

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

HONORABLE J. KENNETH MANGUM

CLERK OF THE COURT
D. Glab
Deputy

COBIZ BANK

DAVID E FUNKHOUSER III

v.

VALLE ALEGRO L L C, et al.

GREGG CLARKE GIBBONS

RULING

This matter having been under advisement, the following constitutes the FINDINGS OF FACT and CONCLUSIONS OF LAW with respect to the evidentiary hearing presented to the Court on May 11, 2009. If any FINDING OF FACT should be a CONCLUSION OF LAW or vice versa, it shall be so considered.

FINDINGS OF FACT

1. The witnesses' testimony is generally summarized under each person's name and it doesn't necessarily constitute the Court's conclusions. For simplicity, witnesses are generally referred to by their last name. The footnotes contain additional or background information not presented by the testimony.
2. The purpose of the hearing was to determine the fair market value (FMV) of the land in question for purposes of determining the deficiency pursuant to ARS §33-814.
3. All of the proffered exhibits 1 through 4 were admitted by stipulation:
 - a. Trustee's deed

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

- b. Raynak Appraisal for plaintiff
- c. Dunlap Appraisal for defendants
- d. Dunlap Rebuttal report

Mitchell Burda

- 4. Mitchell Burda is the Vice President and Loan Officer at Arizona Business Bank. He was formerly VP of M&I Bank. He has 38 years in the banking business.
- 5. He underwrites loan requests and presents them to the bank for consideration. The land in question was sold at a trustee's auction on October 16, 2008, for the credit bid of \$143,000.00.
- 6. The bank categorizes real estate into three divisions.
 - a. A bid on a completed property such as a developed home would be discounted 10% with an additional allowance of 5% for marketing costs.
 - b. A bid on a finished lot would be discounted 20% with an additional 5% for marketing costs.
 - c. A bid on vacant land would be discounted 30% with an additional 5% for marketing costs.
- 7. In actuality, the marketing costs are currently 6% for realtor fees.
- 8. The issue of liquidity deals with how long plaintiff has to hold the property before it can be sold. Holding costs include insurance, taxes, etc.
- 9. The property in question is vacant land and is therefore the least desirable type of property to hold. Custom homes and finished lots cost less than this lot.
- 10. Quick Trip Stores (QT Stations) offered \$225,000.00 for the lot but that had a contingency of a zoning change from R-16 to C-2. The zoning change wasn't approved, so the contract was canceled.
- 11. The bank placed the land under the ownership of Western Subsidiary Investors, a

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

subsidiary of the bank. It is listed on the books as an OREO, or Other Real Estate Owned.

12. The Loan Administration department calculates how much the bank can bid on property, but Burda doesn't know how those calculations are made.

Thomas Aquinas Raynak

13. Thomas Aquinas Raynak has been a commercial real estate appraiser since 1987 after doing non-commercial appraisal work for two years. He has worked for Lefevers Viewpoint Group, Inc., since 1995. He has a B.S. in Geography and Urban Planning from Penn State, and a Masters in Land Use Analysis from ASU. He has performed about 100 appraisals or more per year for the last 15 years.
14. He has been a certified general appraiser for the State of Arizona since 1990.
15. He is also a member of the Appraisal Institute (MAI). This is the largest, most prestigious designation for appraisers and only 5% of commercial appraisers have this designation. He has never had a lapse in certification or membership and has not had a complaint filed against him.
16. For the last five years, he has specialized in residential land: town houses, developments and vacant land. Virtually all of it is proposed.
17. He used various sources of information for sales in the Phoenix metro area.
18. There are three rules for an appraiser to comply with:
- a. Uniform Standards of Professional Appraisal Practice (USPAP).
 - b. Appraisal Institute.
 - c. Client rules (such as requirements set by Arizona Business Bank).¹
19. He has performed about 50 appraisals for plaintiff. He would not do an appraisal for a friend as this would be a conflict of interest.

