

Legal Alert

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Arizona Court of Appeals Allows Guarantors to Prospectively Waive Anti-Deficiency Protection (*Arizona Bank & Trust v. Barrons*)

Arizona is an “anti-deficiency” jurisdiction. A defaulting borrower is not liable for the loan balance that remains following the non-judicial foreclosure of real property that is 2.5 acres or less and used only as a single-family or two-family dwelling. A.R.S. § 33-814(G). This provides homebuyers with some protection from declining real-estate values. It also shifts to lenders the risk of undervaluing collateral.

A new opinion from the Arizona Court of Appeals affects the scope of anti-deficiency protection. But to fully understand this new opinion, it helps to review two prior decisions.

First, in *Mid Kansas v. Dynamic*, the Arizona Supreme Court held that the anti-deficiency statute is not limited to consumers. Rather, the law protects any owner of qualified property—even if the property is held as an investment. As the court explained, although the legislature may have intended to protect individual homeowners and not residential developers, the statute contains no limiting language.

Second, in *Parkway v. Zivkovic*, the Arizona Court of Appeals held that a borrower’s rights under the anti-deficiency statute cannot be waived prospectively. Without this rule, lenders could require such waivers in their loan documents, unsophisticated borrowers would sign, and the policy considerations supporting the anti-deficiency statute would be lost.

The new opinion is *Arizona Bank & Trust v. Barrons*. A company purchased several vacant lots, and the bank agreed to finance a residential subdivision. The company’s principals executed personal guaranties in which they expressly waived protection under the anti-deficiency statute. The loans fell into default, so the bank foreclosed on the individual properties. The bank submitted credit bids that resulted in six-figure deficiency balances. Although the properties qualified for anti-deficiency protection, the bank sued the personal guarantors.

The guarantors argued that the anti-deficiency waivers were unenforceable under *Parkway v. Zivkovic*, but the Arizona Court of Appeals disagreed. After acknowledging the policy reasons for not enforcing waivers against primary borrowers, the court explained that individuals who guarantee loans generally are not the type of consumer whom the statute was intended to protect. This reasoning seems inconsistent with the holding in *Mid Kansas v. Dynamic* that the anti-deficiency statute is not limited to consumers. But the court justified its conclusion by distinguishing primary borrowers from guarantors.

The full effect of *Arizona Bank & Trust v. Barrons* remains to be seen. In theory, lenders could try to avoid anti-deficiency laws by structuring all residential loans to include personal guarantees containing anti-deficiency waivers. We also expect the case to be appealed further to the Arizona Supreme Court. For now, though, Arizona law provides that prospective waivers of the anti-deficiency statute are enforceable against guarantors.

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