FORECLOSURE IN ARIZONA

GENERALLY:

QUESTION: What happens if I go into foreclosure on my mortgage or trust deed?

ANSWER: You can lose your property in a forced sale and in some cases still owe the creditor money.

THE REMEDIES GENERALLY, FOR DEFAULT:

QUESTION: Explain the different remedies for a loan default, please?

ANSWER: In general law and just as in the other states, above, the loan secured by real estate may be enforced by the lender or holder of the instrument either by suing the debtor directly on the promissory note the debtor signed, or by conducting either a judicial foreclosure (in a court) or a non-judicial trustee sale (the latter on trust deed loans, only). Under the law (UNLESS THE DEBT INSTRUMENT WAS A NON-DEFICIENCY INSTRUMENT--SEE BELOW) the creditor sells the property either for enough to get the entire loan paid off (and the creditor keeps the payoff up to the amount of the remaining loan and expenses to foreclose it) or it sells short of that debt amount (very common, recently, due to adverse market conditions) and if there is a shortfall, the creditor can (unless, as noted, it is a non-deficiency instrument explained below) collect the shortfall from the debtor even after the property has been sold on the foreclosure sale.

BUT THE CREDITOR CANNOT do this if the instrument is one that falls under the "ANTI-DEFICIENCY" STATUTES, BELOW. MOST HOME MORTGAGES DO FALL UNDER THE PROTECTION OF THE ANTI-DEFICIENCY STATUTES AND THAT MEANS NO "DEFICIENCY" AGAINST THE DEBTOR IN A FORECLOSURE. See below for what qualifies. But even when there is no deficiency, there can be IRS and credit ramifications, of course, as explained below.

ANTI-DEFICIENCY STATUTES:

QUESTION: What is a “deficiency judgment”?

ANSWER: It is a legal judgment against the borrower for any shortfall in a judicial sale of the property to meet the total remaining debt plus taxable interest, fees and costs.

To the extent the judicial or trustee’s foreclosure auction yields less than the judgment, a deficiency judgment could be available, provided the loan is not a qualifying “purchase money loan” on a residential property (a “non-deficiency” loan), as explained more, below. If it is not such a loan, in judicial sales of the property, whether under a mortgage or deed of trust, the Court lodges judgment for any loan balance, costs, fees and other expenses set forth by statute not meet by the proceeds from the auction. In a non-judicial foreclosure of a loan not qualifying for “non-deficiency” treatment, the creditor has 90 days to file for any shortfall after the date of

sale. As noted, in the case of purchase money mortgages and trust deeds on qualifying residential properties and trust deeds, there is NO DEFICIENCY. See "qualifications" for that non-deficiency treatment, below.

QUALIFYING LOANS FOR ANTI-DEFICIENCY PROTECTION:

QUESTION: What loans qualify for non-deficiency treatment?

ANSWER: Arizona law has two "anti-deficiency" statutes that will often apply to loans secured by single residential real estate and whether or not the home is occupied by the borrower.

Where these statutes apply, a lender's remedy will be ONLY a foreclosure, with NO RIGHT TO SUE FOR MONEY beyond the amount received from the foreclosure sale. These two "safe harbors" are as follows:

One statute applies to mortgages, which must be foreclosed judicially, or deeds of trust if foreclosed judicially (that means by the creditor suing the debtor in a court). A.R.S. 33-729(A). It limits the claim to the proceeds of a sale of the property.

The other "anti-deficiency" statute applies only to deeds of trust when foreclosed via a trustee sale (through a suit in the court). It is A.R.S. 33-814(G). Same rule: The creditor only gets the amount from the sale of the property and no more.

THE TEST FOR WHETHER THESE EXCEPTIONS APPLY:

For either of the anti-deficiency statutes to apply, the mortgage or deed of trust must be secured by real property that: (1) Consists of 2 1/2 acres or less; (2) and is restricted to and utilized for a single-family or dual-family dwelling; (3) the proceeds of the loan had to be used to pay all or part of the purchase price of the property (better that all of it was). If all three of the foregoing apply, a deficiency on a normal foreclosure is unlikely.

REFINANCES:

QUESTION: What about refinances of a loan that was originally a non-deficiency loan? Do they get the same non-deficiency treatment, though, technically, they were not the actual loan used to "purchase the property?"

ANSWER: In most cases, yes.

If the loan is not the original one that purchased the house, but a refinance of one that purchased the house? A "refi" will also often be covered by the same non-deficiency rule. In Bank One v. Beauvais, 188 Ariz. 245, 937 P.2d 809 (App. 1997), in which the court held that an extension, renewal, and/or refinancing of a purchase-money loan retained the character as a purchase-money loan, and therefore was subject to the same general qualification as a purchase money loan. This also applies to second trust deeds or mortgages if they were "purchase money" and were for

residential property as noted above. See Mid-Kansas Federal Savings and Loan Ass'n v. Dynamic Dev. Corp., 167 Ariz. 122, 804 P.2d 1310 (1991).

