ARIZONA DEFICIENCY LAW UPDATES:

OR

LET'S GET READY TO RUMBLE!

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I. INTRODUCTION.

Historically the anti-deficiency statutes as interpreted by the Arizona courts have for the most part been favorable to the borrowers, because the laws are for consumer protection. However, the past decade or so has seen the tide shift mostly in favor of the lenders. In 2020, however, the Arizona Supreme Court did confirm the parameters under which a borrower under a refinanced residential construction loan is entitled to anti-deficiency protection. *Helvetica v. Pasquan*, 249 Ariz. 349 (2020) ("*Helvetica V"*) (discussed below on page 11).

The Arizona decisions of *Parkway Bank v. Zivkovic*, 232 Ariz. 286, 304 P.3d 1109 (App. 2013), *CSA 13-101 Loop, LLC v. Loop 101*, LLC, 233 Ariz. 355, 312 P.3d 1121 (App. 2013), *Arizona Bank & Trust v. James R. Barrons Trust*, 237 Ariz. 401, 351 P.3d 1099 (App. 2015), and *Great Western Bank v. LJC Dev., LLC,* 238 Ariz. 470, 362 P.3d 1037 (App. 2015) represent the most recent additions to the collection of cases attempting to bring clarity to Arizona's law as it relates to guarantors. In addition, the California decision of *California Bank & Trust v. Del Ponti, 232 Cal.App.4th 162* (Ct. App. 2014) may reveal a possible future application of Arizona's anti-deficiency law as it relates to guarantors.

II. ARIZONA'S MORTGAGE AND DEED OF TRUST STATUTES.

A. The Mortgage. A mortgage is a two-party instrument which is basically a pledge of real property given by a borrower (mortgagor) to a lender (mortgagee) to secure a loan. A mortgage is not a debt, rather it is security for the performance of another act, usually the repayment of a promissory note. Arizona follows the "lien theory" rule, which provides that a mortgage is not a conveyance, rather the mortgage merely creates a lien in favor of the mortgagee. Therefore, neither legal nor equitable title passes to the lender upon the creation of a mortgage.

B. The Deed of Trust. A deed of trust is a three-party instrument by which the borrower conveys legal title to the property to the trustee. The trustee holds legal title to the property on behalf of the lender, who is the "beneficiary" of the deed of trust. The beneficiary's remedies under the deed of trust include those available to the mortgagee, but also give the trustee a non-judicial private power of sale (better known as a trustee's sale) not available with mortgages.

Since the adoption of the Arizona deed of trust statutes (A.R.S. §33-801 et seq.) in 1971, the deed of trust has replaced the mortgage as the principal real property security interest used in Arizona. There are two principal reasons why the deed of trust has become more popular: (1) a lender may foreclose without filing a lawsuit; and (2) the borrower has no right to a redemption after the trustee's sale.

C. Enforcement of the Security After Default. Because the mortgage itself is not a debt, the mortgagee may release the security interest under the mortgage without losing the mortgagee's right to bring an action on the original indebtedness which was secured by the mortgage. If a mortgagee chooses to enforce the security, the mortgage must be foreclosed by judicial sale, in which case the security is sold by court order.

The beneficiary under a deed of trust may enforce the security by either (1) foreclosing upon the property as a mortgage (by judicial sale); or (2) having the trustee exercise its private power of sale (trustee's sale). The trustee's sale is often preferred by lenders because it provides a quicker and less expensive remedy than judicial foreclosure, and may be completed as soon as ninety-one days after formal notice of the sale is recorded and sent to the proper parties. A trustee's sale cannot be held after a judicial action to foreclose the deed of trust has been filed unless the foreclosure action is first dismissed.

D. The Deficiency Judgment. If the proceeds of the foreclosure sale of the property secured by a mortgage or deed of trust are insufficient to pay the full loan balance, the mortgagee or beneficiary may be entitled to a personal judgment against the debtor for the amount of the debt minus the foreclosure sale price or fair market value of the property, whichever is greater. This remedy following the foreclosure sale is called a deficiency judgment, and is authorized under A.R.S. §33-725 (mortgages) and §33-814 (deeds of trust).

E. General Rule: Lender Must Elect Remedy. In Arizona, the lender cannot maintain a foreclosure and a separate action on the debt simultaneously. This rule is embodied in A.R.S. §33-722 which allows the mortgagee to either sue directly on the debt, thereby waiving the mortgage, or foreclose the mortgage. Although there is no clear authority with regard to deeds of trust, the accepted practice is that the beneficiary may also elect to sue on the note or foreclose, either judicially or by trustee's sale.

III. ARIZONA'S ANTI-DEFICIENCY STATUTES.

Although historically the lender has the right to obtain a deficiency judgment, the Arizona legislature enacted two anti-deficiency statutes in 1971 barring the right of certain beneficiaries (lenders taking a deed of trust as security), and certain purchase money mortgagees (lenders taking a purchase money mortgage as security) to obtain deficiency judgments where the security does not exceed two and one-half acres, and is used as either a one-family or single two-family dwelling. The statutes do not protect purchasers of commercial properties, tri-plexes, four-plexes, and apartments with more than two units. Both anti-deficiency statutes expressly limit the recovery available to the lender who initiates foreclosure, but do not specifically bar the right of the lender to waive the security of the mortgage or deed of trust and sue the home owner directly on the debt.

The anti-deficiency statute for mortgages applies only to "purchase money" mortgages, which are mortgages given concurrently with a conveyance of real property between the seller and

the buyer or given to secure a loan to pay all or part of the purchase price of the real property. A.R.S. §33-729(A) states as follows:

> A. Except as provided in subsection B, if a mortgage is given to secure the payment of the balance of the purchase price, or to secure a loan to pay all or part of the purchase price, of a parcel of real property of two and one-half acres or less which is limited to and utilized for either a single one-family or single two-family dwelling, the lien of judgment in an action to foreclose such mortgage shall not extend to any other property of the judgment debtor, nor may general execution be issued against the judgment debtor to enforce such judgment, and if the proceeds of the mortgaged real property sold under special execution are insufficient to satisfy the judgment, the judgment may not otherwise be satisfied out of other property of the judgment debtor, notwithstanding any agreement to the contrary.

The deed of trust anti-deficiency statute is not limited to "purchase money" deeds of trust, and applies to all deeds of trust securing a residence not exceeding two and one-half acres. A.R.S. §33-814(G) reads as follows:

> G. If trust property of two and one-half acres or less which is limited to and utilized for either a single one-family or a single two-family dwelling is sold pursuant to the trustee's power of sale, no action may be maintained to recover any difference between the amount obtained by sale and the amount of the indebtedness and any interest, costs and expenses.

Arizona's election of remedies statute (A.R.S. §33-722) generally allows the lender to either sue directly on the debt, thereby waiving the security, or to foreclose on the mortgage or deed of trust. The anti-deficiency statutes, which were enacted after the election statute, seem to conflict with the election statute to the extent that the election statute gives the lender the option to sue directly on the note, whereas the anti-deficiency statutes show a legislative intent to protect residential borrowers against any personal liability. Presumably, the lender would prefer to waive the security and sue on the debt any time it appears that the indebtedness would exceed the foreclosure price, at least where the debtor has sufficient assets to enable the lender to collect upon the judgment.

IV. *BAKER v. GARDNER (1988)* - ARIZONA SUPREME COURT HOLDS THAT THE ANTI-DEFICIENCY STATUTES PROHIBIT A LAWSUIT DIRECTLY ON THE NOTE WHERE A DEFICIENCY IS BARRED . . . (MORE OR LESS).

In the landmark decision entitled *Baker v. Gardner*[1], decided December 20, 1988, the Arizona Supreme Court held that Arizona's anti-deficiency statutes prohibit a lienholder from suing a homeowner who has borrowed money on those types of loans protected by the anti-deficiency statutes. The Court held that a lender's only recourse against such residential debtors is foreclosure of the property, thereby abolishing any personal liability of such homeowners.

