

PROPERTY—NEBRASKA UPHOLDS VALIDITY OF DUE-ON-SALE CLAUSES IN REAL ESTATE MORTGAGES—*Occidental Savings and Loan Association v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

The Nebraskas Supreme Court's decision in *Occidental Savings and Loan Association v. Venco Partnership*<sup>1</sup> is the latest volley in the ongoing judicial battle over the validity of the due-on-sale clause. This clause entitles a lender to accelerate the maturity of a mortgaged debt if the mortgagor sells the secured property.<sup>2</sup> Lenders use the due-on-sale clause to adjust the terms of fixed-interest, long-term obligations during periods of rising interest rates.<sup>3</sup> In a six to one decision, the court in *Occidental* held that these clauses are generally enforceable.<sup>4</sup>

While *Occidental* posed a question of first impression for the Nebraska court,<sup>5</sup> the other jurisdictions have considered the issue and are divided on the enforceability of the due-on-sale clause. *Wellenkamp v. Bank of America*,<sup>6</sup> last major case in the area, narrowly circumscribed the use of this clause by institutional lenders.<sup>7</sup>

The Nebraska Supreme Court, in rejecting the authority of *Wellenkamp*, appeared to strike an important victory for real estate lenders, particularly savings and loan associations.<sup>8</sup> This note will compare the approaches taken by the *Wellenkamp* and *Occidental* courts and explain why the Nebraska position better comports with the long-run interests of borrowers.

### BACKGROUND

The due-on-sale clause assumed an important place in American real estate law during a period of rising interest rates in the mid-1960's.<sup>9</sup> Before that time, the clause was seldom litigated.<sup>10</sup>

1. 206 Neb. 469, 293 N.W.2d 843 (1980).

2. G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 5.21 at 295 (3d. ed. 1979).

3. See notes 15-18 and accompanying text *infra*.

4. 206 Neb. at 482, 293 N.W.2d at 850.

5. *Id.* at 470, 293 N.W.2d at 844.

6. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

7. See 21 Cal. 3d at —, 582 P.2d at 976 n.9, 977, 148 Cal. Rptr. at 385 n.9, 386.

8. The Nebraska League of Savings Association, an organization comprised of state and federal savings and loan associations in Nebraska, filed an amicus brief in support of the due-on-sale clause. See Brief of Amicus Curiae, Nebraska League of Savings Association, No. 42741, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

9. Bartke & Tagaropulos, *Michigan's Looking Glass World of Due-on-Sale Clauses*, 24 WAYNE L. REV. 971, 977-79 (1978).

The due-on-sale clause now appears regularly in promissory notes and deeds of trust.<sup>11</sup> It is a specialized type of acceleration clause,<sup>12</sup> by which a lender's right to accelerate the outstanding balance of a mortgaged debt is triggered by the sale of the security.<sup>13</sup> This right may be waived if the lender consents to the sale.<sup>14</sup>

The due-on-sale clause is used by lenders who wish to avoid becoming locked in to a low rate of return on long-term obligations.<sup>15</sup> The threatened exercise of the clause is used as a lever to exact an assumption fee,<sup>16</sup> increased amortization payments,<sup>17</sup> or a higher rate of interest<sup>18</sup> from a prospective purchaser of the mortgaged property. If the mortgagor pays the principal and accrued interest of the debt immediately, the lender is free to put the money to use at current rates.<sup>19</sup>

Although the validity of acceleration provisions in mortgages is settled as a general proposition,<sup>20</sup> the enforceability of the due-on-sale clause has provoked a wideranging debate in the courts. The cases in this area have been marked by a tension between the policy of the law favoring freedom of contract and that favoring the free transferability of property.<sup>21</sup> The predominant judicial approach has been to characterize the due-on-sale clause as a restraint on alienation.<sup>22</sup> One court has observed that "the due-on-sale clause directly and fundamentally burdens a mortgagor's ability to alienate as surely and directly as the classical promissory restraint."<sup>23</sup> While restraints on alienation are ordinarily struck down as contrary to public policy,<sup>24</sup> the due-on-sale clause is en-

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10. ABA Committee on Real Estate Financing, *Enforcement of Due-on-Transfer Clauses*, 13 REAL PROP. 891, 893 (1978) [hereinafter cited as *ABA Report*].

