enforceable as of October 15, 1982. The second interpretation is consistent with the regulation issued by the Comptroller of the Currency, which applied the window-period exception only to residential loans.[191]

The language of the Garn Act pertaining to due-on-sale clauses does not distinguish between residential and commercial loans.[192] Therefore, it may be argued that the window-period provision of the Act applies equally to commercial and residential loans.[193] It may also be argued, however, that the Garn Act and the window-period provision apply only to residential loans. Statements found in the legislative history of the Act provide that the purpose of the legislation was to protect home buyers.[194] *Scappaticci* contains similar statements.[195] The Arizona statute does not clarify the Garn Act in this respect and therefore does not determine when due-on-sale clauses in commercial loans are enforceable in Arizona.

VI. CONCLUSION

Prior to the enactment of the Garn Act, Arizona limited the enforcement of due-on-sale clauses upon the transfer of encumbered real property to situations in which the transfer of the property jeopardized the lender's security. Federal preemption of state law in this area began with regulations affecting only FSLs and ended with the enactment of the Garn Act, which provides for federal preemption of state statutes and judicial decisions which restrict the enforcement of due-on-sale provisions by any lender.

The Garn Act provides an exception for loans originated during a window period. Due-on-sale provisions in such loans are not enforceable prior to October 15, 1985, unless a state provides otherwise. By judicial decision, Arizona qualifies as a window-period state under the Garn Act,

189. *Id.*

190. October 15, 1985 is three years from the date of enactment of the Garn Act and, as provided in the Act, the end of the three year grace period. Pub. L. No. 97-320, § 341(c)(1)(A).

191. Comptroller's Regulation, 48 Fed. Reg. at 51,286 (to be codified at 12 C.F.R. § 30.1)).

192. The Garn Act, Pub. L. No. 97-320, § 341.

193. The Garn Act, Pub. L. No. 97-320, § 341(c)(1).

194. S. REP. No. 536, 97th Cong. 2d Sess. 1, 20, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 3054, 3074.

195. 135 Ariz. at 460, 662 P.2d at 135. See Western Sav. & Loan Ass'n v. Booker, Civ-83-176-TUC (D. Ariz. Aug. 31, 1983), in which the court stated that the language of *Harn*, *Patton* and *Scappaticci* applied restrictions on enforceability of due-on-sale clauses to all property, residential and commercial.

and the period applies to loans originated or assumed between July 8, 1971 and October 15, 1982.

Pursuant to the authority granted to states by the Garn Act, the Arizona legislature enacted a statute to regulate window-period loans in Arizona. The statute gives residential window-period loans preferential treatment by extending the grace period until October 15, 1987. The statute, however, is ambiguous concerning the treatment of commercial loans.