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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2008-024943 09/28/2009

HONORABLE J. KENNETH MANGUM

CLERK OF THE COURT
D. Glab
Deputy

INDYMAC BANK F S B LEONARD J MCDONALD

v.

BETTE JANE ARTHUR, et al. G GREGORY EAGLEBURGER

RULING

This matter was tried to the Court on August 26, 2009. Having considered the pleadings on file, the testimony of the witnesses and the exhibits admitted into evidence, the Court makes the following Findings of Fact and Conclusions of Law. If any Finding of Fact is more appropriately a Conclusion of Law or vice versa, it shall be so considered.

Findings of Fact

1. This hearing is to determine the fair market value of the defendants' home as of August 12, 2008; the issue is whether it was less, more or equal to the amount which plaintiff paid for the defendants' former home at the foreclosure sale on that date.

2. Plaintiff argues that the deficiency is $389,494.70 with a fair market value of $2.75 million and a debt owed on the house of $3.139 million.

3. Defendants argue that the property was worth between $3.4 and $3.5 million; thus, accordingly to defendants, there is no deficiency as the fair market value exceeded the debt by about the same amount that plaintiff argues the value was below the debt.

4. Mel Arthur spoke on behalf of defendants even though Bette Arthur was the home owner and Mel Arthur jointly owned the land in question with his wife.

5. Generally speaking, testimony is summarized under each person's name.

John Elliott Hainlen

6. John Elliott Hainlen got his BA in 1981 and spent his years since in the real estate and real estate appraisal business for various companies. He has done thousands of appraisals, especially of custom homes and jumbo properties. Most of his work has been in northeast Scottsdale including Pinnacle Peak and Carefree areas as well as north central Phoenix and the Arcadia areas.

7. The home in question is as 232804 N. Church Road, Scottsdale.

8. He appraised the fair market value ("FMV") at $2,900,000.00 as of May 2008.

9. As of the date of the trustee's sale on August 12, 2008, the FMV was $2,750,000.00.

10. Plaintiff is suing to establish the amount of the credit defendants are to receive as appropriate for the FMV or the sales price, whichever is higher. The amount bid at the trustee's sale was $2,605,168.00. Therefore, Mr. Hainlen places the FMV as about $150,000.00 more than the bid price.

11. The home in question was built in 1985 as a custom home made out of adobe block. It is luxury quality and is an 8324 square foot house on a five acre lot. It is fully fenced, has a tennis court, a horse stable and shed, a swimming pool and a four car garage.

12. It is hard to find comparable homes because most homes are much smaller and custom homes vary so much from each other. Age is important in a house's value: for example, new home buyers are not enticed by an old home. Buyers expect to pay less for a 10 to 20 year old home because of repairs and depreciation. Also, design standards change over time such as for lighting and electrical.

13. Exhibit 1 is his appraisal report. He estimates that the value of the lot is $700,000.00.

14. The difference in FMV between May and August derives from the falling market and the supply of available houses was growing. There was a time adjustment made for the August value but not for the May appraisal. The market was beginning to decline in May. It was hard to quantify. It is more accurate to do a retroactive historical appraisal.

15. Exhibits 5-8 show the trend in the neighborhood generally. Between May 2007, and August 2008, the average price per square foot went down as follows.

DATE	AVERAGE PRICE PER SQ. FOOT
May 2007	$315
November 2007	$312
May 2008	$270
June 2008	$292
July 2008	$268
August 2008	$241

16. The luxury home market is hard to value because of the few number of sales.

DATE	AVERAGE PRICE PER SQUARE FOOT	NUMBER OF HOMES
5-07 to 11-07	$513	41
11-07 to 3-08	$505	30
5-08 to 11-08	$432	21

17. By one analysis, using the sale of 12 homes in the May 2008 through August 12, 2008, the average price per square foot was shown to be $412/sq ft.

18. Per the above information, if $412 per square foot is multiplied by the square footage of the home in question, then the FMV would be $3,429,488.00, not even considering that this is the average and the subject home is considered *above* average. However, the witness states that such a use of figures is not appropriate because of the many factors

influencing the value of a home. Also, no home built before 1990 was in the survey that led to the $412/sq. ft. average. Even if the subject home were newer, the formula might still not work because a larger home generally has a lower price per square foot. Because of economies of scale, a larger house has more of the cheaper space to construct that the smaller (though still luxury) homes: bedrooms and living rooms and dining rooms are less costly than kitchens and bathrooms, for example.

19. Once you get to 8000 square feet, your market share shrinks. Generally, people who want luxury homes was 5500 to 7500 sq. feet and *not* 8000 sq. feet.