The 4-1 *Baker* decision finally settled the controversy that had existed between lenders and homeowners since the anti-deficiency statutes were enacted in 1971. Residential lenders had long asserted that the anti-deficiency statutes prohibited only a suit for a deficiency judgment following foreclosure, and that regardless of whether the deed of trust or mortgage secures residential property, the holder of the promissory note may always elect to waive the security and bring an action on the debt. This method would allow the lender to hold the debtor liable for the entire unpaid balance of the note. The Arizona Supreme Court, however, disagreed with the position taken by such lenders and ruled that the allowance of a suit on the promissory note would circumvent the legislature's objective in enacting the anti-deficiency statutes. In support of its decision, the court looked to California and North Carolina case law which had interpreted statutes similar to Arizona's anti-deficiency statutes, wherein such statutes were held to prohibit the lender from waiving the security and suing on the note.

The real importance of *Baker* is contained in the court's supplemental opinion filed March 20, 1989, wherein the court limited its earlier opinion to "purchase money" mortgages and deeds of trust. The purchase money limitation thus authorized suit directly on the note for home equity

1 *Baker v. Gardner*, 160 Ariz. 98, 770 P.2d 766 (1988).

loans, home improvement loans, and similar non-purchase money financing secured by a mortgage or deed of trust on a residence. The court reasoned that because a lender could treat a deed of trust like a mortgage, a deed of trust borrower should only protected against a suit on the note if the loan is "purchase money." This particular limitation only affects the lender's ability to sue directly on the note, and does not change the fact that any residential deed of trust holder who brings a trustee's sale is prohibited from seeking a deficiency judgment. If the deed of trust lender (the beneficiary) desires to seek a deficiency, it must bring a judicial foreclosure, in which case a deficiency is permitted for non-purchase money loans.

The end result of *Baker* is that a lender who takes a mortgage or deed of trust to secure all or part of the purchase price of a home may only take the residence back. Because the two anti-deficiency statutes are different with regard to requiring that the loan be purchase money, much confusion has been created by the Baker decision. Here is a general summary of the aftermath of Baker:

With regard to residential <u>deeds of trust</u>, the following rules apply:

(1) If the loan is "purchase money," the lender cannot sue on the note, nor can the lender seek a deficiency after any foreclosure (including trustee's sale or judicial foreclosure). A "purchase money" beneficiary who is wiped out by a senior lienholder's foreclosure is precluded from suing on the note;

(2) If the loan is not "purchase money," the lender is nonetheless prohibited from seeking a deficiency after holding a trustee's sale, but the lender may seek a deficiency after a judicial foreclosure of the deed of trust; and

(3) If the loan is not "purchase money," the lender may elect to sue directly on the note. The law remains unclear as to when a junior lender who has not been wiped out must waive its security to sue on the note.

With regard to residential <u>mortgages</u>, the following rules apply:

(1) If the loan is "purchase money," the lender cannot sue on the note, nor can the lender seek a deficiency after foreclosure. A "purchase money" mortgagee who is wiped out by a senior lienholder's foreclosure is still precluded from suing on the note; and

(2) If the loan is not "purchase money," the lender may seek a deficiency after judicial foreclosure (which is the only type of foreclosure available under a mortgage) or the lender may elect to waive the mortgage or sue directly on the note.

V. ARIZONA CASE LAW AFTER *BAKER v. GARDNER*.

A. The Anti-Deficiency Statutes Protect Developers, But Only if the Property is Actually Utilized as a Home.

In January, 1991, the Arizona Supreme Court held in *Mid-Kansas v. Dynamic*[2] that Arizona's anti-deficiency statutes did not protect a developer where the homes were still under construction and the homes had never been "utilized" for a dwelling. In that case Dynamic had obtained financing from Mid-Kansas to construct ten "spec" homes. After six of the homes were sold and released, Mid-Kansas held a trustee's sale on the remaining four homes, none of which had been fully completed.

Although the Arizona Supreme Court recognized that the anti-deficiency statutes were designed to protect consumers, the court found that the anti-deficiency statutes do protect residential developers. The court held, however, that under the facts of the case, Dynamic was not entitled to anti-deficiency protection because A.R.S. §33-814(G) requires the property to be "limited to" and "utilized for" a single one-family or two-family dwelling.

B. The Refinance of Purchase Money Loan Remains Purchase Money.

The court in *Bank One v. Beauvais*[3] held that the character of a purchase money obligation is not changed when it is refinanced and the "deed of trust on the property that was bought with the original loan continues or is renewed."[4] "Renew" can mean "to replace" or "to begin again." Black's Law Dictionary 1296 (6th ed. 1990). Section 33–729(A) does not mandate that the lender

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2 *Mid Kansas Fed. Sav. & Loan Ass'n of Wichita v. Dynamic Dev. Corp*., 167 Ariz. 122, 804 P.2d 1310 (1991).
3 *Bank One, Arizona, N.A. v. Beauvais*, 188 Ariz. 245, 934 P.2d 809 (App. 1997)
4 *Id*. at 250, 934 P.2d at 814

remain the same or that the deed of trust of record at the time of foreclosure be the same one recorded when the property was purchased. The statute instead accords protection if a mortgage is "given to secure the payment of the balance of the purchase price, or to secure a loan to pay all or part of the purchase price." In *Helvetica Servicing, Inc. v. Pasquan*[5], the Arizona Court of Appeals held that a construction loan qualifies as a purchase money obligation where the loan proceeds were in fact used to construct a residence that meets the size and use requirements set forth in A.R.S. § 33–729(A). The court also held that the refinancing of a purchase money loan did not change its character and the anti-deficiency protections still applied. *Id.* ¶ 23 *(citing Beauvais*, 188 Ariz. at 250).

C. "Purchase Money" Means a Loan Secured by a Qualifying Residence Must be Used to Buy That Residence.

In *Cely v. Deconcini*, et. al.[6], the Arizona Court of Appeals held that where a first home is mortgaged to secure the purchase price of a second home, the mortgage on the first home is not a "purchase money" security interest, and thus the borrower is not entitled to the protection of the anti-deficiency statutes. More importantly, the court also held that the mere fact that a subsequent purchaser of the first home assumed the loan in his purchase of the home, did not make "non-purchase money" mortgage a "purchase money" mortgage. That is, the character of the loan is not changed by the new home buyer's assumption of the loan, and if the borrower under the original loan was not entitled to protection, neither were persons assuming the loan.

D. A Dwelling Does Not have to be the Primary Residence.

In *Northern Arizona Properties v. Pinetop Properties Group*[7], the Arizona Court of Appeals held that the exemption from deficiency judgment for single one or two-family "dwellings" did not require that dwelling constitute someone's permanent residence or normal

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5 *Helvetica Servicing, Inc. v. Pasquan*, 229 Ariz. 493, 277 P.3d 198 (App. 2012) ("Helvetica I").
6 *Cely v. DeConcini, McDonald, Brammer, Yetwin & Lacy, P.C.*, 166 Ariz. 500, 803 P.2d 911 (App. 1990).
7 *N. Arizona Properties v. Pinetop Properties Grp*., 151 Ariz. 9, 725 P.2d 501 (App. 1986); *see Tanque Verde Anesthesiologists v. Proffer Group*, 172 Ariz. 311, 836 P.2d 1021 (App. 1992) (court noted that anti-deficiency statutes apply where loan was used to acquire properties for repair and resale).

place of abode and did not preclude investment use. In *Northern Arizona Properties*, the seller of a residential condominium judicially foreclosed its carry-back deed of trust and sought a deficiency judgment. The borrower was a general partnership, and while some partners personally used the condo, the condominium was rented out to third parties. The seller argued that the word "dwelling" as used in A.R.S. § 33-729(A) should be defined as a permanent residence not held for investment. The Arizona Court of Appeals disagreed with the lender and held that the statute also protected investors, and thus a deficiency judgment was prohibited.[i] This decision was later affirmed by the Arizona Supreme Court in the *Mid-Kansas* case (1991), discussed above.

