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QUESTION: **SHOULDN'T OWNERS OF HOUSES IN ARIZONA BE CONCERNED ABOUT OWING MORE MONEY TO THE BANK IF THEY LET THE BANK FORECLOSE ON THE HOUSE?**

ANSWER: **ARIZONA'S ANTI-DEFICIENCY STATUTES GENERALLY LET THE LENDER ONLY TAKE THE HOUSE BACK WITHOUT COLLECTING ADDITIONAL MONEY FROM THE BORROWER.**

Why are so many residential properties in foreclosure in Arizona? Why aren't the owners of houses fighting to keep the houses when they are "underwater?" The reason is that owners of residential property can usually walk away from the house or duplex without having to pay any more money to the lender.

Arizona's anti-deficiency statutes generally prevent deficiency judgments for debts that are secured by mortgages or deeds of trust on residences. The anti-deficiency statute even applies to residential property owned by investors or developers because the focus is on the type of property protected, not the type of borrower. *Mid Kansas Federal Savings & Loan v. Dynamic Dev. Corp.*, 167 Ariz. 122, 804 P.2d 1310 (1991).

But let's start with some background. In general, when a sale under a deed of trust recovers less for the lender than the amount of the secured debt, the creditor has ninety days to institute a lawsuit to collect the deficiency. A.R.S. § 33-814(A). Arizona's anti-deficiency statute, however, provides that deficiency judgments are not available under deeds of trust where the trust property is a one- or two-family dwelling located on 2.5 acres or less. The statute states:

> 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.

A.R.S. § 33-814(G). A similar restriction against deficiency judgments exists for mortgage foreclosures (as opposed to trustees' sales) on residential properties, but only if the loan was for the purchase of the house or duplex. A.R.S. § 33-729. The only exception is if the debtor commits "voluntary waste" or tears-up the property making it worth less.

So if the loan was for the purchase of residential property, then all the lender can get is the property, no matter how it forecloses on the house. No money judgment will be allowed on a secured, purchase-money residential loan, even if the house is worth less than the loan.

Moreover, no deficiency judgment will be permitted anytime residential property is foreclosed by trustee's sale. The lender can only get the house or duplex, even if the deed of trust did not secure a purchase-money obligation. *Baker v. Gardner*, 160 Ariz. 98, 106, 770 P.2d 766, 774 (1988).

So, for the most part, the owner of the house does not need to worry about paying more money to the lender after foreclosure if either:

1. a trustee's sale is held pursuant to the deed of trust; or

2. a lawsuit is filed to foreclose on a mortgage or deed of trust if the loan was for the purchase of the house.

So what about a second mortgage securing a home-improvement loan, not a purchase-money loan? If the lender conducts a trustee's sale, no additional money can be claimed. On the other hand, if the second mortgage or deed of trust securing a nonpurchase-money loan is foreclosed through the courts, then the owner of the house may have to pay the deficiency to the lender.

The focus is not on whether the debt is in first, second or third secured position. Rather, the issue is simply whether the collateral is a single-family residence or a duplex on two and one-half acres or less. If the lender sues in court to foreclose, rather than conducting a non-judicial trustee's sale, then it will be able to obtain a money judgment for a deficiency if the loan was not for the purchase of the house or duplex.

In a market where 100% purchase-money financing was popular, how does this stuff apply? What happens if there was a first secured loan for 80% of the purchase price and a second secured loan for the other 20% of the purchase price? Some lenders have considered conducting a trustee's sale of the first deed of trust, thereby extinguishing the second deed of trust. The lender then would theoretically simply sue upon the unsecured promissory note for the last 20% of the purchase money loan. Where that second deed of trust or mortgage secured part of the purchase-money, a lawsuit to collect the money will probably not succeed. *Baker v. Gardner*, 160 Ariz. at 107, 770 P.2d at 775 (1988).

The answers to when a deficiency judgment for the balance of a loan above the value of the collateral can be collected will differ from state-to-state. Even in Arizona, the answer to the question of when a deficiency may be collected will vary with the facts and circumstances. Nevertheless, for the most part, Arizona's anti-deficiency statutes will prevent deficiency judgments on loans for the purchase of houses or duplexes.

If you have any questions concerning the extent of the rights of lenders and borrowers in real estate transactions, please feel free to call me.

Best regards,

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By
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MRK/km