11. Annot., 69 A.L.R.3d 713, 724 (1976).

12. G. OSBORNE, *supra* note 2, at 295.

13. Annot., 69 A.L.R.3d 713, 718-19 (1976).

14. Ordinarily, the consent must be in writing. See G. OSBORNE, *supra* note 2, at 295-96.

15. *Id.* at 296.

16. 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, 275 (1972).

17. *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, —, 509 P.2d 1240, 1242 (1973).

18. G. OSBORNE, *supra* note 2, at 296.

19. *ABA Report*, *supra* note 10, at 896.

20. *Crawford v. Houser*, 115 Neb. 62, 64-65, 211 N.W. 165, 166-67 (1926); *Hockett v. Burns*, 90 Neb. 1, 2-3, 132 N.W. 718, 718-19 (1911).

21. Annot., 69 A.L.R.3d 713, 724 (1976).

22. *ABA Report*, *supra* note 10, at 898.

23. *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, —, 250 N.W.2d 804, 805 (1977) quoting Volkmer, *The Application of the Restraint on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 774 (1973).

24. "The policy against restraints on alienation is said to be based on the belief

forced when it is found to be reasonable.<sup>25</sup>

This reasonableness standard was first applied in the California Supreme Court's decision in *Coast Bank v. Minderhout*.<sup>26</sup> In *Coast Bank*, the court retreated from the strict common law position forbidding all restraints on alienation.<sup>27</sup> Justice Traynor, for the majority, reasoned that a blind adherence to the common-law view encroached upon the freedom of individuals to contract to protect their "justifiable interests."<sup>28</sup> Traynor's opinion, applying a reasonableness analysis that considers justifiable interests, seems to have had an unmistakable influence on the case law in this area. It appears that no case after this has ever held that a due-on-sale clause is invalid *per se* as a restraint on alienation.<sup>29</sup> *Coast Bank*, however, did not offer an exhaustive list of what constitutes the "justifiable interests" of parties. The task of defining the contours of the reasonableness standard thus devolved upon the courts on a case-by-case basis.

The cases commonly point to a lender's interests in guarding against the waste of his security, expected difficulties in the collection of mortgage payments,<sup>30</sup> and the "moral risks" of having to resort to the security upon default by an uncreditworthy buyer.<sup>31</sup> These interests are seen by some courts as justifying the automatic enforcement of the due-on-sale clause when there is a sale of the secured property by the mortgagor.<sup>32</sup>

Another line of the cases hold that a lender's desire to capitalize upon rising interest rates is, in itself, a sufficient basis for the enforcement of the clause.<sup>33</sup> This justification was first approved

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that restraints remove property from commerce, concentrate wealth, prejudice creditors and discourage property improvements." A. CASNER & W. LEACH, CASES AND TEXT ON PROPERTY 1008 (2nd ed. 1969). See 4 RESTATEMENT OF PROPERTY § 404 (1944).

25. 61 Cal. 2d 311, —, 392 P.2d 265, 268, 38 Cal. Rptr. 505, 508 (1964) (overruled in part by *Wellenkamp v. Bank of America*, 21 Cal. 3d at —, 582 P.2d at 977, 148 Cal. Rptr. at 386).

26. 61 Cal. 2d at —, 392 P.2d at 268, 38 Cal. Rptr. at 508.

27. *Id.*

28. *Id.*

29. *ABA Report, supra* note 10, at 897.

30. See, e.g., *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works*, 71 Wis. 2d 531, —, 239 N.W.2d 20, 24 (1974).

31. 21 Cal. 3d at —, 582 P.2d at 975, 148 Cal. Rptr. at 384 (quoting from *Hetland, Real Property and Real Property Security: The Well-Being of the Law*, 53 CAL. L. REV. 151, 170 (1965)).