E. Certain Construction Loans are Purchase Money

In *Helvetica Servicing, Inc. v. Pasquan*[8], the Arizona Court of Appeals held that a construction loan qualifies as a purchase money obligation if: (1) the deed of trust securing the loan covers the land and the dwelling constructed thereon; and (2) the loan proceeds were in fact used to construct a residence that meets the size and use requirements set forth in A.R.S. § 33–729(A).

In *Helvetica v. Pasquan*, 249 Ariz. 349 (2020) ("*Helvetica V")* the Arizona Supreme Court essentially upheld the decision of the Court of Appeals in *Helvetica I*, and reversed and vacated the ruling of the Arizona Court of Appeals in *Helvetica v. Pasquan*, 248 Ariz. 219 (”*Helvetica IV")* which had held applied a rigid "built from scratch" rule that the anti-deficiency protections do not apply to a construction loan on a home unless it is built entirely from a vacant lot. The Arizona Supreme Court held in *Helvetica V* that the following test should apply to determine whether a residential loan is a construction loan entitled to anti-deficiency protection:

> Because determining whether a loan is a home improvement loan or a construction loan depends on a number of criteria, courts should consider the totality of the circumstances surrounding the loan. We identify five non-exclusive factors indicating whether a loan is a construction loan for purposes of anti-

8 *Helvetica Servicing, Inc. v. Pasquan*, 229 Ariz. 493, 277 P.3d 198 (App. 2012) ("*Helvetica I*").

> deficiency protection under § 33-729(A) : (1) whether there was a complete or substantially complete demolition of an existing structure and a new building constructed in its place; (2) the intent of the parties when executing the loan documents; (3) whether the structure was inhabitable or inhabited during construction; (4) whether the structure was largely preserved and improved or substantially expanded; and (5) whether the project is characterized as "home improvement" or "construction" in the loan documents and in the permits or other official documents.

F. Certain Time Share Interests are a Dwelling.

In *Independent Mortgage Company v. Alaburda*[9], the Arizona Court of Appeals held that a fractional ownership time share property was subject to the protections under Arizona's anti-deficiency law. The court explained that the exemption from deficiency judgment for single one or two-family "dwellings" is not determined by how many families pass through the residence, but on the number of families there at a time, and that the protections were not limited to only those who shared an interest in a property as tenants in common, but protected holders of any interest in the real property capable of being transferred.

G. "Dwelling" is Defined by the Borrower's Subjective Intent.

In *M & I Marshall & Ilsley Bank v. Mueller*[10], the Arizona Court of Appeals held that the identity and intent of the borrower - and not the status of construction or actual occupancy—were the relevant issues in determining whether the property has been "used as a dwelling." The court found it was dispositive that, at the time the loan was executed, the borrowers *intended* to personally occupy the land once the house was built. Their subjective intent to occupy the property sometime in the future satisfied the "dwelling" requirement of the anti-deficiency law. (It is worth noting that the borrowers in that case even admitted abandoning this intent once they discovered defective construction.) Following Mueller, it presumably makes no difference whether a house is actually finished or occupied. On the other hand, a commercial developer holding property for

9 *Indep. Mortgage Co. v. Alaburda*, 230 Ariz. 181, 281 P.3d 1049 (App. 2012), review denied (Jan. 8, 2013).
10 *M & I Marshall & Ilsley Bank v. Mueller*, 228 Ariz. 478, 268 P.3d 1135 (App. 2011).

resale necessarily has no intent to occupy the property itself—even if a house were started or even completed.

H. Unimproved Land is Not Protected by Arizona's Anti-Deficiency Statute.

The Arizona Court of Appeals restricted the Mueller's application in *BMO Harris Bank v. Wildwood Creek Ranch*. In *Wildwood Creek Ranch*[11], the court rejected the application of the anti-deficiency statute to "unimproved, vacant land," but did not overrule *Mueller*. Instead, where land is improved and no longer vacant, *Mueller's* use of the borrower's subjective intent to determine whether the property is a "dwelling" remains good law. The court in *Wildwood Creek Ranch* did not, however, provide guidance as to the facts that trial courts should consider in distinguishing "unimproved, vacant land" from property that would fall under the protections of the anti-deficiency statute; this problem was raised by the concurring opinion in *Wildwood Creek Ranch*, but remains an open question for lenders, borrowers and courts to grapple with.

I. Interest and Fees and other Costs are Purchase Money Obligations.

The Arizona Court of Appeals in *First Financial Bank v. Claassen*[12] provided clarification of some of the ambiguities created by the 2012 decision in *Helvetica.* In *Helvetica* the Court noted that there were "payments that clearly [were] not purchase money in nature, including sums for maintenance, utilities, marketing fees, and penalties." This created the ambiguity of what portions of a loan qualify as purchase money. The Claassen court held interest and late fees owed on loan for the construction of new home, as well as a mandatory construction deposit paid from loan proceeds, were purchase money obligations and, thus, fell within the protection of the anti-deficiency statute; just as a refinancing could be deemed a purchase money obligation, costs commonly associated with a loan could likewise be considered purchase money sums.

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11 *BMO Harris Bank N.A. v. Wildwood Creek Ranch, LLC*, 234 Ariz. 100, 317 P.3d 641 (App. 2014), as amended (Jan. 21, 2014)
12 *First Financial Bank, N.A.. v. Claassen*, 238 Ariz. 160, 357 P.3d 1216 (App. 2015)

J. No Waiver of Anti-Deficiency Law by Borrowers.

The Arizona Court of Appeals in *Parkway Bank v. Zivkovic*[13] resolved the issue of waiver of the protections arising under Arizona's anti-deficiency laws. The Parkway Bank court held that the anti-deficiency statutes have broad public purposes and reflect a legislative determination that lenders, rather than borrowers, should bear the risk of loans secured by overvalued property. Therefore, because the anti-deficiency statutes were established for a public purpose, they cannot be contractually waived or contravened by private agreement by a borrower.

K. Guarantors Cannot Waive the Anti-Deficiency Law Protections.

The Arizona Court of Appeals held in the *CSA 13-101 Loop, LLC v. Loop 101, LLC*[14] decision that a borrower or guarantor cannot contractually waive its statutory right to a determination of fair market value in a deficiency action following non-judicial foreclosure or sale of property under a deed of trust.

L. Guarantors Can Waive the Anti-Deficiency Protections in A.R.S. § 33-814.

Despite the 2013 holding in *Parkway Bank v. Zivkovic,* in 2015 the Arizona Court of Appeals held in *Arizona Bank & Trust v. James R. Barrons Trust*[15] that guarantors can contractually waive or contravene by private agreement the protections provided by the Arizona anti-deficiency law at A.R.S. § 33-814. This case raises interesting issues concerning the structure of private investor transactions.

Summary. In mid–2005, TDJ Land Investments, LLC (“TDJ”) purchased several vacant lots of real property (“Subdivision”). Arizona Bank & Trust (“AZ Bank”) financed TDJ’s purchase and development of the Subdivision with a business loan secured by a promissory note and a blanket construction deed of trust on all lots within the Subdivision. Several individuals and

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13 *Parkway Bank v. Zivkovic*, 232 Ariz. 286, 304 P.3d 1109 (App. 2013)
14 *CSA 13-101 Loop, LLC v. Loop 101, LLC,* 233 Ariz 355, 312 P.3d 1121 (App. 2013)
15 *Arizona Bank & Trust v. James R. Barrons Trust*, 237 Ariz 401, 351 P.3d 1099 (App. 2015)

entities (collectively, “Guarantors”)[2] executed written, unconditional loan guaranties, which expressly waived any protection under anti-deficiency statutes:

> Guarantor also waives any and all rights or defenses based on suretyship or impairment of collateral including, but not limited to, any rights or defenses arising by reason of (A) any “one action” or “anti-deficiency” law or any other law which may prevent [AZ Bank] from bringing any action, including a claim for deficiency, against Guarantor, before or after [AZ Bank’s] commencement or completion of any foreclosure action, either judicially or by exercise of a power of sale ... or (F) any defenses given to guarantors at law or in equity other than actual payment and performance of the indebtedness.

