

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2012-013788

10/05/2015

HONORABLE LORI HORN BUSTAMANTE

CLERK OF THE COURT
T. Nosker
Deputy

ZIONS FIRST NATIONAL BANK

DEVIN SREECHARANA

v.

OLD CYPRESS HOLDINGS L L C, et al.

MICHAEL N POLI

RULING MINUTE ENTRY

The court has reviewed and considered the numerous exhibits admitted, the testimony presented and the law regarding fair market value. The court hereby enters the following findings of fact and conclusions of law.

FINDINGS OF FACT

General Background

1. In 2007, the Woof Expressions (“WE”) Parties purchased real property and improvements (a warehouse building) located at 1619 West Knudsen Drive, Phoenix, Arizona 85027 (the “Property”) for the purpose of operating their fine custom woodworking and cabinetry business. *Hearing Exhibit 1 (Note); Hearing Exhibit 2 (Deed of Trust); Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter.*

2. The WE Parties purchased the Property for \$3.2 million. To fund this purchase, the Potters invested \$500,000 of their personal funds, and they obtained a \$1,585,000 loan from Western National Bank (the “Loan”), and a separate loan from the U.S. Small Business Administration. *Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter; Hearing Exhibit 1 (Note); Hearing Exhibit 2 (Deed of Trust).*

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3. Western National Bank later sold the Loan to Zions First National Bank (“Zions”). As a result, Zions then held a first position lien on the Property. *Zions’ Complaint*, ¶¶ 19-20.

4. The WE Parties did not miss a payment on the Western National / Zions Loan between their 2007 purchase of the Property and February of 2012. *Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter*.

5. Between 2007 and 2012, the WE Parties made improvements and upgrades to the Property to customize it for their use as a woodworking showroom/ manufacturing facility. *Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter; Hearing Exhibit 50*.

6. On January 23, 2012, the Property sustained fire damage, related water damage from the sprinkler system, and damage as a result of acts of fire suppression by firefighters. *Hearing Exhibits 14, 15, 22*. As a result of that damage, the WE Parties’ business was interrupted and they were not able to make payments on the Loan. *Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter; Zions’ Complaint*, ¶ 21.

7. The WE Parties submitted an insurance claim with regard to the fire and water damage. The purpose of the insurance claim was to restore the Property to its prior use as a high-end custom cabinetry showroom and woodworking manufacturing shop. *Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter; Hearing Exhibit 50 (photos of the Property’s interior before the damage)*.

8. The WE Parties retained David Fix and his company, Adanac Enterprises, to prepare a construction estimate for the insurance claim, and he prepared an estimate to restore the Property to its prior use as a high-end custom cabinetry showroom and woodworking manufacturing shop. *Hearing Exhibit 10 (Adanac estimate); Hearing Testimony of David Fix; Hearing Testimony of Kelly Potter; Hearing Testimony of David Potter*.

9. The WE Parties had purchased insurance coverage under a Replacement Cost insurance policy – also called a Replacement Cost Value insurance policy – they may have been entitled under their insurance policy to replacement of any significantly damaged property even if the item was still functional (such as smoke-damaged but functional HVAC units). *Hearing Testimony of David Fix*.

10. The insurance carrier for the WE Parties, Cincinnati Insurance Company (“CIC”), retained a construction consultant, Rimkus Engineering (“Rimkus”), with respect to the insurance claim. Rimkus determined that the Property’s HVAC units still functioned properly after the fire and had sustained only smoke damage. Rimkus did not recommend replacement of the HVAC units. *Hearing Exhibit 19 (Rimkus Estimate), pages 10-11*.

11. The WE Parties’s insurer, CIC, also retained Aaxiom Consulting & Engineering (“Aaxiom”) to perform its own evaluation of the cost to restore the Property to its prior use as a high-end custom cabinetry facility. *Hearing Exhibit 11 (Aaxiom Estimate), page 32; Hearing Exhibit 12 (2014 Lyons Report), page 102*.