EXCEPTIONS THAT COULD STILL MAKE ONE LIABLE:

This rule will not apply if the debtor has allowed the property to be wasted by such things as his own bad maintenance, by vandalism of him or others or uninsured losses before the foreclosure sale (voluntary waste). See A.R.S. 33-729(A). Also: If money was taken out of the loan for other purposes than purchase of the property (lines of credit, home equity loans and even purchase money loans where there was cash-back that was itemized as such), these anti-deficiency rules do not apply and the lender could see that cash directly from the borrower as a result of or in addition to the foreclosure. Id. Beauvais. The anti-deficiency rules also do not apply to a loan guarantee executed separately. As to the Guarantor, they are liable.

NON-RESIDENTIAL PROPERTIES:

QUESTION: So unless the loan meets the above qualifications, a deficiency is possible?

ANSWER: Yes.

Bare land, office buildings, tri-plexes and larger, commercial offices and the like ARE NOT NON-DEFICIENCY instruments. On those, the lender can sue for money, go to a sale and collect for a deficiency. The defenses in these situations are narrower. There are defenses in foreclosure law, itself, such as that the property was not sold at a reasonable value or that a claim for deficiency was not instituted in a timely fashion and other defenses. In some cases there can also be the defense of a wrongful appraisal and underwriting failures that could arise to a regulatory violation in addition to being actionable by the borrower or guarantors as misleading lending practices.

GUARANTEES AND LINES OF CREDIT:

QUESTION: What if I have signed a "Guaranty" for someone on the debt or they have signed one for my debt?

ANSWER: You or they could be liable for the debt or judgment to the extent it falls short of paying off the lender, even on a non-deficiency debt, depending upon how the Guaranty is worded.

Guarantys are enforceable even if for a debt which was purchase money, as the actual is on the separate written Guaranty and not the debt and even where there is no deficiency for the primary borrower. Pure lines of credit (for any use such as a credit card or for cash or for home improvement but not used as part of the purchase price of the property) all pull out money and so they are not purchase money debt and can be claimed upon independently and are not limited by the anti-deficiency statutes. A so-called pure "HELOC" is a line of credit-type loan when not used to purchase the home, though some HELOCs have been used for part or the entire purchase price. It is likely under the Beauvais theory (above) that if the HELOC was actually used to buy the home it is probably "purchase money" in fact and no deficiency on it can be had or, at the very least, as to the amount used to buy the home, it is purchase money if it was spent that way the

moment it was generated, but the balance taken out and not used to purchase the home may be collectible in an action on the debt. There is no clear authority on the effect of a "blended" (purchase and non-purchase in the same note) HELOC instrument, but there are some very logical questions that would cloud enforcement, such as "what part of each payment on a 'blend' goes to the "sub-non-deficiency" part of the debt and which to the "sub-deficiency"; what part of the foreclosure sale proceeds to which "sub-balance"? What part of the remaining debt is which "sub-balance?" A great deal of confusion is possible here and there is no legal authority to resolve that on a single note which, itself, does not even mention, let alone divide the "sub-balances".

RAMIFICATIONS OF FORECLOSURE OR DEBT RESOLUTIONS COMMON TO ALL STATES

QUESTION: Are there other ramifications for a failure to pay a debt?

ANSWER: Yes, and they must all be considered.

Most any foreclosure or debt reduction in the form of a loan modification, short sale, deed in lieu or other change of a pre-existing debt will have tax, credit eligibility, insurance, professional, licensure eligibility, immigration, employment, security clearances and other impacting affects. These must be analyzed in each case by a competent, licensed professional. In addition, the debtor has a separate liability for "rent-skimming," which is the taking of rents from a tenant at the secured property while not paying the loans against the property. A claim for rent recovery is the recourse in most states, and, in some states, this is also a crime. In all states it is a violation of the residential landlord-tenant acts if it is a residential property and most always a landlord violation of the lease agreement, whether residential or commercial. Real estate agents facilitating such skimming activity by a landlord or owner are in licensure violation in all states. Under current federal law, tenants in good stead with lease that predate the foreclosure will be permitted to remain for the period of their lease or 90 days.

Now how about some DEFENSES COMMON TO ALL STATES?

DEFENSES TO DEBT CLAIMS COMMON TO ALL STATES

QUESTION: Are there more defenses for the debtor in debt-collection actions or is the debtor (residential or commercial loan) strictly limited to what is in the foreclosure statutes?

ANSWER: There are many, many more debtor defenses than were mentioned in discussing the debt enforcements, above. Some defenses have nothing to do with foreclosure rules and are governed by criminal law, laws for general consumer protection, bank regulation, underwriting and appraisal rules and laws, bankruptcy and others.

