

Certain Residential Developers are Unprotected by the Anti-Deficiency Statute after Foreclosure of a Deed of Trust on Vacant Property

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Nearly three years ago, in *M&I Marshall & Isley Bank v. Mueller*, the Arizona Court of Appeals held that the Arizona anti-deficiency statute (A.R.S. § 33-814) protects a borrower who started, but never completed, construction of a single-family dwelling before defaulting on its loan. Recently, the same appellate court limited those anti-deficiency protections by holding in ***BMO Harris Bank v. Wildwood Creek Ranch, LLC*** that a developer of vacant land - land on which no construction has begun - cannot invoke the anti-deficiency statute as a matter of law, regardless of whether the borrower intends to eventually reside on that land.

In 2006, Wildwood Creek Ranch, LLC ("Wildwood") obtained a \$296,200 loan from BMO Harris Bank's predecessor in interest, M&I Bank, for the purchase of an unimproved, vacant lot in Scottsdale, Arizona. The vacant lot was secured by a deed of trust on the land. Shaun and Kristina Rudgear, Wildwood's sole members, executed a promissory note on behalf of Wildwood and also personally guaranteed the promissory note. There was never any construction upon the property. In 2011, Wildwood and the Rudgears defaulted on their loan obligations. BMO Harris Bank ("BMO") foreclosed on its deed of trust securing the vacant lot through a trustee's sale and then sued Wildwood and the Rudgears to obtain a deficiency judgment for the unpaid balance of the loan.

The parties filed cross-motions for partial summary judgment regarding the applicability of A.R.S. § 33-814(G), the anti-deficiency-judgment statute. Seeking protection under the anti-deficiency statute, the Rudgears argued that BMO could not recover the unpaid balance of the loan because, as they asserted in affidavits, they intended to build a house on the property and occupy it as their primary residence. BMO submitted evidence that the Rudgears owned three separate parcels, each of which they purportedly intended to use as a primary residence. However, the Superior Court ruled in favor of Wildwood and the Rudgears, concluding that no material evidence contradicted the Rudgears' affidavits and that their intent to build a residence on the property precluded BMO from obtaining a deficiency judgment.

The Court of Appeals reversed the holding of the Superior Court on the basis that vacant property upon which no construction had begun does not constitute a "dwelling" as defined by the anti-deficiency statute, and as such, protection thereunder could not be invoked. Specifically, A.R.S. § 33-814(G) prohibits an action to obtain a deficiency judgment if the property at issue: (1) was

encumbered by a deed of trust, (2) sold at a trustee's sale, (3) consists of two-and-a-half acres or less, and (4) "is limited to and utilized for either a single one-family or a single two-family **dwelling**." (Emphasis added). Only the last requirement was disputed in this case. The critical difference between *M&I Marshall & Isley Bank v. Mueller* and this case is that here, the property at issue was vacant, and there had never been any construction. Unimproved, vacant land is not a "dwelling" as required by the anti-deficiency statute.

Judge Kessler of the Court of Appeals specially concurred to discuss his views on what triggers the applicability of the anti-deficiency statute. Judge Kessler suggested the need to scrutinize a borrower's alleged intent to occupy the property for residential purposes. In this particular instance, Wildwood's loan renewal documents listed the primary purpose of the loan as "Business," it purchased several contiguous lots and made plans to develop them simultaneously, and represented in several other deeds of trust that the Rudgears intended to utilize those different parcels as their residences as well. Judge Kessler ultimately concluded that "once construction has begun, a court should determine whether the debtor is protected from a deficiency judgment based on a totality of the circumstances to see if the debtor intended the structure under construction to be utilized as his or her dwelling." In other words, if any construction has occurred, the borrower's intent regarding the use of the building under construction would be determinative.

As a result of the opinion set forth in *BMO Harris Bank v. Wildwood Creek Ranch, LLC*, lenders and developers will be affected in that this decision shows a shift in favor of lenders in that it renders the anti-deficiency statute a less powerful defense to be used by a borrower who has defaulted.

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