32. *First Commercial Title, Inc. v. Holmes*, 550 P.2d 1271, 1272 (Nev. 1976); *Poydan, Inc. v. Agia Kiriak, Inc.*, 130 N.J. Super. 141, —, 325 A.2d 838, 842 (1974); *People's Savings Ass'n v. Standard Indus.*, 22 Ohio App. 2d 35, —, 257 N.E.2d 406, 407-08 (1970).

33. *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, —, 509 P.2d 1240, 1245 (1973); *Century Fed. Sav. & Loan Ass'n v. Van Glahn*, 144 N.J. Super. 48, —, 364

by the California Appellate court in a 1969 decision, *Cherry v. Home Savings & Loan Association*.<sup>34</sup> The *Cherry* court reasoned that lenders were entitled to offset the double risk they faced at the hands of borrowers.<sup>35</sup> The double risk was said to encompass two possibilities. The first was that a lender would be saddled with a fixed-interest long-term mortgage as interest rates were increasing.<sup>36</sup> The second was the prospect that a mortgagor would prepay his debt when interest rates drop leaving the lender with money to invest—but at a lower rate of interest.<sup>37</sup> The courts relying on the *Cherry* rationale have pointed out that “acts related to securing a current lawful rate of interest are neither unconscionable nor inequitable.”<sup>38</sup> Indeed, at least one court has suggested that the directors of savings and loan associations are bound by fiduciary concepts to pursue the maximum allowable rate of interest.<sup>39</sup>

Other cases reject the view that a lender's *theoretical* interest in protecting his security can justify enforcement of the due-on-sale clause.<sup>40</sup> Here the burden is placed upon the lender in each case to prove a potential or actual threat to his security or the increased likelihood of default.<sup>41</sup> Finally, some courts refuse to enforce a due-on-sale clause which is defended only as a means of

A.2d 558, 562 (1976); *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, —, 224 S.E.2d 580, 585 (1976); *Gunther v. White*, 489 S.W.2d 529, 531 (Tenn. 1973).

34. 276 Cal. App. 574, —, 81 Cal. Rptr. 135, 138 (1969). This case was disapproved in *Wellenkamp v. Bank of America*, 21 Cal. 3d at —, 582 P.2d at 977, 148 Cal. Rptr. at 386 (1978). See *ABA Report, supra* note 10, at 896.

35. See 276 Cal. App. at —, 81 Cal. Rptr. at 138; see also *ABA Report, supra* note 10, at 896.

36. 276 Cal. App. at —, 81 Cal. Rptr. at 138.

37. *Id.* When the interest rate drops, however, the mortgagor may have to pay a prepayment penalty before he refinances. Also, unsophisticated mortgagors may not realize that they can refinance at more favorable terms. Comment, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1126 (1975). On the other hand, the prepayment penalty is normally limited in amount and thus “does not appear to represent a major factor in most situations.” *ABA Report, supra* note 10, at 923. The Nebraska Supreme Court in *Occidental* pointed out that the mortgage in question did not contain a prepayment penalty clause. 206 Neb. at 479, 293 N.W.2d at 848.

38. *Gunther v. White*, 489 S.W.2d 529, 531 (Tenn. 1973). See *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, —, 224 S.E.2d 580, 585 (1976).

39. *Century Fed. Sav. & Loan Ass'n v. Van Glahn*, 144 N.J. Super. 48, —, 364 A.2d 558, 562 (1976).

40. *Tucker v. Pulaski Fed. Sav. & Loan Ass'n*, 481 S.W.2d 725 (Ark. 1972); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, —, 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385 (1978); *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, —, 250 N.W.2d 804, 809 (1977).