In every state there are valid defenses to debt claims and these must be raised in any debt analyses or debt dispute by a competent, licensed attorney. Defenses common to bare land, residential and commercial debts incurred within the last 5-7 years are violations of the myriad of Federal and state law related to consumer protection, wrong or false appraisals, national or international subdivision application or subdivision sales defects, defective underwriting and reselling,

holder-in-due-course failures by the lenders and their assignees and their collection arms, bait-and-switch, loan-slamming, 100% loans lender-disguised and booked as "equity transactions" through 80/20 and 70/30 dual loans in violation of both warehousing and secondary market underwriting rules, contractual and tortuous bad faith, violation of a lender's own internal or Regulator-required standards, process and rules, dealings with the primary borrowers that void Guarantys, loan terms and Guarantys with terms so onerous they will be stricken as violations of public policy, and, especially in commercial settings, the debt being secured by a defective property or proforma for the property, inappropriate or negligent proprietarily involvement by the lender or its agents in the property, waste by the lender in possession, failure to follow mitigation duties or laws and other defenses among the multiple other contract and tort defenses such as outright statutory or consumer fraud, common law fraud, unlawful collection practices, racketeering and others. The parties need to consult their attorneys for these as they vary with each fact and transaction pattern.

TAX AFFECTS?

TAX AFFECTS COMMON TO ALL SHORT SALES AND FORECLOSURES

QUESTION: Is it true that a borrower can get taxed for the debt forgiven through loan write-offs, write-downs and foreclosures?

ANSWER: Yes.

IRS Section 108 governs the taxability to borrowers of losses, write-offs and write-downs by lenders, i.e. "phantom gain." Borrowers can be liable for income taxes for these excused debts. At the federal level, IRC 108 should be consulted for each application, but, in general, debts for which the only recourse is the property are not considered "phantom gain" when defaulted and written off. Debts which maybe pursued personally against the borrower are eligible for "phantom gain" treatment. Currently, "phantom gains" on purchase money debts against residential property which the debtor occupies—whether or not recourse—are exempt from taxation under a federal law up to $2 million in gain, but this law will "sunset" unless renewed soon. Some states do not recognize the same federal tax rules, so state treatments can vary. On the flip side, there are also losses that the debtor can write down for business or investment property lost in foreclosure or short sales or modified and these can have tax benefits, though often ones that must be spread over long periods of time or tax-planned to trigger along with gains. There are other ramifications. Some of these ramifications can be avoided by an artfully raised and effectuated claims and defense-tradeoffs between creditor and borrower. The debtor should contact a licensed professional for advice and applicability for the particular debtor.

There you have a thumbnail. Aside from Mark Twain's "issue" with the legal system, the judges and the lawyers—with whom he had frequent personal interaction due to his many patent, copyright and investor lawsuits, most of which he lost to his great resultant impoverishment ***if the***

22nd Century has taught us anything, it is that knowledge is power. Knowing and using the law for one's protection from the ravages of the Bad Guys is now probably one of the most important forms of modern literacy. Especially when there are so many more Bad Guys round these days than was once the case. "Smart" is not only knowing the law, but also knowing when to get help with it and that sometimes means getting a…..(gulp!)…lawyer. But another "Head's Up" here: ***Not all good lawyers—including those that know both the judge and the law—want to work for the Bank.*** Some favor the "Davids" of the world.

'Nuff said.

BIO FOR J. ROBERT ECKLEY

J. Robert Eckley is a multi-state real estate and banking attorney, successful litigator, popular writer, educator and national speaker with an immense personal and professional involvement in forefront issues over the past three decades. He has been a keynote speaker at NAR® National Conventions (receiving a perfect presentation score) and many state Association conventions which have honored him with top ratings. He has established precedent at the Supreme Court and co-founded transactional laws, rules and forms that guide practitioners today. He has been a licensee and/or Realtor® or Realtor® Affiliate for three decades, 5 years of which were with the Beverly Hills Board, 10 with the Phoenix, Scottsdale and Portland Associations, now a member of the North San Diego County Association of Realtors®, was named to numerous Commissioner's Advisory Committees, received a host of leadership and instructor awards, is a CCIM® Affiliate, testified in Congress against the due-on-sale clauses in 1982, successfully fought the clause in state and federal courts, fought against all and defended a half dozen state and nationally chartered banks and thrifts, and has received leadership awards and honors from former California Governor and U.S. President Reagan and former Arizona Governor and now head of U.S. Homeland Security Janet Napolitano, to cover just a few of the miles he has gone. He is a "been there, done that" type who is often as entertaining as he is practical and enlightening! See more at www. eckleylaw.com. To be on his "Counselor's Corner" monthly hotline e-mail to education@eckleylaw.com or call (602) 952-1177 or out of the Phoenix free dialing region 1-800-999-4LAW and ask to get on the hotline!