



# Arizona Mortgage Deficiency Law 2012 Update

By: Larry O. Folks, Esq., Folks & O'Connor, PLLC

Arizona's mortgage deficiency statutes located at A.R.S. §33-729, §33-814 and §12-1566 and the case law interpreting them are complex. This article includes a checklist of items to be considered to determine whether a mortgage lender has the right to obtain a mortgage deficiency judgment against a borrower or guarantor of a loan secured by real property pursuant to applicable Arizona law subsequent to:

- ◆ An administrative non-judicial trustee's foreclosure sale of the subject property ("Trustee's Sale");
- ◆ A judicial foreclosure lawsuit upon the subject property ("Judicial Foreclosure"); or
- ◆ A lawsuit upon the remaining unsecured promissory note and/or guaranty obligation following the closing of a short-sale pursuant to which the mortgage lender releases its mortgage lien upon the subject property in exchange for receipt of funds in an amount less than the loan balance, but does not waive its deficiency rights ("Short-Sale").

The content of this article is not intended to address every possible scenario, nor the rapidly emerging nuances, of Arizona mortgage deficiency law. Also, the term mortgage is used herein with the understanding that the vast majority of mortgage liens in Arizona are evidenced by recorded deeds of trust. Furthermore, this article should not be used as a substitute for conducting current legal research.

## STEP 1

### DETERMINE WHETHER THE MORTGAGE LOAN IS "PURCHASE MONEY" VS.

#### "NON-PURCHASE MONEY"

- ◆ A loan is a purchase money obligation if it secures a mortgage given to secure the payment of the balance of the purchase price, or to secure payment of all or part of the purchase price of the subject real property.
- ◆ A mortgage loan secured by a borrower's residence is not a purchase money loan if the proceeds of the loan are used to purchase a different residence such as a vacation home.
- ◆ Home equity loans that are not 80/20 loans typically are non-purchase money loans.
- ◆ A construction loan is a purchase money obligation if the proceeds of the loan are used to build a residence protected by the Arizona "anti-deficiency" statute if: (i) the deed of trust securing the loan covers the land *and* the dwelling constructed thereon; and (ii) the loan proceeds were in fact used to construct the residence.
- ◆ Refinancing a purchase money obligation by the original, or a new, mortgage lender does not in and of itself convert the nature of the obligation to non-purchase money.
- ◆ A mortgage lender may obtain a deficiency judgment for the *non-purchase money portion* of a mortgage loan in a judicial foreclosure and likely in other types of deficiency lawsuits. This remedy is typically available concerning a "cash out" refinance loan of the original purchase money loan which

results in the borrower receiving funds in excess of the original loan balance from the refinance loan proceeds.

## STEP 2 DETERMINE WHETHER THE REAL PROPERTY WHICH SECURES THE LOAN FITS WITHIN THE STATUTORY DEFINITION OF A “QUALIFIED PROPERTY” PROTECTED BY THE ARIZONA “ANTI-DEFICIENCY” STATUTES

- ◆ *First, evaluate the physical characteristics of the real property which secures the mortgage loan:*
  - A “**Qualified Property**” protected by Arizona’s “**anti-deficiency**” statutes means **real property of 2.5 acres or less and that is limited to and utilized as a single one-family or single two-family dwelling.** Real Property, regardless of its use, located on more than 2.5 acres of land is not a Qualified Property. Four single-family condo units, which are not a single one-family or single two-family dwelling, are not a Qualified Property.
- ◆ *Second, evaluate the type of borrower and their intent concerning the use of the real property which secures the mortgage loan to determine if the property is being “utilized” as a single one-family or single two-family dwelling.*
- ◆ A fully constructed single-family condominium owned by *investment borrowers* who occasionally occupied and rented it out is “utilized” by the borrowers as a single one-family dwelling and, as such, the condominium is a Qualified Property.
- ◆ A partially constructed single-family residence owned by *consumer “homeowner” borrowers who intend to occupy* the residence upon its completion is “utilized” by the borrowers as a single one-family dwelling and, as such, the partially constructed residence is a Qualified Property.
- ◆ A partially constructed single-family residence owned by a *commercial builder developer borrower* who is holding the residence for eventual sale to its first occupant and *does not intend to occupy* the residence is *not* “utilized” as a single one-family dwelling and, as such, the partially constructed residence is *not* a Qualified Property.