41. Some of the cases make the point that the automatic enforcement of the due-on-sale clause is inequitable. “Equity has always been the final arbiter of foreclosure proceedings and the protector of the rights of mortgagors.” Note, *Deeds of Trusts—Restraints Against Alienation-Due-on-Clause is an Unreasonable Restraint*

increasing the mortgage income of a lender.<sup>42</sup> It has been argued that this purpose may not be furthered through a clause that was designed only to protect the security of a lender.<sup>43</sup> This was the position taken in *Wellenkamp*.<sup>44</sup> Increasingly, the enforceability of the due-on-sale clause is becoming a matter of legislative concern.<sup>45</sup>

### FACTS

In 1975, Venco Partnership executed a promissory note in favor of the Occidental Savings and Loan Association in consideration of a loan of \$48,000. Occidental was given a mortgage on undeveloped land owned by Venco in Omaha, Nebraska to secure the note. The mortgage contained a due-on-sale clause.

In 1978, Venco was contemplating a sale of the secured property.<sup>46</sup> Occidental stressed to both Venco and the prospective purchaser, Midwest Crating and Packing Services (Midwest), that it would withhold its consent to any such sale unless an assumption fee of \$455.55 was paid.<sup>47</sup> Venco and Midwest consummated the sale without the permission of Occidental.

Upon learning of the sale, Occidental demanded that Midwest

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*on Alienation Absent a Showing of Protection of Mortgagee's Legitimate Interests*, 47 MISS. L.J. 331, 343 n.66 (1976).

[T]he Courts have been prone to compassion in dealing with acceleration, and readily find waiver, estoppel, lack of good faith by the mortgagee, or some other factual basis for relieving the mortgagor. In so doing, the courts have frequently extended their discretionary powers beyond the ordinary bounds of equity.

McManus, *The Enforcement of Acceleration Clauses in New York*, 8 N.Y.L.F. 466, 466 (1962). See generally Comment, *Mortgages—A Catalogue and Critique of the Role of Equity in the Enforcement of Modern-Day "Due-on-Sale" Clauses*, 26 ARK. L. REV. 485, 485-507 (1973). It has been held that accepting allegations of impairment of security at face value is in derogation of the powers of a court of equity. *Baltimore Life Ins. Co. v. Harn*, 15 Ariz. App. 78, —, 486 P.2d 190, 193 (1971).

42. 21 Cal. 3d at —, 582 P.2d at 976, 148 Cal. Rptr. at 385; *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, —, 250 N.W.2d 804, 809 (1977).

43. 21 Cal. 3d at —, 582 P.2d at 976, 148 Cal. Rptr. at 385. Not all the authorities agree, however, on this characterization of the original purpose of the due-on-sale clause. For a discussion of this issue, see Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 769 (1973).

44. 21 Cal. 3d at —, 582 P.2d at 976, 148 Cal. Rptr. at 385.

45. Some states have enacted laws restricting the use of the due-on-sale clause. See, e.g., CAL. CIV. CODE § 2924.6 (—); COLO. REV. STAT. § 38-30-165 (1973); GA. CODE ANN. § 67-3002 (1967); IOWA CODE ANN. § 535.8(c) (1946); N.M. STAT. ANN. § 48-7-13 (1978).

46. Brief for Appellants, No. 42741 at 6-7, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

47. *Id.* at 8. The fee was requested in order to increase the mortgage yield to the prevailing rate. *Id.*

pay the stipulated fee. When Midwest refused, Occidental elected to assert its rights against Venco under the due-on-sale clause. Venco declined to pay the full amount due on the loan. Occidental then initiated a mortgage foreclosure proceeding in the district court, naming Venco and Midwest as defendants.<sup>48</sup> The district court held that the disputed due-on-sale clause was fully enforceable. A decree of foreclosure was entered.<sup>49</sup>

Venco and Midwest then filed an appeal to the Nebraska Supreme Court.<sup>50</sup> Venco and Midwest argued that the due-on-sale clause constitutes an unreasonable restraint on alienation where no threat to the lender's security caused by the assumption of a mortgage is pled or proven.<sup>51</sup> They pointed out that Occidental did not allege impairment of its security at any time,<sup>52</sup> and that, in fact, Occidental seemed to view Midwest as an excellent credit risk.<sup>53</sup> It was noted that Midwest had made timely mortgage payments since assuming the mortgage.<sup>54</sup>