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The Trustee's Sale

12. Pursuant to the Notice of Trustee's Sale, Zions conducted a trustee's sale of the Property on August 10, 2012 at 10:00 a.m. *Hearing Exhibits 3 and 5; Hearing Testimony of Margaret Gillespie.*

13. Zions opened the Trustee's Sale with a credit bid of \$755,233.00. *Joint Prehearing Statement, page 3, line 3; Hearing Exhibit 5 (notes from the Trustee's Sale).*

14. Potential buyers attended the Trustee's Sale, and four interested buyers placed \$10,000.00 deposits in order to be allowed to bid on the Property. *Hearing Exhibit 5 (notes from the Trustee's Sale); Hearing Testimony of Margaret Gillespie.*

15. Two potential buyers engaged in very active bidding and made 60 separate competing bids on the Property. Ultimately, the Property was sold at auction for \$885,000.00 (the "Auction Price"). *Hearing Exhibit 5 (notes from the Trustee's Sale); Hearing Testimony of Margaret Gillespie.*

16. The winning bidder was MC Development ("MCD"), which is owned by Marty Ceccarelli, and upon tendering payment of \$885,000.00 to Zions, Zions recorded its Trustee's Deed of Sale on August 20, 2012. *Hearing Exhibit 5 (notes from the Trustee's Sale); Hearing Exhibit 6 (email from Ms. Gillespie to Mr. Ceccarelli); Hearing Exhibit 7 (Trustee's Deed of Sale); Hearing Testimony of Margaret Gillespie.*

17. MC Development made repairs to the property and then sold the property within three months for \$1,400,000.00. *Hearing Exhibit 13.*

The Initial FMV Figure

18. Before the Trustee's Sale, Zions retained an appraiser, David Lyons, to determine the Fair Market Value of the Property if the fire / water damage had been repaired back to a generic warehouse condition for sale to a variety of potential buyers (the "Initial FMV"). *Hearing Exhibit 8.*

19. Mr. Lyons' concluded that the Initial FMV of the Property to be \$1,400,000 as of April 9, 2012. *Hearing Exhibit 8.*

20. Mr. Lyons' April 16, 2012 report was ninety-five pages and set forth the figures and analysis used in arriving at the FMV figure of \$1,400,000.00. *Hearing Exhibit 8.*

21. Mr. Lyons' retrospective June 27, 2014 one hundred and four page report again provides an "as if repaired" value of the Property at \$1,400,000.00. *Hearing Exhibit 12.*

22. Michael Ciosek testified on behalf of the WE parties that his analysis, conducted after the Trustee Sale, revealed that the Initial FMV is anywhere between \$80.00 to \$93.00 per square foot or \$1,534,720.00 to \$1,784,112.00. *Hearing Exhibits 20 and 21; Video Deposition Transcript of Mr. Ciosek.*

23. The tax amount owed on the Property through the Sale Date was \$37,301.06. *Hearing Exhibit 13.*

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The Repair Cost Figure

24. The parties in this matter both presented evidence on the proper amount of a reduction in the Initial FMV for the necessary cost of repair to restore the Property back to a standard warehouse condition for sale (the "Repair Cost"), so as to determine the Property's actual fair market value in a damaged condition on the date of the Trustee's Sale, August 10, 2012 (the "FMV").

25. David Fix of Adanac Enterprises testified regarding the Repair Cost. Mr. Fix prepared an insurance repair estimate for the WE Parties for the purpose of restoring the Property to its prior use as a high-end custom cabinetry showroom and woodworking facility. *Hearing Testimony of David Fix; Hearing Exhibit 18 (2015 Adanac Report)*.

26. For purposes of the FMV Hearing, Mr. Fix prepared an estimate of the cost to restore the Property for the purpose of selling it to a wide variety of potential buyers (i.e., for use as a generic warehouse, without restoring any of the custom features added by the WE Parties and without replacing any items that were still functional such as the HVAC units). *Hearing Testimony of David Fix; Hearing Exhibit 18 (2015 Adanac Report)*.

27. Mr. Fix's Repair Cost number to restore the Property for sale as a standard or generic warehouse is \$65,963.48. *Hearing Testimony of David Fix; Hearing Exhibit 18 (2015 Adanac Report)*.

28. MCD repaired the damage to the Property before it resold the Property. MCD's accounting firm, Reid & Reid, produced a spreadsheet that MCD alleged reflected the expenses MCD incurred in purchasing, repairing, and reselling the Property (the "Spreadsheet"). Because the Spreadsheet purports to track all of MCD's costs associated with its ownership of the Property, it contains various entries that do not relate to repairs. For that reason, the following entries do not pertain to the costs of repair:

- All entries between 5/12/2012 and the date of the Trustee's Sale, 8/14/2012 (i.e., expenses incurred before MCD purchased the Property) (\$887,505.32, including the \$885,000 spent by MCD to purchase the Property at the Trustee's Sale);
- Interest payments on 8/15/12 and 9/16/12 (\$1,700 and \$3,100, respectively);
- HOA fee payments on 9/28/12 (\$150.96 and \$272.57);
- A phone payment on 10/19/12 (\$132.95); and
- Administrative fees on 12/31/2012 (\$3,013 and \$365.88).

