

Can Your Lender Pursue a Deficiency in Arizona?

Borrowers sometimes face the daunting question of whether their mortgage lender can foreclose on their property and still pursue them for any remaining balance that may be owed on their loan. The answer in Arizona depends on your specific factual situation and other factors.

First, if a person obtains a loan on property of two and a half acres or less that has a single one family or two family dwelling that is secured by a deed of trust, the general rule is that the trustee may not seek a deficiency judgment after pursuing a trustee's sale. *See* A.R.S. § 33-814(G). The Arizona Legislature recently amended that statute to limit and clarify the anti-deficiency protections available under Arizona law. For deeds of trust originated after December 31, 2014, the statute will not apply to borrowers who secure a loan collateralized by a deed of trust for the purpose of constructing and selling the dwelling to another person. The protections also do not apply if the dwelling to be constructed on the property is never substantially completed or is never actually utilized as a dwelling. So, the builders and/or developers out there who borrow money to buy land and build homes to be sold, cannot take advantage of the anti-deficiency protections of the statute. And if you borrow money to purchase land with the intent to build a home, it will need to be substantially completed and you will need to utilize it as a dwelling for the anti-deficiency protections to apply.

Second, anti-deficiency protections may also be available to those borrowers who buy real property of two and a half acres or less that is also for a single one family or two family dwelling that is secured by a mortgage (instead of a deed of trust). *See* A.R.S. § 33-729. Under Section 33-729, a lender who seeks a judicial order to foreclose on a mortgage will not be

allowed to get a judgment against the borrower's property besides the secured real property, so long as the borrower meets the statutory requirements. Some questions have come up about what happens if a loan is refinanced or what happens if loan monies are used to construct a dwelling on the property. Lenders have tried, unsuccessfully, to argue that a refinance loan or a loan where construction proceeds are used to build the dwelling lose their potential anti-deficiency protections under the statute. But Arizona courts have rejected the lenders' arguments, to the extent that the monies lent were used to purchase or construct the dwelling. One way this concept has been described is to refer to the loan as a "purchase money loan." In *Helvetica Servicing, Inc. v. Pasquan*, 229 Ariz. 493, 277 P.3d 198 (App. 2012), the Arizona Court of Appeals held that a loan did not lose its purchase money characteristics just because it was refinanced and if loan proceeds are used to construct a qualifying residence on property that otherwise meets the statutory requirements, the loan will still be subject to the anti-deficiency protections of the statute. The *Helvetica* court added that if loan proceeds are not used for "purchase money" purposes, those proceeds may not be subject to statutory protection and the lender may be able to seek a deficiency judgment for non-purchase money sums. What *Helvetica* left partially unanswered, however, is what is, or is not, a disbursement for purchase money purposes? The answer to that question really will vary from case to case, but some aggressive lenders may contend that it includes even interest that accrues on the loan. That is an open question in Arizona at this point, but the policies behind Arizona's anti-deficiency statutes supports the notion that interest should be subject to the anti-deficiency protections.

One other area where the deficiency question arises relates to commercial properties. If you borrow money to acquire a commercial property and secure it by a deed of trust, generally you will not have anti-deficiency protection in Arizona. However, under Section 33-814, you

may be able to limit the amount of deficiency you might face. A lender who credit bids at a trustee's sale for an amount less than the fair market value of the property to set-up a higher deficiency against the borrower may not be able to get away with it. The statute entitles the borrower to request a valuation hearing where the court would determine the "fair market value" of the property (which may be higher than the lender's credit bid) and that number will be used to determine whether a deficiency actually exists.

We at Brooks & Associates have counseled clients on deficiency questions; have litigated purchase money deficiency matters and conducted fair market valuation hearings on behalf of our clients. If you have a real estate question or matter, let us know.

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