Occidental asserted that the "primary and true purpose" of the due-on-sale clause is to compensate lenders for the effects of rising interest rates.<sup>55</sup> It observed that Midwest was attempting to assume a mortgage bearing on interest rate at least a full percentage point below the prevailing market rate.<sup>56</sup> Occidental maintained that contractual restrictions on the assumption of long-term, fixed-interest mortgages promoted the societal interest in sound lending institutions.<sup>57</sup>

The Nebraska Supreme Court affirmed the lower court decision holding that "a due-on-sale clause in an otherwise valid mortgage is enforceable, absent pleading and proof by the mortgagor that such enforcement would be inequitable."<sup>58</sup> In so doing, the court rejected the appellant's principal argument, holding simply that the record of the case did not support the conclusion "that the only purpose of the due-on-sale clause is to protect the lender's interest in the security."<sup>59</sup>

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48. *Id.* at 9.

49. *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 470, 293 N.W.2d 843, 844 (1980).

50. Brief for Appellee, No. 42741 at 10, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

51. *Id.* at 9.

52. *Id.* at 8.

53. *Id.* at 7.

54. *Id.* at 23.

55. *Id.* at 17.

56. *Id.* at 8.

57. *Id.* at 28.

58. 206 Neb. at 482, 293 N.W.2d at 850.

59. *Id.* at 478, 293 N.W.2d at 848.

## ANALYSIS

The *Occidental* court critically examined many of the diverse arguments that had been advanced in the prior cases. It began by questioning the familiar premise that the due-on-sale clause should be analyzed as a restraint on alienation.<sup>60</sup> Noting that due-on-sales clauses do not fit within any of the classic categories of restraints,<sup>61</sup> the court held that they "are not direct restraints on alienation within the meaning of the law."<sup>62</sup>

The court next considered the appellant's chief argument, that the due-on-sale clause constitutes an unreasonable indirect or practical restraint on alienation.<sup>63</sup> This contention posed a more difficult problem for the court in light of its previous holding in *Cast v. National Bank of Commerce* that "[a]ny provision in . . . [a] legal instrument which, if valid, would tend to impair the marketability of property, is a restraint on alienation."<sup>64</sup>

The *Occidental* court impliedly overruled the authority of *Cast*, characterizing some of the language in that case as "overly broad."<sup>65</sup> While conceding that an acceleration provision might sometimes inhibit the transfer of property, it stated flatly that "not every impediment to a sale is a restraint on alienation, let alone contrary to public policy."<sup>66</sup> The court seemed to regard the whole area of practical or indirect restraints as rife with confusion. It pointed out that the law has traditionally upheld restrictions that, in some way, impair the marketability of property.<sup>67</sup> The crucial flaw in the concept of practical inalienability, in the court's view, was that it did not provide a "framework within which a court could operate."<sup>68</sup>

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60. *Id.* at 471, 293 N.W.2d at 845. Most courts assume that the due-on-sale clause is a restraint on alienation. *ABA Report, supra* note 10, at 898.

61. 206 Neb. at 472, 293 N.W.2d at 845. There are three types of direct restraints:

(1) A restraint of alienation . . . is 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 one who makes the latter conveyance when such liability results from a breach of an agreement not to convey; or

(c) to terminate or subject to termination all or a part of the property interest conveyed.

4 RESTATEMENT OF PROPERTY § 404 (1944). These are respectively known as disabling, promissory and forfeiture restraints. *Id.*

62. 206 Neb. at 473, 293 N.W.2d at 845-6.

63. *Id.* at 473, 293 N.W.2d at 846.

64. 186 Neb. 385, 391, 183 N.W.2d 485, 490 (1971).

65. 206 Neb. at 473, 293 N.W.2d at 846.

66. *Id.* at 473, 293 N.W.2d at 845.

67. *See id.* at 473, 293 N.W.2d at 845.