20. Per the Johnson appraisals, in September 2007, the FMV is $4.9 million and the estimated cost to build is $400/sq. ft. Nine months later, in June 2008 the FMV is $3.8 million and the estimated cost to build is $300/sq. ft. (This drop in the cost to build is hard to explain–the builders might be cutting their prices.) In June 2008, you need to make a time adjustment.

21. Johnson used the cost approach but Hainlen considered it but did not use it. The premise of the cost approach is that the buyer may decide to build his own. The older a home, the less valuable the cost approach is.

22. Johnson came up with $4.9 million as FMV. $3,393,043.00 would be the correct math for the cost approach with the adjusted values. Thus, it would cost more to build than to buy so Hainlen doesn't think the cost approach is effective.

23. Johnson came up with $3.8 million as the cost approach method. Johnson utilized a house for September 2007, stating that the house was not offered for sale, but in fact the house had been listed for sale two months before the appraisal date and for 12 months before that per exhibit 11. It was listed for $4.975 million for 10 days on November 2006, and by Februray 15, 2007, it was listed for $4.475 million and the listing was cancelled on July 30, 2007. Yet in September Johnson said that the FMV was $4.9 million. And prices weren't going up and people weren't paying list price, which means that it couldn't sell for the listing price of $4.475 million.

24. Comparable #3 was a short sale though the exhibit shows it as a conventional sale.

25. The subject property is simply not a standard house. It was built and also designed by famous architect William Tull, though not so famous as Frank Lloyd Wright. None of the comparables were adobe construction though buyers will tend to pay more for adobe homes. Heinlen doesn't know the amount of the premium to be paid for a Tull home. He has appraised 8 Tull-designed homes

Melvin Lewis Arthur

26. Melvin Lewis Arthur is husband of Bette Arthur. The deed of trust shows that Bette Arthur owns the house as her sole and separate property and the couple jointly own the land.

27. By stipulation, the total debt on the house as of August 12, 2008, was $3,139,000.00. Therefore, Mr. Arthur believes there was more than $1,000,000.00 in equity.

28. The financial difficulty came from a $3,000,000.00 loan from plaintiff in 2007. $600,000.00 was spent in 2007 to update all the plumbing and thresholds and wooden flooring; also, the doors were all replumbed. The kitchen got 4 ½ tons of new stone and all new top appliances. The bunkhouse got a new roof. Incidentally, the bunkhouse was a replica of a bunkhouse from Tubac, Arizona.

29. The house was foreclosed on, on August 12, 2008. The Arthurs lived there for 25 years.

30. The Arthurs selected Tull based on his reputation. He was a master of the Santa Fe style of adobe homes. Tull spent two years designing the home and 1 ½ years to build it. Some of the features include:

    a. There are 14 separate flat roofs in the home, each roof with it's own or shared parapet.

    b. The walls are finished with Italian plaster over a wire frame. The interior walls were hand troweled.

    c. The building blocks for the walls were double 14" blocks.

    d. The walls are from 28" to 42" thick.

    e. No rooms have a 90 degree corner; thus, there is no sound reverberation. There are 144 corners.

    f. All doors are arched.

    g. The front door is 2 ½ inches thick.

h. There is more than 5000 sq ft of flagstone in the interior floors and over 6000 sq ft of flagstone outside.

i. Poplar wood was used for all wood surfaces, more than 4000 sq ft worth.

j. The exercise room is 14' X 16'.

k. There is a full sized commercial sauna and heat treatment room.

l. Native tile is throughout the house.

m. There are 8 bathrooms including the bunk room (part of the horse shed). Each bedroom was a suite with its own bathroom.

n. Each room looks out at Pinnacle Peak.

o. All light switches are toe switches except for one switch in the Dining Room.

p. There are 9 chimneys including three that are outside.

q. The roofing is composed of 3/4" tongue and groove, maritime treated wood.

r. The house is so well insulated that the highest electric bill has been between $375 and $500 for a month.

s. The tennis court is Astro turf, regulation size.

t. There was a swimming pool.

u. Three culvert bridges lead to the house given the drainage gullies on the property.

v. The house is surrounded by an 8' high wall composed of exposed adobe block. It is 1/3 of a mile in length for privacy and quiet. Each block in the wall weighed 35 pounds and there were more than 5000 blocks used. The contractor used wheel barrels to move the block to avoid having trucks on the terrain. The wall alone cost $275,000.00 to build.

31. The appraisal for the loan was by Paul Johnson. Mr. Arthur hired Mr. Johnson to do his litigation appraisal for continuity's sake.

32. There is no similar home in the area. The home was surrounded by five acre homes. There is a horse trail across the street that runs to the mountains, about the only such trail in the city.

33. The cost approach shows a value of $3,393,000.00.

34. Mr. Arthur believes that the FMV of the home before the collapse of the economy in September 2008, was about $4,500.000.00. It would cost $2,000,000.00 to build the walls of the house based on new adobe block with asphalt for waterproofing.