¹ See, for example, Exhibit C to exhibit 2, ABB/VA-0199
Docket Code 019

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

20. The particular property in question was appraised three times. (He did the original appraisal and did the review appraisal for the second and third appraisals.) He visited the property for the first appraisal and saw it again a month ago.
21. The market for such properties has significantly declined in the last many months. His last appraisal of this land underestimated the market decline.
22. He determined that the area was .83 acres, but this is not a significant difference compared to the .99 acres as determined by defendants' appraiser; it wouldn't affect the value.
23. The property has a large municipal water tank on the lot to the west, the Santa Fe RR and Grand Avenue are to the west and south, a small, vacant land is to the south, older homes with deferred maintenance (i.e., a state of disrepair) are to the north, and 83rd is to the east. Peoria Avenue is to the south. The city owns a tiny plot between the parcel and 83rd Avenue. The major streets provide good visibility but the RR and the streets detract from value because of traffic and noise.
24. The effective date of the appraisal is 9-18-2008, and was done without knowing there was a prospective foreclosure. The understanding was that 14 town homes were proposed for the land. The first two appraisals were done with a per unit basis (i.e., per townhouse) and the 3rd was based on a square foot basis.
25. There is not much of a market for this type of small, infill property. Two years ago there was more of a market but it wasn't financially feasible even then.
26. Dunlap's appraisal has an evaluation date as of 10-16-08, with the inspection having occurred on 2-27-09, and the date of the report being 3-13-09. Dunlap used three sales and two pending sales (L-4 and L-5).
27. Raynak does not believe that L-5 is a comparable because it is at 2345 E. Indianola, Phoenix, or about a mile from Biltmore Fashion Square. It is a superior location. L-4 was two vacant lots with one livable home and one unlivable home. He doesn't know if L-4 sold, but L-5 is still pending. Dunlap's use of a 20% discount for location is too light. A better discount would be 40-50%, which would mean a lower per-foot price.
28. L-1 sold in January 2007 and is discounted 27% for the sale date, but Raynak would discount it up to 50% or more, which would mean a lower per-foot price.

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

29. L-2 was sold 13 months before the valuation date of the property in question and the adjustment by Dunlap of 18% is too light and should be 30% or more.
30. L-3, L-4, and L-5 are in Phoenix and L-1 and L-2 are in Peoria.
31. It's very difficult to appraise the property because there's no market for a small, infill lot. Most builders are nationally traded or are big regional builders who don't build this kind of property.
32. Dunlap's appraisal was \$215,000.00 plus or minus 10% but Raynak doesn't know anyone who would buy it. For example, in the last half of 2008, we had a drop of 30% in the value of land and finished lots.
33. Therefore, fully improved lots in Maricopa County are less than \$10,000.00 per townhouse unit.² Thus, just above \$140,000.00 for this project of 14 units is about right. Raynak's analysis is separate from the credit bid by plaintiff. Accordingly, the value is less than \$10,000.00 per unit.
34. He believes that the FMV was at best \$220,000.00 as of 9-18-08, but that isn't the FMV on the date of the trustee's sale. As he sits today, he would appraise the lot significantly below \$220,000.00.

Roger Lee Dunlap

35. Roger Lee Dunlap has appraised commercial land since 2001. Before than he was in training as an appraiser and before than he spent 13 years doing analysis for a law firm specializing in condemnation.
36. He has a BA from ASU and has taken 12 to 15 week-long courses. He is a member of the Appraisal Institute, but not a designated member (as is Raynak).
37. The property in question is the SW corner of 83rd Avenue and Stone Avenue (just north of 83rd Avenue and Peoria). The Stone street side would require a sidewalk and curb to be installed by the developer. Off site facilities means the city would require amenities such as a sidewalk and street lights even though these are not on the property.

² The property was assembled in 2005 and 2006 for a per-unit price of \$34,357 and a total price of \$481,000.