AZ Bank later provided TDJ two additional loans for the construction of specific homes within the Subdivision. Both loans specified that they were secured by the previously-executed guaranties. TDJ defaulted on both of these loans, and Guarantors failed to bring the loans current. AZ Bank foreclosed on the deeds of trust and purchased the loan properties at trustee’s sales with credit bids for less than the amount owed, leaving deficiency balances of several hundred thousand dollars. AZ Bank sued Guarantors to recover the deficiency under the terms of the written guaranties. The superior court granted summary judgment in favor of AZ Bank on Guarantors’ liability for the deficiencies, reasoning in part that Guarantors had waived any protection provided by § 33–814(G). After the parties stipulated to the loan properties’ fair market values, the court entered judgment in favor of AZ Bank.

Guarantors argued that the superior court erred by denying their cross-motion for summary judgment and by granting summary judgment in favor of AZ Bank. Guarantors assert that (1) as a matter of public policy, the anti-deficiency protections under § 33–814(G) apply to guarantors as well as borrowers and cannot be waived; (2) their generic waivers signed as part of a previous business loan did not waive anti-deficiency protections under § 33–814(G); and (3) whether the purported waivers were made knowingly and voluntarily is a question of fact that precludes entry of judgment.

The Court of Appeals held that guarantors can contractually waive by agreement the protections provided by the Arizona anti-deficiency law at A.R.S. § 33-814.

In making this holding the Court of Appeals had to address the Court's two earlier decisions in *Parkway Bank & Trust Co. v. Zivkovic,* 232 Ariz. 286, 304 P.3d 1109 (App. 2013)(holding that § 33–814(G) precludes recovery of any type of deficiency from a *borrower* notwithstanding the borrower's express written agreement in the original deed of trust to waive anti-deficiency protections) and *CSA 13-101 Loop, LLC v. Loop 101, LLC,* 233 Ariz 355, 312 P.3d 1121 (App. 2013)(holding guarantors cannot waiver the fair market value protection in § 33–814(A)).

On the issue of the public policy prohibiting a waiver of the anti-deficiency protections, the Court held that prohibiting a guarantor from waiving anti-deficiency protections would be inconsistent with the basic purpose of a contract such as a guaranty. If a guarantor could never be held liable for a deficiency on a residential real estate loan of the type contemplated under § 33–814(G), a guaranty on such a loan would be substantively meaningless following a trustee's sale. Of course, this is why the Arizona legal community has not used guarantees for properties subject t0 the anti-deficiency law. The Court held such a guaranty would be "illusory" and thus enforced the waiver.

And the court relied on its holding in *CSA 13-101 Loop, LLC v. Loop 101, LLC* to support is decision in this case. The Court noted that unlike § 33–814(G), a separate portion of the anti-deficiency statute that provides "fair market value" protections following a trustee's sale specifically references guarantors. See A.R.S. § 33–814(A) (limiting the deficiency amount to be recovered from borrowers and guarantors under a foreclosed deed of trust by requiring an offset for the fair market value of the property or the sales price at the trustee's sale, whichever is higher). And in *CSA 13–101 LOOP*, the Court had held that the fair market value protection in subsection (A) applies to and cannot be waived by guarantors.

In a 2020 Memorandum Decision, the Arizona Court of Appeals held that a contractual waiver of the protections under the anti-deficiency statutes is valid where the borrower negotiated and voluntarily entered into a settlement agreement with the lender after defaulting on the loan. 16 There, the court recognized that a pre-default waiver of the anti-deficiency protections offends the public policy, but a post-default contractual waiver does not raise the same concerns because it involves predictable risks and an actual default.

M. A Full Credit Bid Terminates a Lender's Right to Pursue Other Remedies Such as Insurance Proceeds for Pre-Foreclosure Damage.

The California Court of Appeals held in the *Najah v. Scottsdale Insurance Company*[17] decision that a lender who acquires a property at a foreclosure sale following a full credit bid is not entitled to insurance proceeds payable for pre-purchase damage to the property, pre-purchase net rent proceeds, or damages for waste, because the lender's only interest in the property, the repayment of the debt, has been satisfied upon the full credit bid, and any further payment would result in a double recovery.

Summary. In 2006, the Najahs sold a California property to borrower. Borrower borrowed $2,021,000 from the Lantzman Family Trust in return for a promissory note secured by a first deed of trust on the property. The Najahs took back a promissory note and a second deed of trust for an additional $2.55 million.

The $2.55 million promissory note payable to the Najahs stated, "[Borrower] will do no remodeling or construction on the property secured by this Note until the [Lantzman Trust] loan and this Note are paid in full." The second deed of trust securing the $2.55 million note similarly required Borrower to "keep [the] property in good condition and repair, not to remove or demolish any building thereon; [and] to complete or restore promptly and in good and workmanlike manner

16 *Aerial Funding v. Van Sickle*, No. 1 CA-CV 19-0543 (Ariz. App. Oct. 20, 2020) (Memorandum Decision)
17 *Najah v. Scottsdale Insurance Company, 230 Cal.App.4th 125, 178 Cal.Rptr.3d 400 (2014).*

any building which may be constructed, damaged or destroyed thereon."

The $2.55 million note payable to the Najahs provided that Borrower would "furnish full all risk insurance with replacement cost guarantee insuring [the Najahs]." Borrower obtained a commercial general liability policy from Scottsdale, listing the Lantzman Trust and the Najahs as mortgage holders. The original policy, which ran from February 16 to May 16, 2006, identified itself as a "special form" policy. However, the language that described the covered "causes of loss" stated it was a "basic form" policy and that only specific items were covered, including "vandalism," but not "theft."[7] The policy defined "vandalism" as "willful and malicious damage to, or destruction of, the described property."

The policy included a provision describing Scottsdale's obligation to the Najahs and the Lantzman Trust as the mortgage holders:

> "We will pay for covered loss of or damage to buildings or structures to each mortgage holder shown in the Declaration in their order of precedence, as interests may appear. [¶] ... The mortgage holder has the right to receive loss payment even if the mortgage holder has started foreclosure or similar action on the building or structure. [¶] ... If we deny your [(referring to Borrower's)] claim because of your acts or because you have failed to comply with the terms of this Coverage Part, the mortgage holder will still have the right to receive loss payment if the mortgage holder: [¶] (1) Pays any premium due under this Coverage Part at our request if you have failed to do so; [¶] (2) Submits a signed, sworn proof of loss with[in] 60 days after receiving notice from us of your failure to do so; and [¶] (3) Has notified us of any change in ownership, occupancy or substantial change in risk known to the mortgage holder."

The policy remained in effect until July 16, 2008, although Borrower stopped paying premiums in February 2008. The premiums needed to keep the policy in effect through July 16 were paid by the agent who obtained the policy for Borrower. Scottsdale did not request payment of insurance premiums from the Najahs.

In 2008 the borrower ceased making payments on the loans. Shortly thereafter, the first position Lantzman Trust began the process of foreclosure under its first deed of trust. To stop the

foreclosure, in March 2008, the Najahs purchased the Lantzman Trust's interest in the property for the balance due on the Lantzman Trust note, approximately $1,749,000, and the Lantzman Trust assigned its first trust deed to the Najahs. The assignment stated that it "grant[ed], assign[ed] and transfer[red]" to the Najahs "all beneficial interest under [the first] Deed of Trust," including "the note or notes as therein described or referred to, the money due and to become due thereon with interest, and all right accrued or to accrue under said Deed of Trust."

In November 2008, the Najahs foreclosed on the second deed of trust. At the foreclosure sale, the Najahs acquired the property with a full credit bid of $2,878,060.25, the amount of the unpaid debt on the second promissory note, including interest, fees, and the costs of foreclosure.