35. The MLS listing from January 13, 2006, to June 2008 was $5.8 million and then $4.975 in October and then $3.950 million on June 10, 2008, but it still wouldn’t sell. On September 6, 2008, the bank’s listing was $2.266 million.

36. The sales price in October 2008 was $1,950,000.00, and the buyer was a car dealer who had dickered over a price of $3.4 million. In fact, the buyer had come out to the house four or five times, sitting in rooms and deciding where he was going to place his furnishings. Also, he knew of Tull. There was going to be a trade of a townhouse as part of the deal. So, in less than 30 to 40 days, the buyer saved some $2 million by waiting for the foreclosure sale when he learned the bank was foreclosing.

37. In June 2008, the listing was for $3.9 million. But when the bank listed the home for a trustee’s sale, the buyer quit negotiating.

Paul Bryan Johnson

38. Paul Bryan Johnson was the appraiser for the defendants. He has been a real estate appraiser for 11 years, specializing in the area in question. His office is two miles from the subject home.

39. He report is dated June 3, 2008, and is exhibit 13. It uses both the sales approach and the cost approach especially because of the uniqueness of this house. Mr. Johnson has built in the area and there is available land on which a person can build.

40. His conclusion for the FMV is as follows:

APPROACH	FMV
Sales/Market Approach	$3.8 million

Cost Approach	$4.9 million corrected at trial to be $3.3 million

41. The cost approach was important but not applicable. He didn't rely on it too much.

42. His first appraisal for this house was in 2007. He did several appraisals per month for plaintiff.

43. The difficulty in appraising this home is finding an equivalent home. Mr. Johnson found that the updating done by defendants made their home more like a newer home. Thus, he didn't adjust for age when compared to other similar homes.

44. Exhibit 7 is a statistical market analysis showing that the average price per square foot for 27 sold homes between June 3, 2007 to January 3, 2008, to be $513.82. His exhibit doesn't show lot size, though the 8263 square foot house makes it more like a house in a gated community with a gold course.

45. The average price for raw land in the year prior to June 2008, was $550,000.00 for 1.6 acres of land.

46. The notice of the trustee sale for the subject property was placed at least 90 days before the sale. This notice would affect the sale price. Also, foreclosure sales will affect the FMV.

47. Another error by Johnson (besides the mathematical mistake mentioned in the table in ¶40, *supra*) is to have overlooked the fact that the subject home had in fact been listed for sale on the market. This error was due to Johnson not realizing of the listing history of the house. Thus, in July 2007, the house was listed for sale at $4,475,000.00 at the same time that Johnson listed the FMV of the house as $4.9 million. Of course, the sales price and listing price depends a lot on the motivation of the seller and it's possible to list the house for less than the appraisal; in addition, the season of the year can affect the listing price.

48. A third mistake is to show the house as having a six car garage whereas it is maybe a three + two car garage.

49. The site value in 2007 was $1.5 million and $900,000.00 as of June 2008. Mr. Johnson is comfortable with the $900,000 figure because the price was just falling so fast. Since $850,000.00 is plaintiff's estimate for the site value, the two figures are close.

50. Mr. Johnson came up with a square foot price of $400 in 2007 and $300 in 2008, because of builders lowering their costs.

51. He didn't adjust for the adobe block construction because he already included quality and recent upgrading.

52. In August 2008, the market was in a free fall with inventory going up and prices coming down. However, Johnson didn't adjust down from June 2008, to August 2008, because he saw no transactions to define the value. Of course, sales drop off during summers.

Conclusions of Law

53. The Court concludes that the FMV of the subject home on August 12, 2008, was between $3.4 and $3.5 million dollars. Thus, there is no deficiency.

54. The Court determines that the appraisal by Mr. Johnson, even give his mistakes, deserves more credit that the appraisal of Mr. Hainlen for the following reasons.

    a. There is credibility because of the continuity of Mr. Johnson having appraised the house for the bank both for the loan and afterwards to determine the FMV.

    b. Mr. Johnson gives more appropriate credit for the quality of the home and for it having been recently updated.

    c. The average price per square foot compels a higher appraisal than Mr. Hainlen determined. If the *average* price for the average luxury home of near that size would result in a value of well above the FMV determined by Mr. Johnson, then the FMV for this remarkable home should not be as low as plaintiff asserts. *See* ¶18, *supra*, showing $3,429,488.00. The court is not convinced by plaintiff's argument that the average price per square foot is composed of smaller houses and one can't use that figure to help determine the subject house's value.

55. The foreclosure notice affected the FMV of the property. Mr. Ross was ready to buy the house for probably the court's estimate of FMV, but once he knew the property was going into foreclosure, it would be silly to continue to negotiate with the owner.