Once these entries are removed, the MCD Spreadsheet reflects alleged repair costs of \$105,665.20. *Hearing Exhibit 53 (MCD's Spreadsheet)*.

29. In responding to separate subpoenas duces tecum from the parties with regard to the amount it spent on repairs to the Property, MCD provided an estimate, dated October 26, 2012, of \$75,000.00 for new HVAC units. MCD did not provide an invoice or any evidence that the new HVAC units had actually been purchased and installed. The \$75,000.00 expense was not described on MCD's Spreadsheet of its expenses. *Hearing Exhibit 53 (MCD's Spreadsheet)*.

30. The custodian of records from MCD's accounting firm, Reid & Reid, indicated that MCD claimed on its taxes that it had spent \$75,000.00 on new HVAC units, which reduced

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MCD's capital gains taxes on the resale of the Property. Mr. Ceccarelli provided the \$75,000.00 number to Reid & Reid only verbally, with no documentation. *Hearing Testimony of John Schroder.*

31. The custodian of records for Honeyman AC, L.L.C. ("Honeyman"), the HVAC company that is listed on the "Estimate," testified that he spent two hours searching (1) all records from 2012, (2) all warranty records, and (3) records that the company maintained relating to work performed for MCD, without finding any evidence that Honeyman actually installed new HVAC units at the Property (Honeyman is under new ownership, but as part of the purchase, the new owners received what they believe to be the company's complete business records). *Hearing Testimony of Patrick Durfee.*

32. With permission from Honeyman, Kelly Potter separately reviewed Honeyman's records, for both 2012 and 2013 (in case records were misfiled), without finding any support for the \$75,000.00 HVAC expense. *Hearing Testimony of Kelly Potter.*

33. David Potter testified that he asked the new owner of the Property if the HVAC units were new as of 2012, and he was informed they were not. *Hearing Testimony of David Potter.*

34. No actual bill was provided regarding the HVAC units. The document provided stated on the top of the form that it was an "ESTIMATE." *Hearing Exhibit 13 (MCD documents), page MCD 0024.*

35. The \$75,000.00 expense was not included in the lengthy and detailed Spreadsheet of all the costs that MCD incurred in repairing and reselling the Property. *Hearing Exhibit 53 (MCD's Spreadsheet).* The Spreadsheet includes minor sums (e.g., \$11.76 for breakfast for the crew on 8/31/12 and \$22.43 for a mirror from Target on 9/21/12) yet there is no reference to a \$75,000.00 expense for HVAC unit replacement. The Spreadsheet does describe an expense for minor HVAC work. An entry dated September 14, 2012 describes a \$475 expense to "install 2 new ducts & 2 new 8" diffusers." *Hearing Exhibit 53 (MCD's Spreadsheet).*

36. The insurance carrier's (CIC's) consultant, Rimkus Consulting Group, examined the HVAC units months prior to the Trustee's Sale and found them to be functioning. *Hearing Exhibit 19 (Rimkus report), pages 10-11.*

37. MCD's principal, Mr. Ceccarelli, testified that he would not have replaced anything if it didn't need to be replaced. *Hearing Testimony of Marty Ceccarelli.*

38. MCD's Spreadsheet also has an expenditure of \$20,000 for "electric." *Hearing Exhibit 53 (MCD's Spreadsheet).* There is a "work order" for electrical work that MCD supplied in response to a subpoena, which indicated \$3,000 of electrical work. *Hearing Exhibit 53 (MCD's Spreadsheet) and Exhibit 13 (MCD documents), page MCD 00019.*

39. There is an expense of \$10,351.68 in the Spreadsheet for "screen wall replacement." David Potter testified the property does not contain a screen wall. *Hearing Testimony of David Potter.* Neither Aaxiom (the vendor for the insurance carrier) nor Adanac (Mr. Fix) described any "screen wall" work in their respective estimates. *Hearing Exhibit 10 (Adanac Estimate); Hearing Exhibit 11 (Aaxiom Estimate).*

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40. In a letter to Zions, Mr. Lyons stated, “we are not construction experts, and do not have experience in preparing or reviewing these types of estimates.” *Hearing Exhibit 27 (letter dated July 9, 2012), page 2; Hearing Exhibit 12 (2014 Lyons Report), pp. 104* (“Lyons Valuation Group, LLC and David M. Lyons, MAI are appraisers and not part of the insurance industry and are not experts in estimating costs associated with repairing fire damage.”).