Prior to the foreclosure the Najahs had discovered severe damage to the building secured by the DOT and debris everywhere. There was electrical wires hanging from the ceiling; broken mirrors, furniture and bathroom fixtures; damaged walls, ceilings and carpets; and interior doors removed and left lying on the floor. In addition, a number of items that had been in place and functional at the time of the sale were missing, including air conditioning and heating units, kitchen appliances and equipment, breaker panels, the main water heater, commercial laundry equipment, light poles, mailboxes, furniture, tiles and drywall.

After purchasing the Lantzman Trust's interest, the Najahs filed a police report with the Riverside Police Department. The Najahs then submitted a claim to Scottsdale. Finally, the Najahs filed a lawsuit against Scottsdale.

The trial court found in favor of Scottsdale on the issues of insurable interest and coverage. The court ruled that an owner cannot vandalize or steal his own property, as those terms are defined by California law, and thus any damage or removal of property by Borrower was not recoverable under the policy. The court further found that except for the two minor items involving a broken window and copper pipe, the damage to the building and removal of fixtures and other items was

undertaken by Borrower. In addition, the court found that any claim the Najahs had to insurance proceeds as mortgagees under the second deed of trust was extinguished by their full credit bid at the foreclosure sale. With respect to their rights as the holders of the first deed of trust, the court preliminarily agreed with the Najahs that the Lantzman Trust had assigned its right to insurance proceeds to the Najahs when it assigned that deed of trust to them. The court concluded, however, that the Najahs' full value purchase of the Lantzman Trust's first deed of trust in a private transaction extinguished the debt and any right to insurance proceeds. Judgment was entered in favor of Scottsdale. The Najahs appealed.

The California Court of Appeals held that under the full credit bid rule, when the lienholder obtains a property at a foreclosure sale by making a full credit bid—bidding an amount equal to the unpaid debt, including interest, costs, fees, and other expenses of foreclosure—"it is precluded for purposes of collecting its debt from later claiming that the property was actually worth less than the bid. [Citations.]" After acquiring the property in this manner, the beneficiary is generally unable to pursue " 'any other remedy regardless of the actual value of the property on the date of the sale.' " This is because the lender's only interest in the property is the repayment of the debt. The lender's interest having been satisfied, any other payment would result in a double recovery.

The Court noted that under the full credit bid rule, a foreclosing lender that has purchased the real property security for such a bid is precluded from pursuing further claims to recoup its debt, because the bid has established that the foreclosed security is equal in value to the debt, which therefore has been satisfied."].) "Thus, the lender is not entitled to insurance proceeds payable for pre-purchase damage to the property, pre-purchase net rent proceeds, or damages for waste, because the lender's only interest in the property, the repayment of its debt, has been satisfied, and any further payment would result in a double recovery."

The Court further held that apart from preventing double recovery, the full credit bid rule serves to protect the integrity of the foreclosure auction. The Court noted that the California Supreme Court had previously held that the "'[t]he purpose of the trustee's sale is to resolve the question of value ... through competitive bidding....'". In order to ensure that a "fair price" is obtained for the foreclosure property, it must be "sold at public sale to the highest bidder, and at least 20 days' notice of the sale must be given." These procedures guarantee that foreclosure auctions are conducted in a "fair and open manner," with the property going to the party placing the highest value on it, and that any interested member of the public has the opportunity "to participate in setting the price for the property." A lender who intends to later claim that the value of the property was impaired due to waste, fraud or insured damage, but nonetheless makes a full credit bid, interferes with that process by impeding bids from third parties willing to pay some amount between the value the lender places on the property and the amount of its full credit bid. The full credit bid rule may act to limit recovery by a foreclosing lender who hopes to pursue a legal claim for injury to the property. But "[i]f there were no repercussions for making a full credit bid, lenders could manipulate the sale and discourage prospective purchasers who might have been willing to pay just under the value of the lien."

The Court also noted that the amount payable to the mortgagee under the policy is limited to the amount necessary to satisfy the debt, even if it is less than would be required to repair the physical damage to the property, and once the debt is satisfied, "[the lienholder] ha[s] no further claim on any insurance proceeds." Because a mortgage debt is extinguished by a full credit bid, it is well established that a mortgagee who purchases an encumbered property at a foreclosure sale by making a full credit bid is not entitled to insurance proceeds payable for pre-foreclosure damage to the property.

N. Lender's Breach of Loan Agreement Can Offset Deficiency Amounts.

The Court of Appeals held in *Great Western Bank v. LJC Development, LLC,* that a Guarantor's lost profits resulting from a lender's breach of the underlying loan agreement can completely offset the amount owed under the guaranty.[18]

Summary. In early 2007, Borrower sought funding to develop a fifty-home subdivision in Flagstaff to be known as Cedar Ridge. Borrower first obtained a loan from Great Western to acquire and develop infrastructure (the A & D Loan) in May 2007. Guarantors agreed to guarantee the A & D Loan in an amount up to but not exceeding Borrower's total principal indebtedness to Great Western.

In January 2008, Borrower entered into a second agreement with Great Western to fund the actual construction of homes (the Agreement). The Agreement required Guarantors to execute a guaranty separate from that securing the A & D Loan and was signed by eight bank officials.

In July 2008, as acquisition and development of the infrastructure was nearing completion and Borrower was preparing to obtain permits for the construction of model homes, Great Western made an internal decision to cease construction financing in Arizona and advised Borrower it was withdrawing from the Agreement. When notified of this decision, Borrower immediately expressed to Great Western its concern regarding the continued viability of the project without the financing agreement in place, slowed construction in an effort to save money, and attempted to secure alternate financing. Borrower's efforts were ultimately unsuccessful, and without financing to build model homes, Borrower could not sell homes in Cedar Ridge and was therefore unable to generate revenue through which to service the A & D Loan.

Great Western then foreclosed on the A & D Loan, sold the property to another developer, and sued Guarantors for the balance of approximately $2.6 million. Guarantors conceded they, as

18 *Great Western Bank v. LJC Development, LLC*, 238 Ariz. 470, 362 P.3d 1037 (2015).

guarantors, failed to repay the A & D Loan but sought offset and affirmative relief for profits Borrower lost as a result of Great Western's termination of the Agreement, which they contend constituted anticipatory repudiation and breach of the implied covenant of good faith and fair dealing. The case proceeded to trial for determination of the merit and value, if any, of Guarantors' claims and counterclaims which might offset the deficiency owed to Great Western. Great Western submitted a timely request for findings of fact and conclusions of law.

At trial, Great Western argued it was not required under the Agreement to actually finance construction within Cedar Ridge, asserting the Agreement was merely a "guidance line" or an outline of proposed future loans, and Great Western retained complete discretion to decline funding. The trial court disagreed, noting the Agreement was titled "Loan Agreement," contained express language obligating Great Western to "make the Loans to Borrower," and required Borrower to "accept such Loans," subject to various terms and conditions. And, according to the Agreement's terms, the only basis upon which Great Western was entitled to withdraw its participation was Borrower's default—an event never alleged by Great Western.

The trial court concluded Great Western breached the Agreement by unilaterally terminating its obligation to extend financing without conducting case-by-case review of individual loan requests. The court determined Great Western's breach had prevented Borrower from receiving the benefit of the contract—namely, financing it required to build and market homes within Cedar Ridge, which would have, in turn, provided Borrower revenues through which it would be able to repay the A & D Loan. The court found Great Western had no valid excuse for doing so because Borrower had the ability to begin construction and was not in default of the Agreement. Finally, the court determined Borrower had proven with reasonable certainty it would have profited between $2,808,000 and $3,500,000 had Great Western not terminated the Agreement. Because the lost profits exceeded the outstanding balance on the A & D Loan, the

court found Guarantors' liability under the guaranty was reduced to zero. The trial court determined Guarantors were the prevailing parties, having "effectively recovered $3.1 million, absolving them of their liability" to Great Western, and awarded Guarantors their attorneys' fees.

The Court of Appeals upheld all of the trial court's rulings.