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

38. He visited the property several times for this retrospective date of value. He considered Raynak's report, a subscription to CoStar, MLS, Wind II Data from a title company, and talking to nine brokers, sellers and buyers. None of the nine said they would buy the property though one said it would go for \$5 to \$8 per square foot. This property is in a flood plain (unlike L-5) and additional negatives are the nearby RR and arterial streets.
39. L-5 is relevant as a comparable. The highest and best use of this property in question is to hold it for multifamily housing.^{3,4}
40. Because multifamily housing has gone down over time, you have to use equivalent sales. He concludes that 8-15% decline is appropriate and 15%, or over 1% per month, is the best. Thus, you would discount Raynak's figure of \$220,000.00 by 2% (for two months) and this would reduce his FMV for the date of the trustee's sale to \$117,800.00, or very similar to Dunlap's appraisal.
41. The square footage of the land in question is very important. At a square foot analysis of \$6 times the actual size of the lot, the resulting value for Raynak would be \$258,156.00. Dunlap looked at the title report and deed and used the metes and bounds with a computer program to get an exact size.⁵ There are actually five different parcels in this lot.⁶ This explains the difference in lot size in the two reports (i.e., the .83 acre for plaintiff vs. the .99 acre for defendants). The metes and bounds do not include land that is dedicated to the city for streets though there may be easements included in that.
42. L-5 is a preferable property as there is no RR and no vacant property nearby. Also, it is close to the Ritz Carlton and the Biltmore Shopping Center. That is one of the

³ Raynak concludes that "*townhouse development of the site, as vacant, is not financially feasible at the present time.*" (Emphasis in original) [ABB/VA-0172]

⁴ Raynak's report points out that while the overall prospect is good for residential units, the market will be soft until late 2009 or early 2010. This is based on the vacancy rates for housing and the decline in demand for homes. [ABB/VA-0170 and preceding page]

⁵ See, the calculations at pages CAMPO0254 to 0258, exhibit 3 and pages CAMPO0287 to 0291, exhibit 4.

⁶ The Assessor's Plat Map seems to show seven parcels [ABB/VA-0124] as does the property history [0128]. See, also, the aerial photograph at CAMPO0199, exhibit 3.

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

reasons that the overall downward adjustment is 55%. It appears that the sale hasn't closed yet. Closed sales are preferable, but here we have a buyer and seller who agreed to open escrow.

- 43. He couldn't find any comparable sales in Peoria since 2007 because the market is very soft.
- 44. L-4 was to be seller financed which indicates that no bank would finance him.
- 45. No one showed up to bid at the trustee's sale, not even the guarantors, but a trustee's sale doesn't expose the property to possible buyers.⁷
- 46. The drop of 20% in the Dow Jones in October 2008 had an effect on the market for properties.⁸
- 47. Dunlap concluded that the FMV of the land was less than half of the cost to assemble the property.

CONCLUSIONS OF LAW

- 48. As stated, the purpose of the hearing was to determine the fair market value of the property in question for the purpose of determining the appropriate deficiency per ARS §33-814.
- 49. Plaintiff asserts that although there were appraisals made before the trustee's sale, they were too high given the declining market, and especially give the stock market drop and bank failures the week before the trustee's sale that started the current economic recession; thus, the trustee's sale represented the appropriate value for the

⁷ Per Raynak's report, the FMV of the property assumes "an exposure period of one year, or less, and assumes the subject property is adequately marketed at a price commensurate with the value conclusion." [ABB/VA-0119 and 0123. *See also*, 0183] Dunlap states that the appropriate holding period for the property would be 9 to 12 months with professional marketing. [CAMPO0239]

⁸ "The failure of several large banks and insurance companies has created uncertainty in the stock market causing massive selling. In the week of October 6-10, 2008, the Dow Jones declined 18% - the worst week in history. . . . [T]he near term economic future is bleak." [exhibit 3 at CAMPO0191]

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

property on that date. Plaintiff points out that no one else bid at the sale, not even the guarantors on the loan. Moreover, the amount of the bid, though a credit bid, was higher than might have otherwise obtained had someone else shown up to bid. While Raynak did not posit an exact figure for the FMV, the bank believes that \$143,000.00 is justifiable as the FMV.

50. Defendants argue that the trustee's sale, although not legally flawed, nevertheless cannot be considered a realistic value for the property; that is to say, no property could drop in value so far so fast. They assert that the best indicator of FMV are the appraisals for the month before the sale.
51. Courts are familiar with foreclosure sales that are inadequately low.⁹ For example, in *First American Title Insurance Company, v. Action Acquisitions, LLC*, 187 P3d 1107, (Ariz. 2008), the court subsequently disallowed the bid at the trustee's sale of \$3500.00 for a property deemed worth between \$300,000 and \$400,000 with a deed of trust for \$162,000. The court declared:

In *Krohn*, we held that a trustee's sale of property under a "deed of trust may be set aside solely on the basis that the bid price was grossly inadequate." Id. at 214 P 38, 52 P.3d at 783 (emphasis omitted). In so ruling, we observed that a price of twenty percent or less of fair market value is generally considered a grossly inadequate price. Id. at 213 P 34, 52 P.3d at 782. The purchaser in *Krohn* had bid slightly more than \$ 10,000 at the trustee's sale for property worth \$ 57,000. Id. at 207 P 5, 52 P.3d at 776. We acknowledged that the purchaser was a bona fide purchaser for value, but concluded this status did not insulate the sale from being set aside for a grossly inadequate price. Id. at 211 P 24, 52 P.2d at 780; see also id. at 214 P 41, 52 P.2d at 783 (McGregor, J., dissenting).

First American, supra, at ¶22.

52. In the case of *In re: Krohn vs. Sweetheart Properties, Ltd.*, 203 Ariz. 205, 52 P.3d 774 (Ariz. 2002), the Supreme Court dealt with the adequacy of a trustee's sale bid of just over \$10,000 on property worth \$57,000. The court pointed out that the sales price bid at trustee's sales may bear little relation to the FMV of the property:

⁹ The *Krohn* case, *infra*, points out that Arizona cases discuss the problem as far back as 1905 and a similar California case dates to 1924. *Krohn, infra*, at ¶¶31 and 32.

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

Sales in actions to foreclose mortgages are subject to judicial review for substantive fairness as well as for procedural compliance. Thus, it is well established that such sales can be overturned based on price alone. "Where a grossly inadequate price is bid, such as shocks one's conscience, an equity court may set aside the sale, thus insuring within limited bounds a modicum of protection to a party who has absolutely no control over the amount bid and this, in effect, insures that the foreclosed property is not 'given away.'" *Nussbaumer v. Superior Court*, 107 Ariz. 504, 507, 489 P.2d 843, 846 (1971)

Krohn, supra, at ¶6.

53. The *Krohn* court struggled with the issue of adequacy of a price obtained at a trustee's sale by pointing out that

It is to be expected, therefore, that courts will occasionally experience difficulty when attempting to determine fair market value in the context of a forced sale.

Krohn, supra, at ¶27.

54. There is a difference, of course, between the issue in *Krohn* and *First American* and the instant case. *Krohn* and *First American* concerned whether, and if so to what degree, a court could overturn a trustee's sale for being too inadequate to be justified. In the instant case, the question is to determine the FMV of the property and whether the trustee's bid is adequate evidence of the FMV. But the two cited do cases establish that there is no automatic acceptance of the trustee's sale price as establishing the FMV of the property in question.

55. The definition of FMV is stated in the statute governing this hearing, ARS §33-814(A), and makes no mention of the bid at a trustee's sale:

"Fair market value" shall mean 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 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

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-014949

05/12/2009

self-interest, and assuming that neither is under duress.

56. This Court concludes that the trustee's bid did not establish the FMV of the property. Instead, the Court finds that the two appraisals were much more appropriate. Even though there were bank failures and a stock market decline within days of the trustee's sale, the FMV cannot have fallen as precipitously as plaintiff posits. If the property in question had been on the market for up to a year and had been marketed appropriately, then the likelihood is that someone would have offered \$215,000.00 for the lot as of October 16, 2008.
57. The two appraisals are remarkably similar. Even though Raynak objects to several of Dunlap's comparable properties, the net result was similar.¹⁰ And assuming the gradual decline in the market of 1% per month as claimed by Dunlap, the Raynak appraisal comes even closer to what this court considers the FMV.
58. IT IS ORDERED establishing the fair market value of the property in question as \$215,000.00.
59. The statute in question, ARS §33-814, provides that the Court determine the deficiency once the FMV is determined, but the court understands that the parties will stipulate to the final numbers once the FMV has been determined, or will await a decision of other matters before the final number is calculated.

¹⁰ Eliminating the two objected to comparables, the average of L-1 through L-3 (\$4.73) would result in a FMV of almost \$205,000.00. Thus, including L-4 and L-5 doesn't affect the FMV by more than about 5% from the \$5.00/sq. ft. that Dunlap ended up with as his adjusted average price.