68. *Id.* at 474, 293 N.W.2d at 846.

The tone of the court's opinion was distinctly hostile to the *Wellenkamp* decision.<sup>69</sup> The court in *Wellenkamp* postulated a situation where "money is 'tight' and funds available for real estate loans are in short supply . . . [or where] interest rates and the transactional costs of obtaining new financing are high. . . ."<sup>70</sup> It noted that in these circumstances the exercise of the due-on-sale clause might preclude the only alternative open to a buyer—the assumption of a low-interest mortgage.<sup>71</sup> The court also observed that a lender's threatened use of the due-on-sale clause to secure a higher rate of interest might cause a potential buyer to insist upon a reduced purchase price from the mortgagor.<sup>72</sup> This would force the mortgagor to either lower the selling price or scrap the sale entirely.<sup>73</sup> The *Wellenkamp* court implied that the inhibitory effects of the actual or threatened exercise of the due-on-sale clause in the context of the market condition it postulated amounted to a significant quantum of restraint.<sup>74</sup>

The *Occidental* court faulted *Wellenkamp* for "plac[ing] an unreasonable burden upon lenders."<sup>75</sup> Indeed, it appears that the *Wellenkamp* court was generally unsympathetic toward lenders. It characterized the vulnerability of lenders to changes in the interest rate as merely one of the "general risks inherent in every lending transaction."<sup>76</sup> By contrast, the *Occidental* court seemed to regard the interests of lenders as a central concern. Briefly, the court took the position that unless lenders are allowed flexibility to cope with variations in the interest rate, future financing for pro-

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69. See 206 Neb. at 477, 293 N.W.2d at 847.

70. 21 Cal. 3d at —, 582 P.2d at 974, 148 Cal. Rptr. at 383.

71. *Id.*

72. 21 Cal. 3d at —, 582 P.2d at 975, 148 Cal. Rptr. at 384.

73. *Id.*

74. Quantum of restraint is a term that was coined by the California Supreme Court in *Tuckerit v. Lassen Sav. & Loan Ass'n.*, 12 Cal. 3d 629, —, 526 P.2d 1164, 1173, 116 Cal. Rptr. 633, 637 (1974). The *Tucker* court weighed the quantum of restraint generated by the due-on-sale clause against the asserted justifications for the clause. *Id.* The *Wellenkamp* court stated that if "[the] automatic exercise of the [due-on-sale] clause . . . results in little, if any, restraint on alienation, we need not reach the question whether there exists justification sufficient to warrant enforcement." 21 Cal. 3d at —, 582 P.2d at 974, 148 Cal. Rptr. at 383. It is worth noting that in *Tucker*, the court pointed out that the quantum of restraint would be less severe in case of an outright sale by the mortgagor because he "normally receives enough money through the financing of the second sale to pay off his note. . . ." The court said, on the other hand, in an installment sale situation, the mortgagor typically receives a down payment that is not large enough to permit him to pay off his indebtedness. 12 Cal. 3d at —, 526 P.2d at 1174, 116 Cal. Rptr. at 638. This distinction did not survive *Wellenkamp*. G. OSBORNE, *supra* note 2, at 301. The *Occidental* court did not comment on this distinction.

75. 206 Neb. at 477, 293 N.W.2d at 874.

76. 21 Cal. 3d at —, 582 P.2d at 976, 148 Cal. Rptr. at 385.

spective buyers of encumbered and unencumbered property alike will be jeopardized.<sup>77</sup>

Due-on-sale clauses, as noted above, are used to soften the impact of rising interest rates upon real estate lenders.<sup>78</sup> In the case of savings and loan associations, the prime dispensers of residential loans in the United States,<sup>79</sup> this purpose is especially important.<sup>80</sup> The assets of these institutions are, in the main, invested in long-term, fixed-interest mortgages;<sup>81</sup> the money needed to finance these mortgages is obtained on a short-term basis from depositors.<sup>82</sup> When the interest rate rises, a savings and loan association must pay more to its depositors to remain competitive while it continues to receive a fixed rate of return on long-term obligations.<sup>83</sup>

The *Occidental* court suggested that any assessment of the due-on-sale clause must include a careful consideration of the plight of savings and loan associations.<sup>84</sup> It observed that the due-on-sale clause contributes to the "survival of lending associations" by helping these institutions narrow the gap between their mortgage yield and interest expense.<sup>85</sup>

The court's reasoning seemingly evidences a concern for the financing needs of buyers generally as opposed to the interest of those who wish to assume existing mortgages. It is submitted that this emphasis marks the essential difference between *Occidental* and *Wellenkamp*.