O. Guarantor's Contractual Waivers Do Not Extend To All Lender Defaults.

The California Court of Appeals held in *California Bank & Trust v. DelPonti* that a Guarantor's waiver of defenses in a guaranty agreement that waived all defenses "except as prohibited by applicable law," was limited to those legal or statutory defenses particularly set forth in the guaranty agreements and did not constitute a waiver of all equitable defenses, and thus did not apply to construction lender's post-foreclosure deficiency claims against guarantor in light of determination that lender had breached a loan agreement causing a default.[19]

Summary. Construction lender brought post-foreclosure action against townhome project developer and guarantors, seeking deficiency judgment, and general contractor brought action against developer and lender for restitution, breach of contract, and promissory estoppel.

Five Corners Rialto, LLC (Five Corners), obtained a construction loan from Vineyard Bank (Bank) to develop a 70–unit townhome project (Project), with guaranties from the principals of Five Corners (Guarantors). Five Corners contracted with Advent, Inc. (Advent), a general contractor, to build the project in two phases. Everything went according to schedule for the first 18 months. However, when phase one of the Project was nearly complete, the Bank stopped funding approved payment applications, preventing completion and sale of the phase one units, which, in turn, caused Five Corners to default on the loan.

The Bank reached an agreement with Five Corners, requiring Advent to finish phase one so the units could be sold at auction, and promising to pay the subcontractors if they discounted

19 *California Bank & Trust v. Del Ponti, 232, Cal.App. 4th 162, 181 Cal.Rptr.3d 216 (2014).*

their bills and released any liens. Advent paid the subcontractors out of its own pocket in order to keep the project lien free, so the auction could proceed. However, the Bank foreclosed against Five Corners. Advent filed an unbonded stop notice. The Bank (through its assignee California Bank & Trust), sued Five Corners and the Guarantors under various theories for the deficiency following a trustee's sale of the deed of trust, while Advent sued the developer and the Bank for restitution for the amounts it paid out of pocket.

The Bank argues that the court erred in rendering judgment in favor of the Guarantors in the Bank's action to collect the deficiency owed under the guarantees. The Bank argued the Guarantors had waived their claims against the bank in the written guaranty agreements.

The Court noted that California law does provide that any guarantor or other surety, including a guarantor of a note secured by real property, may waive rights and defenses that would otherwise be available to the guarantor. Waivable defenses under California law include the guarantor's rights of subrogation, reimbursement, indemnification, and contribution; any rights or defenses the guarantor might have by reason of any election of remedies by the creditor; or any rights or defenses the guarantor might have because the principal's obligation is secured by real property or an estate for years. These statutory rights of the guarantor may be waived and such waiver provision is not invalid as opposed to public policy.

However, a guarantor cannot be held liable where a contract is unlawful or contravenes public policy. The rule against enforcement of illegal transactions is founded on considerations of public policy that are independent of California Civil Code provisions. Following this reasoning, the Court in DelPonti held that a pre-default waiver of notice by a guarantor is unenforceable as void. The Court held a guarantor's waiver of defenses is limited to legal and statutory defenses expressly set out in the agreement. A waiver of statutory defenses is not deemed to waive all defenses, especially *equitable defenses,* such as unclean hands, where to enforce the guaranty

would allow a lender to profit by its own fraudulent conduct. The doctrine of unclean hands bars a plaintiff from relief when the plaintiff has engaged in misconduct relating directly to the transaction concerning which suit is brought. Although originally an equitable defense, it may apply to legal claims, as well. The Court support from the fact that the waiver provision of the guaranty agreement specifically states, "Except as prohibited by applicable law, Guarantor waives...." This language contemplates the retention of defenses, the pre-default waiver of which would be contrary to public policy.

P. Guarantor's Contractual Waivers Do Not Extend To All Lender Defaults.

The Arizona Court of Appeals held in *Morgan AZ Financial v. Gotses*, that common-law defenses to liability under promissory notes survived trustee's sales of parcels of real property that secured borrowers' obligations under the notes, such that borrowers could assert those defenses in a post-sale deficiency action brought against them by lender's successor in interest, even though borrowers did not seek to enjoin the sales, and successor pointed to a provision found at A.R.S. §§ 33–811(C) that a trustor who failed to enjoin a trustee's sale waived any claims that were dependent on the sale.[20] The Court held that a trustee's sales and deficiency actions were separate mechanisms by which a lender could seek recovery, and mere occurrence of a trustee's sale did not constitute a judicial determination that the borrower had breached or that the note was enforceable.

Summary. William Gotses executed promissory notes secured by deeds of trust on two undeveloped lots in a Flagstaff subdivision. Gotses defaulted on the notes, and the lender's successor-in-interest, Morgan AZ Financial, L.L.C. ("Morgan"), initiated trustee's sales of the properties. Gotses did not seek to enjoin the sales. The sales were completed and Morgan obtained title to both of Gotses' lots.

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20 *Morgan AZ Financial, LLC, v. Gotses, 235 Ariz. 21, 326 P.3d 288 (2014).*

After the trustee's sales, Morgan commenced actions against Gotses, later consolidated with actions against a second property owner in the same subdivision, seeking deficiency judgments under A.R.S. § 33–814(A). Gotses answered and asserted that Morgan had taken the loan documents from the original lender subject to fraud-based defenses that rendered them void and unenforceable. Gotses also applied for determinations of the properties' fair market values at the times of the trustee's sales, but failed to produce any evidence on the issue. The court therefore determined the values based on Morgan's uncontested appraisals.

Morgan then moved for summary judgment, arguing that A.R.S. § 33–811(C) effected a waiver of all defenses related to the enforceability of the promissory notes because Gotses had failed to enjoin the trustee's sales. A.R.S. § 33–811(C) provides:

> The trustor, its successors or assigns, and all persons to whom the trustee mails a notice of a sale under a trust deed pursuant to section 33-809 shall waive all defenses and objections to the sale not raised in an action that results in the issuance of a court order granting relief pursuant to rule 65, Arizona rules of civil procedure, entered before 5:00 p.m. mountain standard time on the last business day before the scheduled date of the sale. A copy of the order, the application for the order and the complaint shall be delivered to the trustee within twenty-four hours after entering the order.

Based upon the language of A.R.S. § 33–811(C) the trial court granted Morgan's motion and entered a signed judgment consistent with Ariz. R. Civ. P. 54(b) that awarded Morgan more than $850,000 and "reasonable attorneys' fees and costs in an amount to be determined by subsequent Fee Application."

In deciding the matter the Court of Appeals held nonjudicial foreclosures, or trustee's sales, allow the beneficiary of a deed of trust "to cause the trust property to be sold and to apply the proceeds of that sale to a defaulted loan, without going to court." Such sales "are meant to operate quickly and efficiently, 'outside of the judicial process.'"

However, Arizona law may provide under A.R.S. § 33–811(C), that a trustor who fails to enjoin a trustee's sale waives his claims to title of the property upon the sale's completion, *BT Capital, LLC v. TD Serv. Co. of Ariz.*, 229 Ariz. 299, 301, ¶ 10, 275 P.3d 598, 600 (2012), and also waives any claims that are dependent on the sale, *Madison v. Groseth*, 230 Ariz. 8, 13, ¶ 15, 279 P.3d 633, 638 (App.2012).

The Morgan decision resolves the issue of whether a borrower who does not enjoin the sale loses his right to litigate any defenses to a potential post-sale deficiency action. The Arizona Court of Appeals concluded that the borrower does not and such a finding would be inconsistent with the process and purpose of nonjudicial foreclosures.

The Court noted that A.R.S. § 33–811(C) provides that "[t]he trustor ... shall waive all defenses and objections to the sale not raised in an action that results in the issuance of [an injunction against the sale]." Further, the Court noted that the plain language prescribes waiver only of defenses and objections "to the sale," and that the statutory language must be strictly construe in favor of trustors. A completed trustee's sale does not operate to deprive the trustor of the ability to pursue claims or defenses that are independent of the sale. A.R.S. § 33–811(C) does not prevent a borrower from asserting claims for relief independent of voiding the trustee sale.

