

# ARIZONA STATE BAR CONVENTION 2008

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CONSUMER BANKRUPTCY PROGRAM

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*ARIZONA MORTGAGE DEFICIENCY LAWSUITS*

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PRESENTED BY

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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 memorandum includes a checklist of items to be considered to determine whether, or not, a mortgage lender has the right to obtain a mortgage deficiency judgment against a borrower, or guarantor, of a loan subsequent to a real property foreclosure in Arizona. The content of this memorandum is not intended to address every possible scenario and it should not be used as a substitute for conducting current legal research concerning Arizona's mortgage deficiency laws.

**1. STEP ONE: DETERMINE WHETHER THE MORTGAGE LOAN IS "PURCHASE MONEY" VS. "NON-PURCHASE MONEY"**

- A loan is purchase money even if less than 100% of the loan proceeds are used to purchase the real property which secures the loan.
- 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.

**2. STEP TWO: 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**

- Evaluate the physical characteristics of the real property to be foreclosed upon.
- 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".
- Four single-family condo units are not a Qualified Property.
- A single-family residence under construction by a residential developer, but not yet sold or occupied is not a Qualified Property.

**3. STEP THREE: 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**

- Non-judicial 91-day administrative trustee's sale of the real 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 lawsuit and Sheriff's execution sale of the real property ("Judicial Foreclosure"): **NO DEFICIENCY JUDGMENT IS ALLOWED AGAINST THE BORROWER.**
- Real Property is sold to a third-party buyer and mortgage lender voluntarily releases its lien, but does not cancel the promissory note debt ("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 may be able to obtain a deficiency judgment against a guarantor of the loan based upon the independent guaranty contract, but there is no reported AZ case on this issue.
- 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 a vacant lot or real property used for any non-residential purpose (such as an office building, restaurant or other business purpose).

### 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 may be able to obtain a deficiency judgment against a guarantor based upon the independent guaranty contract, but there is no reported AZ case on this issue.
- 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 the loan is located on 2.5 acres or less and is used as a single-one-family or a single-two-family dwelling.
- **NOTE SPECIAL EXCEPTION:** If a mortgage lender holds a non-purchase money 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 for a deficiency. In addition, the 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.

### 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 vacant lot or real property used for a non-residential purpose (such as an office building, restaurant or other business purpose).

#### **4. STEP FOUR: 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, and limited to, 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.

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.

An additional common example of foreclosures currently pending in Arizona are Trustee’s Sales related to loans secured by deeds of trust upon vacant land. In such cases, if the mortgage lender completes the Trustee’s Sale, it may sue the borrower for a deficiency judgment against the borrower as long as the deficiency lawsuit is filed within 90 days after the date of the foreclosure sale.

The 2 foregoing examples probably represent 90% or more of the scenarios facing mortgage lenders in Arizona. The other scenarios will be controlled by Rules #1-4 discussed above.

An excellent analysis of the Arizona mortgage deficiency statutes is included in 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).