## STEP 3 DETERMINE WHICH OF THE FOUR GENERAL RULES LISTED BELOW APPLY TO THE MORTGAGE LOAN TO BE SUED UPON BY THE MORTGAGE LENDER

### RULE #1 PURCHASE MONEY LOAN + SECURED BY A QUALIFIED PROPERTY

- ◆ Trustee’s Sale: **NO DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.** Note that only deeds of trust may be foreclosed through a Trustee’s Sale.
- ◆ Judicial Foreclosure: **NO DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Short Sale: **NO DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER— the mortgage lender cannot elect the remedy to voluntarily release/waive the mortgage lien on the real property collateral and sue the borrower directly on the unsecured note.**
- ◆ Mortgage lender should presumptively assume that any guarantor of the mortgage loan will receive the same “anti-deficiency” protection against a deficiency judgment as the borrower. Certain contractual waivers included in guaranties, however, are enforceable under Arizona law. Although there is no reported decision, active litigation over the enforceability of guaranty waivers of the “fair market value” credit and protection of the entire “anti-deficiency” statute is taking place at this time in Arizona.
- ◆ An example of when Rule #1 applies is if a mortgage lender has made a loan to a borrower that is used to purchase a single-family residence located on 2.5 acres or less.

### RULE #2 PURCHASE MONEY LOAN + SECURED BY A NON-QUALIFIED PROPERTY

- ◆ Trustee’s Sale: **DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER. A mortgage deficiency lawsuit must be filed within**

**90 calendar days after the date of the Trustee's Sale. The 90-day statutory deadline after the date of the Trustee's Sale is an absolute bar against filing a mortgage deficiency lawsuit after that date.**

- ◆ **Judicial Foreclosure: DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ **Short Sale: DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Mortgage lender can obtain a deficiency judgment against a guarantor of the loan based upon the independent guaranty contract.
- ◆ An example of when Rule #2 applies is if a mortgage lender has made a loan to a borrower used to purchase real property used for any non-residential purpose (such as an office building, restaurant or other business purpose).

the loan is located on 2.5 acres or less and is "utilized" as a single one-family or a single two-family dwelling.

## **RULE #3**

### **NON-PURCHASE MONEY LOAN + SECURED BY A QUALIFIED PROPERTY**

- ◆ **Trustee's Sale: NO DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ **Judicial Foreclosure: DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ **Short Sale: DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Mortgage lender should presumptively assume that any guarantor of the mortgage loan will receive the same "anti-deficiency" protection against a deficiency judgment as the borrower. Certain contractual waivers included in guaranties, however, are enforceable under Arizona law. Although there is no reported decision, active litigation over the enforceability of guaranty waivers of the "fair market value" credit and protection of the entire "anti-deficiency" statute is taking place at this time in Arizona.
- ◆ An example of when Rule #3 applies is if a mortgage lender has made a non-purchase money loan to a borrower and the real property securing

◆ **NOTE SPECIAL EXCEPTION:** If a mortgage lender holds a non-purchase money promissory note and junior deed of trust lien upon a Qualified Property and a senior lien holder completes a Trustee's Sale of the property to extinguish the mortgage lender's junior lien, then the mortgage lender can sue the borrower and/or guarantor upon the remaining unsecured promissory note and/or guaranty for a deficiency. This exception applies even if the same mortgage lender holds both the senior promissory note and deed of trust lien foreclosed upon and the junior promissory note and/or guaranty and deed of trust lien extinguished by the senior lien Trustee's Sale. In addition, the junior mortgage lender may apply for any excess foreclosure sale proceeds that result from the senior lien holder's Trustee's Sale, apply them against the junior loan balance and still sue the borrower for deficiency judgment.

Furthermore, the 90-day limitations period does not apply to this type of suit, because it is technically a suit on the junior promissory note and not a deficiency lawsuit under the foreclosure statute.

restaurant or other business purpose).