VI. 2014 LEGISLATIVE CHANGES TO ARIZONA'S ANTI-DEFICIENCY STATUTES - THE HOME MUST BE COMPLETED TO BE PROTECTED.

The have been substantial changes to Arizona's anti-deficiency laws for loans originated *after December 31, 2014*. Accordingly, as to loans originated after December 31, 2014, A.R.S. §33-814 now provides the following limitations in new subsections H and I:

> G. If trust property of two and one-half acres or less which is limited to and utilized for either a single one-family or a single two-family dwelling is sold pursuant to the trustee's power of sale, no action may be maintained to recover any difference between the amount obtained by sale and the amount of the indebtedness and any interest, costs and expenses.

H. For deeds of trust that are originated after **December 31, 2014**, subsection G of this section does not apply to trust property as follows:

1. Trust property owned by a person who is engaged in the business of constructing and selling dwellings that was acquired by the person in the course of that business and that is subject to a deed of trust given to secure payment of a loan for construction of a dwelling on the property for sale to another person.

2. Trust property that contains a dwelling that was never substantially completed.

3. Trust property that contains a dwelling that is intended to be utilized as a dwelling but that is never actually utilized as a dwelling.

I. For the purposes of this section, a dwelling is substantially completed if either of the following occurs:

1. Final inspection is completed, if required by the governmental body that issued the building permit for the dwelling.

2. If a final inspection is not required by the governmental body that issued the building permit, the dwelling has been completed in all material respects as prescribed in the applicable ordinances and regulations of the governmental body that issued the building permit for the dwelling.

VII. THE JUNIOR LIENHOLDER'S REDEMPTION PRICE AFTER A SHERIFF"S SALE UNDER THE *HELVETICA* DECISIONS.

In 2017, the Arizona Court of Appeals issued a published opinion concerning a junior lienholder's redemption rights after a judicial foreclosure where the type of property qualifies for anti-deficiency protection. *Helvetica v. Giraudo*, 242 Ariz. 498 (App. 2017) ("*Helvetica III*"). The trial court had held that in order for Giraudo to redeem as a junior lienholder, he had to pay the entire balance of Helvetica's senior loan, even though Helvetica had bid only a portion of the balance at the sheriff's sale (Helvetica bid $400,000 on its $3.4 million principal loan). Helvetica was the prevailing bidder at the sheriff's sale.

The Arizona Court of Appeals vacated the trial court's ruling that the junior lienholder was required to pay the entire balance of Helvetica's loan regardless of amount bid at the sheriff's sale. Giraudo argued the redemption price should be based entirely on the prevailing bid at the sale (i.e., the prevailing bid of $4000,000 plus the statutory eight percent). Helvetica argued the redemption price should be based entirely on the principal balance of Helvetica's $3.4 million loan. The Court of Appeals did not agree with either party and instead created a hybrid redemption price whereby the appropriate price is to be contingent upon the determination by the trial court of the deficiency judgment owed by the borrower on the foreclosed loan, after consideration of the anti-deficiency statutes. *Helvetica v. Giraudo*, 242 Ariz. at 501-02.

Specifically, the Court of Appeals held that Giraudo's redemption price is to include (in addition to the $400,000.00 prevailing bid plus the statutory eight percent) "*the value of the foreclosed senior lien that survives the post-auction proceedings between the foreclosing lienholder and the mortgage debtor*," or in other words, the "deficiency judgment" awarded by the trial court in favor of Helvetica and against the borrower:

> The value of the lien is determined by the deficiency judgment after the foreclosure sale. Redeeming junior lienholders must only pay the value of the foreclosed senior lien that survives the post-auction proceedings between the foreclosing lienholder and the mortgage debtor. The mortgage debtor's only opportunity to request a fair market value determination or redeem the property is before the junior lienholder's redemption right begins. A.R.S. § 12-1566(C). We therefore hold that when the judgment debtor requests a fair market value determination, the junior lienholder's redemption price is reduced to the extent the deficiency judgment is reduced by the fair market value proceedings.
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> By rendering a portion of the debt unenforceable against the judgment debtor, the anti-deficiency statutes effectively reduce the lien value immediately upon the sale of the property. When a deficiency judgment is smaller than the loan balance because of the anti-deficiency statute, the redemption price is likewise reduced.
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> Thus, by the time a junior lienholder's right to redeem ripens, the lien's value may have changed. We hold that the redemption price includes only the portion of the lien that survives any actions between the foreclosing creditor and the mortgage debtor that must be commenced before the junior lienholder's right to redeem ripens.

Helvetica v. Giraudo, 242 Ariz. at 501-502. In other words, the Arizona Court of Appeals held that Giraudo's redemption price does not have to include the balance of the loan being foreclosed but must include the amount of the resulting deficiency judgment against the borrower. *Helvetica v. Giraudo*, 242 Ariz. at 501-502.

VIII. UPDATE ON EXCESS PROCEEDS AFTER A JUDICIAL FORECLOSURE.

In a 2022 Arizona Court of Appeals decision, the court held that A.R.S. §33-727(B) does not entitle a senior lienholder to the excess proceeds that is generated by the judicial foreclosure of a junior lienholder's foreclosure (in this case, an HOA foreclosure). 21

In *Tortosa*, the homeowner's association filed a judicial foreclosure against the homeowner for unpaid assessments. A third party, Maricopoly, LLC, purchased the property at the sheriff's sale, generating over $72,000 in excess proceeds. Maricopoly argued that pursuant to A.R.S. §33-727(B), the proceeds must be paid to the senior lienholder, U.S. Bank. The judicial excess proceeds statute does appear to require that the proceeds be paid to all other liens. However, the Court of Appeals disagreed with Maricopoly and held that lienholders (such as first-position U.S. Bank) who are not affected by the judicial foreclosure have no right to the excess proceeds. Therefore, the court ordered that the excess proceeds be paid to the homeowner rather than be used by the bidder to pay down the balance of the existing first lien, which had not been extinguished by the homeowner's association's sheriff's sale.

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21 *Tortosa Homeowners Association v. Garcia*, 524 P.3d 1157 (App. 2022).

This decision effectively overrules the court's prior memorandum decision from a few years earlier which had held that the excess proceeds be paid to the senior lienholder. *Matt Steinmetz, PLLC v. Everyone Wins, LLC*, No 1 CA-CV 17-0549 ¶¶ 1-4, 2018 WL 3028964 (Ariz. App. June 19, 2018) (Memorandum Decision).

IX. RECENT ARIZONA CASELAW REGARDING THE LENDER'S STATUTE OF LIMITATIONS TO BRING AN ACTION ON THE NOTE.

A.R.S. § 12-548(A) bars an action for a debt that is not prosecuted within 6 years after the cause of action accrues. Therefore, with respect to any loan in which monthly payments are due, the moment of the acceleration of that loan is crucial to determining the running of the statute of limitations on that loan.

In a recent case, the Arizona Supreme Court held that when a debtor defaults on a debt secured by a deed of trust and the trustee chooses to sell the property, the trustee's act of recording and serving a notice of trustee's sale does not accelerate the debt as a matter of law. In this case, the plaintiff borrower had defaulted on a promissory note secured by a deed of trust against his residential property. Subsequently, the lender recorded two notices of trustee's sales, but neither notice invoked an optional acceleration clause included in the promissory note and deed of trust. When the property was not sold at a trustee's sale, Nationstar Mortgage began servicing the loan. Plaintiff sought declaratory relief, arguing that Nationstar was not permitted to foreclose on the property because the 6-year statute of limitations in A.R.S. § 12-548(A)(1) had expired. The trial court granted summary judgment for the borrower plaintiff, concluding that the notices of trustee's sales accelerated the debt and thus the 6-year statute of limitations had expired as a matter of law. The Arizona Supreme Court reversed and remanded for the entry of summary judgment in favor of Nationstar, holding that the mere recording of a notice of trustee's sale, by itself, is not an

affirmative act that accelerates the debt. *Bridges v. Nationstar Mortg. LLC*., 78 Arizona Cases Digest 8, 515 P.3d 1270 (Ariz. 2022).