41. For his Repair Cost figure, Lyons relied exclusively on two insurance repair estimates that were supplied to him by Zions. *Hearing Exhibit 12 (2014 Lyons Report), page 102* (“In doing this, I reviewed the data available from two sources. Two bids were submitted to the appraiser, one from the property owner and one from the insurance company.”).

42. Lyons’ Repair Cost estimate is based on insurance estimates which reflect the cost to restore the Property to its prior use as a high-end custom cabinetry business, and doing so under a Replacement Cost insurance policy. Lyons noted that these insurance estimates were prepared for a different purpose, on page 104 of his 2014 report, stating, “the property does not need to be returned to its original condition in order to be completely functional.” *Hearing Exhibit 12 (2014 Lyons Report), page 104*.

43. In his deposition, Lyons criticized both insurance repair estimates (one for \$525,000 and one for \$1,161,852) as being “wildly wrong from the actual cost to -- to cure [repair] the property to area standards.” *Excerpt from Lyons deposition played in the Hearing, page 131:18-19; Hearing Exhibit 12 (2014 Lyons Report), p. 104* (“[T]here are items listed in both estimates that the appraiser feels did not need replacement[.]”).

44. Lyons admitted that both insurance estimates were prepared for a different purpose, and he thought they were both too high. Lyons employed these estimates to arrive at a Repair Cost of \$600,000. *Hearing Exhibit 12 (2014 Lyons Report), page 104*.

45. Lyons’ Repair Cost estimate is \$75,000 greater than the lower of the two estimates that Lyons himself criticized as being too high. *Hearing Exhibit 10 (Adanac Estimate); Hearing Exhibit 11 (Aaxiom Estimate); Hearing Exhibit 12 (2014 Lyons Report)*.

46. Lyons determined that the “as is” FMV of the Property was \$800,000 (\$1,400,000 less the projected Repair Cost of \$600,000). *Hearing Exhibit 12 (2014 Lyons Report), page 104*.

CONCLUSIONS OF LAW

1. A.R.S. § 33-814(A) provides the definition for “fair market value”:

The fair market value shall be determined by the court at a priority hearing upon such evidence as the court may allow. The court shall issue an order crediting the amount due on the judgment with the greater of the sales price or the fair market value of the real property. For the purposes of this subsection, “fair market value” means the most probable price, as of the date of the execution sale, in cash, or in terms equivalent to cash, or in other precisely revealed terms, after deduction of prior liens and encumbrances with interest to the date of sale, for which the real property or interest

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therein would sell after reasonable exposure in the market under conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably and for self-interest, and assuming that neither is under duress. Any deficiency judgment recovered shall include interest on the amount of the deficiency from the date of the sale at the rate provided in the deed of trust or in any of the contracts evidencing the debt, together with any costs and disbursements of the action.

2. Appraisal evidence of the value of the property at or near the proximate time of the Trustee Sale is relevant to the determination of fair market value. *N.W. Bank (MN), N.A. v. Symington*, 197 Ariz. 181, 3 P.3d 110 (Ariz. Ct. App. 2000).

3. The price that the Property sold for at auction in the Trustee's Sale is not necessarily accurate evidence of its fair market value. See *MidFirst Bank v. Chase*, 230 Ariz. 366, 368, ¶7, 284 P.3d 877, 879 (Ariz. Ct. App. 2012) ("Because of the nature of a trustee's sale, the statute does not contemplate that the purchase price will necessarily reflect the fair market value of the property."); *First Interstate Bank of Arizona, N.A. v. Tatum & Bell Ctr. Assoc.*, 170 Ariz. 99, 100, 821 P.2d 1384, 1385 (Ariz. Ct. App. 1991) (the Fair Market Value determination "serves to protect the borrower against a deficiency artificially inflated by a deflated trustee's sale."); *TCC Enterprises v. Estate of Erny*, 149 Ariz. 257, 258, 717 P.2d 936, 937 (Ariz. Ct. App. 1986) ("Market value is determined by hypothesizing a sale; it is that price a desirous but unobligated purchaser would pay a desirous but unobligated seller after consideration of all uses to which the property is adapted and for which it is capable of being used.").