## **RULE #4**

### **NON-PURCHASE MONEY LOAN + SECURED BY A NON-QUALIFIED PROPERTY**

- ◆ Trustee's Sale: **DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Judicial Foreclosure: **DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Short Sale: **DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- ◆ Mortgage lender can obtain a deficiency judgment against a guarantor based upon the independent guaranty contract.
- ◆ An example of when Rule #4 applies is if a mortgage lender has made a non-purchase money loan to a borrower and the real property securing the loan is a real property used for a non-residential purpose (such as an office building,

## STEP 4

### CONSIDER THE "FAIR MARKET VALUE" LIMITATION OF ANY DEFICIENCY

#### JUDGMENT OBTAINED BY THE MORTGAGE LENDER

- ◆ Any deficiency following a Trustee's Sale or a Judicial Foreclosure permitted against either a borrower, or a guarantor, is subject to a "fair market value" limitation. In particular, the deficiency amount is calculated as the difference between the loan balance due on the date of the foreclosure sale less the greater of the foreclosure sale price or the "fair market value" of the property on the date of the sale.

## MISCELLANEOUS MATTERS

There is no statutory right of "redemption" following a Trustee's Sale.

Any judgment debtor, or their successor-in-interest, in a Judicial Foreclosure is granted a statutory right of "redemption" which allows them to recover title to the subject property for a judicially determined period of time of either 30 days, or six months, after the date of the Sheriff's sale of the property. To "redeem" the property, the judgment debtor must pay the purchase price at the Sheriff's sale, 8 percent interest accrued thereon and certain taxes and assessments. In addition, each judgment debtor is granted the right to apply to the Court for a "fair market value" determination within 30 days after the Sheriff's sale of the property. When any one judgment debtor applies for a "fair market value" determination, the right to "redeem" the property is extinguished as to all judgment debtors.

An arbitration clause included in a promissory note is enforceable to compel arbitration of a mortgage deficiency action.

## CONCLUSION

The vast majority of residential foreclosures currently pending in Arizona concern Trustee's Sales related to loans secured by deeds of trust upon single-family residences located on 2.5 acres or less. In such cases, if the mortgage lender completes the Trustee's Sale, it may not obtain a deficiency judgment against the borrower.

Despite the foregoing, as illustrated by the rules above, there are many instances in which a mortgage lender may pursue collection of a deficiency balance from a borrower, or guarantor, subsequent to a Trustee's Sale, Judicial Foreclosure or Short Sale. In such cases, if the mortgage lender completes a Trustee's Sale, it must file the deficiency lawsuit against the borrower and any guarantors for a deficiency judgment against within 90 days after the date of the foreclosure sale. This limitations period is a strictly enforced absolute bar date for filing a mortgage deficiency lawsuit following a Trustee's Sale.

Three useful resources to assist in understanding the scope and applicability of the Arizona mortgage deficiency statutes are: (i) the *Ins And Outs Of Foreclosures*, Third Edition 2010, available for purchase from the State Bar of Arizona; (ii) an article published in the *Arizona Attorney* titled *Arizona's Deficiency Laws: When Is A Deficiency Judgment Available And How Is One Obtained?*, 28-APR Ariz. Att'y 23 (April 1992); and (iii) a Comment article titled *Arizona's Anti-Deficiency Statutes: Ensuring Consumer Protection In A Foreclosure Crisis*, published in the *Arizona State Law Journal* Fall 2010, 42 Ariz. St. L.J. 1019 (2010).



Folks & O'Connor, PLLC represents many of the major banks located in the Southwest and other lenders concerning a broad range of legal services concerning loan workout, bankruptcy, collection, foreclosure, mortgage deficiency and other creditors' rights litigation cases.

If you have any questions concerning the content hereof, or if Folks & O'Connor, PLLC may assist you, please contact Larry Folks, Esq. at Folks & O'Connor, PLLC, Suite 1140, 1850 North Central Avenue, Phoenix, Arizona 85004, telephone (602) 262-2265, direct line (602) 256-5906, facsimile (602) 256-9101 or [folks@folksconnor.com](mailto:folks@folksconnor.com).