In an earlier Arizona Court of Appeals case, *Webster Bank, N.A. v. Mutka*, 250 Ariz. 498 (App. 2021), the borrower (Mutka) appealed the trial court's judgment in favor of Webster Bank on the bank's claim for breach of a home-equity line of credit agreement. In 2011 the borrower stopped making payments on the loan. Over six and a half years later the lender accelerated the debt and sued for the balance. The borrower argued the entire lawsuit was untimely because the limitations period began to accrue upon his first missed payment, more than six years before the lawsuit was filed. The trial court granted summary judgment to the lender. The Court of Appeals affirmed the trial court and disagreed with the borrower. The Court of Appeals held that the statute of limitations on a home equity line of credit with a defined maturity date "commences on the due date of each matured but unpaid installment and, as to unmatured future installments, the period commences on the date the creditor exercises the optional acceleration clause." Ultimately the Court of Appeals held the lender was barred under A.R.S. § 12-548(A) from pursuing a little more than a half year of payments over the life of the thirty-year HELOC loan. For the remainder of the loan, the lender was not barred by any statute of limitations because the loan had not previously been accelerated.

A.R.S. § 33-729. Purchase money mortgage; limitation on liability.

A. Except as provided in subsections B and C of this section, if a mortgage is given to secure the payment of the balance of the purchase price, or to secure a loan to pay all or part of the purchase price, of a parcel of real property of two and one-half acres or less which is limited to and utilized for either a single one-family or single two-family dwelling, the lien of judgment in an action to foreclose such mortgage shall not extend to any other property of the judgment debtor, nor may general execution be issued against the judgment debtor to enforce such judgment, and if the proceeds of the mortgaged real property sold under special execution are insufficient to satisfy the judgment, the judgment may not otherwise be satisfied out of other property of the judgment debtor, notwithstanding any agreement to the contrary.

B. The balance due on a mortgage foreclosure judgment after sale of the mortgaged property shall constitute a lien against other property of the judgment debtor, general execution may be issued thereon, and the judgment may be otherwise satisfied out of other property of the judgment debtor, if the court determines, after sale upon special execution and upon written application and such notice to the judgment debtor as the court may require, that the sale price was less than the amount of the judgment because of diminution in the value of such real property while such property was in the ownership, possession, or control of the judgment debtor because of voluntary waste committed or permitted by the judgment debtor, not to exceed the amount of diminution in value as determined by such court.

C. For mortgages that are originated after December 31, 2014, subsection A of this section does not apply to real property as follows:

1. Real property owned by a person who is engaged in the business of constructing and selling dwellings that was acquired by the person in the course of that business and that is subject to a mortgage given to secure payment of a loan for construction of a dwelling on the property for sale to another person.

2. Real property that contains a dwelling that was never substantially completed.

3. Real property that contains a dwelling that is intended to be utilized as a dwelling but that is never actually utilized as a dwelling.

D. For the purposes of this section, a dwelling is substantially completed if either of the following occurs:

1. Final inspection is completed, if required by the governmental body that issued the building permit for the dwelling.

2. If a final inspection is not required by the governmental body that issued the building permit, the dwelling has been completed in all material respects as prescribed in the applicable ordinances and regulations of the governmental body that issued the building permit for the dwelling.

A.R.S. § 33-814. Action to recover balance after sale or foreclosure on property under trust deed.

A. Except as provided in subsections F, G and H of this section, within ninety days after the date of sale of trust property under a trust deed pursuant to section 33-807, an action may be maintained to recover a deficiency judgment against any person directly, indirectly or contingently liable on the contract for which the trust deed was given as security including any guarantor of or surety for the contract and any partner of a trustor or other obligor which is a partnership. In any such action against such a person, the deficiency judgment shall be for an amount equal to the sum of the total amount owed the beneficiary as of the date of the sale, as determined by the court less the fair market value of the trust property on the date of the sale as determined by the court or the sale price at the trustee's sale, whichever is higher. A written application for determination of the fair market value of the real property may be filed by a judgment debtor with the court in the action for a deficiency judgment or in any other action on the contract which has been maintained. Notice of the filing of an application and the hearing shall be given to all parties to the action. The fair market value shall be determined by the court at a priority hearing upon such evidence as the court may allow. The court shall issue an order crediting the amount due on the judgment with the greater of the sales price or the fair market value of the real property. For the purposes of this subsection, "fair market value" means the most probable price, as of the date of the execution sale, in cash, or in terms equivalent to cash, or in other precisely revealed terms, after deduction of prior liens and encumbrances with interest to the date of sale, for which the real property or interest therein would sell after reasonable exposure in the market under conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably and for self-interest, and assuming that neither is under duress. Any deficiency judgment recovered shall include interest on the amount of the deficiency from the date of the sale at the rate provided in the deed of trust or in any of the contracts evidencing the debt, together with any costs and disbursements of the action.

B. If a trustee's sale is a sale of less than all of the trust property or is a sale pursuant to one of two or more trust deeds securing the same obligation, the ninety day time limitations of subsection A of this section shall begin on either the date of the trustee's sale of the last of the trust property to be sold or the date of sale under the last trust deed securing the obligation, whichever occurs last.

C. The obligation of a person who is not a trustor to pay, satisfy or purchase all or a part of the balance due on a contract secured by a trust deed may be enforced, if the person has so agreed, in an action regardless of whether a trustee's sale is held. If, however, a trustee's sale is held, the liability of a person who is not a trustor for the deficiency is determined pursuant to subsection A of this section and any judgment for the deficiency against the person shall be reduced in accordance with subsection A of this section. If any such action is commenced after a trustee's sale has been held, it is subject, in addition, to the ninety day time limitations of subsections A and B of this section.

D. If no action is maintained for a deficiency judgment within the time period prescribed in subsections A and B of this section, the proceeds of the sale, regardless of amount, shall be deemed to be in full satisfaction of the obligation and no right to recover a deficiency in any action shall exist.

E. Except as provided in subsection F of this section, the provisions of this chapter do not preclude a beneficiary from foreclosing a deed of trust in the same manner as a real property mortgage. In an action for the foreclosure of a deed of trust as a real property mortgage the provisions of chapter 6, article 2 of this title are applicable.

F. A deed of trust may, by express language, validly prohibit the recovery of any balance due after trust property is sold pursuant to the trustee's power of sale, or the trust deed is foreclosed in the manner provided by law for the foreclosure of mortgages on real property.

G. If trust property of two and one-half acres or less which is limited to and utilized for either a single one-family or a single two-family dwelling is sold pursuant to the trustee's power of sale, no action may be maintained to recover any difference between the amount obtained by sale and the amount of the indebtedness and any interest, costs and expenses.

H. For deeds of trust that are originated after December 31, 2014, subsection G of this section does not apply to trust property as follows:

1. Trust property owned by a person who is engaged in the business of constructing and selling dwellings that was acquired by the person in the course of that business and that is subject to a deed of trust given to secure payment of a loan for construction of a dwelling on the property for sale to another person.

2. Trust property that contains a dwelling that was never substantially completed.

3. Trust property that contains a dwelling that is intended to be utilized as a dwelling but that is never actually utilized as a dwelling.

I. For the purposes of this section, a dwelling is substantially completed if either of the following occurs:

1. Final inspection is completed, if required by the governmental body that issued the building permit for the dwelling.

2. If a final inspection is not required by the governmental body that issued the building permit, the dwelling has been completed in all material respects as prescribed in the applicable ordinances and regulations of the governmental body that issued the building permit for the dwelling.

A.R.S. § 33-722. Election between action on debt or to foreclose.

If separate actions are brought on the debt and to foreclose the mortgage given to secure it, the plaintiff shall elect which to prosecute and the other shall be dismissed.