4. "When value is to be fixed and determined as of a date certain, increases or decreases in value from that point in time should not be considered in the valuation." *Life investors Ins. Co. of Am. v. Horizon Res. Bethany, Ltd.*, 182 Ariz. 529, 534, 898 P.2d 478, 483 (Ariz. Ct. App. 1995). However, information post-sale in determination of fair market value may be given the weight "deemed appropriate on the valuation question." *Id.*

5. "The court must determine whether the witness' expertise is applicable to the subject about which he intends to testify, and specifically whether the witness' training and experience qualify him to render opinions which will be useful to the trier of fact." *Lay v. City of Mesa*, 168 Ariz. 552, 554, 815 P.2d 921, 923 (Ariz. Ct. App. 1991).

ANALYSIS/CONCLUSIONS

The court accepts David Lyons Initial FMV amount of \$1,400,00.00 based upon his expertise and extensive report. His report details a personal inspection of the property, sales comparisons of other properties, extensive research and reasoning regarding how he arrived at the fair market value figure of \$1,400,000.00. The court recognizes that Michael Ciosek analysis revealed that the Initial FMV is anywhere between \$80.00 to \$93.00 per square foot or \$1,534,720.00 to \$1,784,112.00. However, the court finds Mr. Ciosek's analysis was conducted

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after the sale of the property and is not as detailed as the report and analysis provided by Mr. Lyons.

Although the court accepts David Lyons appraisal of the property and his expertise to appraise the property, the court is unable to accept Mr. Lyons \$600,000.00 figure as the repair cost estimate because it is not his area of expertise and the repair cost estimates he used were flawed. The estimates involved replacement cost values and/or expenditures that would be unnecessary to get the building back to a “plain” warehouse. David Lyons admitted in a letter to Zions: “we are not construction experts, and do not have experience in preparing or reviewing these types of estimates.” *Hearing Exhibit 27 (letter dated July 9, 2012), page 2 (emphasis added); Hearing Exhibit 12 (2014 Lyons Report), pp. 104* (“Lyons Valuation Group, LLC and David M. Lyons, MAI are appraisers and not part of the insurance industry and are not experts in estimating costs associated with repairing fire damage.”). By his own admission, Mr. Lyons is not qualified to testify as an expert with regard to the Repair Cost issue because he possessed neither the experience nor the training with regard to the review and evaluation of construction and insurance estimates. Furthermore, Mr. Lyons stated that the estimates he used were “wildly wrong from the actual cost to - to cure [repair] the property to area standards.”

The court did consider the actual sale price at the Trustee Sale but the entire opening bid figure was based upon erroneous repair cost information. The fact that there was active bidding that resulted in sixty bids is an indication that the opening bid figure was too low. As a result of the inaccurate Repair Cost Estimate supplied by Mr. Lyons, the court is in the position of needing to determine the repair cost of the property from other sources including the actual costs to repair the property. There is an abundance of evidence to show that Mr. Ceccarelli did not replace the HVAC at a cost of \$75,000 so the court did not consider the HVAC in the analysis of the cost of repairs. The MCD Spreadsheet reflects alleged repair costs of \$105,665. Although the \$20,000 figure for the electrical work is not supported by any additional documentation other than a “work order” for \$3,000, there is insufficient information to preclude this expense. There is an expense of \$10,351.68 in the Spreadsheet for “screen wall replacement.” However, the undisputed testimony was that the Property does not contain a screen wall. Since this entry describes the replacement of a feature that did not exist on the Property, the court deducted the amount of \$10,351.68. After removing the non-repair expenses and the \$10,351.68 figure to replace a non-existing screen wall, the Spreadsheet reflects that MCD invested \$95,313.52 in repairs before reselling the Property.

The actual cost of repairs in the amount of \$95,313.52, described above, appears to be the best evidence of the cost of repairs. This figure is also fairly close, or at least more in line with, the testimony of Mr. Fix, a construction expert, indicating repair costs in the amount of \$65,963.48.

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THE COURT FINDS the Property's Fair Market Value on August 10, 2012, without accounting for the fire or related damage (the Initial FMV) is \$1,400,000.00.

THE COURT FURTHER FINDS the Initial FMV should be reduced by the reasonable amount of Repair Cost as a result of the fire and related damage, in the amount of \$ 95,313.52.

THE COURT FURTHER FINDS that after deducting the Repair Cost (\$95,313.52) and the taxes owed (\$37,301.06), the Property's Fair Market Value on the date of the Trustee's Sale, August 10, 2012, was \$1,267,385.50.