Savings and loan associations have responded to inflationary pressures by charging a higher rate of interest on some new loans.<sup>86</sup> This practice is likely to become more common if the use

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77. See 206 Neb. at 477-48, 293 N.W.2d at 847-48.

78. See notes 15-19 and accompanying text *supra*.

79. Federal National Mortgage Association, A GUIDE TO FANNIE MAE 76 (1979) [hereinafter cited as A GUIDE TO FANNIE MAE].

80. See ABA Report, *supra* note 10, at 895 n.6.

81. Comment, *Adjustable Interest Rates in Home Mortgages: A Reconsideration*, 1975 WISC. L. REV. 742, 743.

82. *Id.*

83. *Id.* at 743-44. The effect of this is to create what has been described as a "profit squeeze" on savings and loan associations. Comment, *A Case for Preemption: Wellenkamp v. Bank of America Is Inapplicable to Federal Savings and Loan Associations*, 20 SANTA CLARA L. REV. 219, 236 (1980) [hereinafter cited as *A Case for Preemption*]. A related problem facing savings and loan associations is that of disintermediation "which occurs when depositors take their money out of savings accounts and put it in higher yield investments or simply do not deposit it into savings accounts in the first place." Comment, *Variable Rate Mortgages: The Transition Phase*, 61 MARQ. L. REV. 140, 141 (1977). Government regulations limit the amount of interest savings and loan associations may pay depositors. G. OSBORNE, *supra* note 2, at 672.

84. 206 Neb. at 480, 293 N.W.2d at 849.

85. *Id.*

86. ABA Report, *supra* note 10, at 896 n.6.

of the due-on-sale clause is restricted.<sup>87</sup> The Federal Home Loan Bank Board, the regulatory body for federal savings and loan associations,<sup>88</sup> has noted that this development "could adversely affect home buyers generally and particularly young families who are purchasing their first home—the group which ordinarily can least afford the additional expense."<sup>89</sup> Prospective buyers will be similarly disadvantaged if lenders are forced to insist upon short-term amortized loans<sup>90</sup> as a hedge against inflation.<sup>91</sup>

Strict limitations on the use of the due-on-sale clause would also impair the marketability of mortgages in the secondary or resale market.<sup>92</sup> This market plays an important role "in bring[ing] lenders and borrowers together and channel[ing] housing credit from areas of lesser demand to those of greater demand."<sup>93</sup> Loans that cannot be refinanced at prevailing rates for a period of twenty-five to thirty years are unattractive to secondary purchasers.<sup>94</sup> In fact, the Federal National Mortgage Association, the largest single institutional purchaser of home mortgages on the resale market,<sup>95</sup> has restricted its purchases of mortgages in states that limit or prohibit the use of the due-on-sale clause.<sup>96</sup>

It has been suggested that the traditional fixed-interest mortgage is not well-suited to reconciling the needs of lenders and borrowers.<sup>97</sup> In recent years, lenders have increasingly turned to the variable rate mortgage to boost their portfolio yield.<sup>98</sup> This type of mortgage provides that the "[interest] rate may be adjusted over the course of what is otherwise a normal twenty-five or thirty-year mortgage according to an index of the lender's cost of funds."<sup>99</sup> The variable rate mortgage offers two prime advantages to borrow-

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87. Knox, *The Due-on-Clause: A Preemption Controversy*, 10 LOY. L.A. L. REV. 628, 640 (1977).

88. 12 U.S.C. § 1464(a) (1976).

89. 41 FED. REG. 30 (1976).

90. This type of loan "involves a higher down payment with the lower beginning balance to be paid off in higher installments over a relatively short period of time." Knox, *supra* note 87, at 639 n.63.

91. *Malouff v. Midland Federal Sav. & Loan Ass'n*, 181 Colo. 294, —, 509 P.2d 1240, 1245 (1973).

92. Comment, *A Case for Preemption*, *supra* note 83, at 237 n.84.

93. A GUIDE TO FANNIE MAE, *supra* note 79, at 7.

94. Knox, *supra* note 87, at 638.

95. Wall St. J., Oct. 24, 1980, at 17, col. 3.

96. *Id.* The association requires that conventional mortgages it agrees to buy in these states be callable after seven years. *Id.*

97. See G. OSBORNE, *supra* note 2, at 670-674.

98. G. OSBORNE, *supra* note 2, at 677. The variable rate mortgage made its first appearance in 1975 in California. Kanner, *Financing Ideas*, 9 REAL EST. L.J. 55, 56 (1980).

99. Kanner, *supra* note 98, at 56.

ers.<sup>100</sup> First, it permits existing mortgagors to share the benefits of a decrease in the cost of money.<sup>101</sup> Second, it allows increases in the cost of money to be "absorbed on a pro-rata basis by both the existing and new mortgages."<sup>102</sup>

In *Occidental*, the court suggested that the concept of practical or indirect inalienability, as applied in *Wellenkamp*, can be read so as to strike down alternative mortgage concepts such as the variable rate mortgage.<sup>103</sup> It pointed out that property which is not subject to a long-term fixed interest mortgage will presumably always be unattractive to some buyers.<sup>104</sup> The court raised the specter that "[i]f any market hindrance imposed by the lender can be held to be a practical restraint on alienation . . . no solution to varying market conditions can ever be validated and, ultimately, no one will be able to secure satisfactory financing."<sup>105</sup>

### CONCLUSION

The Nebraska Supreme Court's decision in *Occidental* represents a fair balancing of the interests of lenders and borrowers. The benefits of long-term, fixed-interest loans are still available to mortgagors as long as they retain ownership of the security. The due-on-sale clause works to ensure an ample supply of lendable funds by helping to keep the mortgage income of lenders in line with their cost of borrowing. The brunt of strict limitations on the use of the due-on-sale clause will be felt most keenly by those who seek credit to buy homes in the future.

It seems unlikely that the enforceability of the due-on-sale clause in Nebraska will be seriously questioned in the years to come. The Federal Home Loan Bank Board promulgated a regulation, effective July 31, 1976, explicitly sanctioning the use of the due-on-sale clauses by federally-chartered savings and loan associations.<sup>106</sup> The Nebraska statute, section 8-355, confers upon

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100. Generally lenders have been in the forefront of the variable rate mortgage movement. Some consumer advocates have expressed serious misgivings about the concept. G. OSBORNE, *supra* note 2, at 680.

101. Comment, *Variable Rate Mortgages: The Transition Phase*, 61 MARQ. L. REV. 140, 142 (1977).

102. *Id.* "In effect this terminates any so called 'subsidy' the new mortgages may be required to provide to the already existing mortgages because of lenders' need for compensation by a yield sufficient to cover the cost of lendable funds." *Id.* at 143.

103. 206 Neb. at 477-78, 293 N.W.2d at 847-48.

104. *Id.*

105. *Id.* at 477, 293 N.W.2d at 847.

106. 12 C.F.R. § 545-6.11. The regulation was reissued in 1980 to read that a federal savings and loan association "may, as a matter of contract between it and the borrower," use the due-on-sale clause. 44 Fed. Reg. 39129(f).

state savings and loan associations "all the rights, powers, privileges, benefits and immunities which may be exercised as of July 19, 1980 by a federal savings and loan association doing business in Nebraska."

*Morris O. Pasqual, Jr.—'81*