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10 UNITED STATES BANKRUPTCY COURT
11 EASTERN DISTRICT OF CALIFORNIA
FRESNO DIVISION

12 In re) Case No. 11-19408-B-11
13 Salvador Padilla and)
14 Maria Lopez,) DC No. TOG-1
15 Debtors.)
_____)

16
17 **MEMORANDUM DECISION REGARDING DEBTORS’**
MOTION TO VALUE COLLATERAL OF DEUTSCHE BANK
18 **TRUST COMPANY AMERICAS AS TRUSTEE FOR RALI 2005QA4**

19 Thomas O. Gillis, Esq., appeared on behalf of the debtors, Salvador Padilla and Maria Lopez.

20 Bryan Fairman, Esq., appeared on behalf of Deutsche Bank Trust Company Americas as Trustee for Rali 2005QA4.

21
22 Before the court is a motion by the debtors, Salvador Padilla and Maria Lopez (the
23 “Debtors”) to value the collateral of Deutsche Bank Trust Company Americas as Trustee
24 for RALI 2005QA4 (“Deutsche Bank”).¹ Deutsche Bank holds the first priority trust

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26 _____
27 ¹The proof of claim for this secured obligation states that the debt is owed to Deutsche
28 Bank Trust Company Americas as Trustee for RALI 2005QA4. GMAC Mortgage, LLC, is listed as the party to which notices should be sent. Apparently, GMAC Mortgage, LLC, is the servicer of the loan. The motion named GMAC Mortgage as the respondent and was served on GMAC Mortgage. However, the responsive opposition and subsequent pleadings were filed by Deutsche Bank.

1 deed against a parcel of real property located in Winton, California (the “Property”). The
2 Property is described in the Debtors’ schedules as a residential rental property. The
3 Debtors contend that the fair market value of the Property is \$275,000. Deutsche Bank
4 objects to the motion based on its contention that the value of the Property is much
5 higher, \$370,000. The Debtors and Deutsche Bank offered competing appraisals
6 prepared by competent and experienced appraisers. However, the appraisers took
7 significantly different approaches to determine their proffered values. For the reasons set
8 forth below, the Debtors’ motion will be granted.

9 This memorandum decision contains the court’s findings of fact and conclusions of
10 law required by Federal Rule of Civil Procedure 52(a), made applicable to this contested
11 matter by Federal Rule of Bankruptcy Procedure 7052. The court has jurisdiction over
12 this matter under 28 U.S.C. § 1334, 11 U.S.C. § 506² and General Orders 182 and 330 of
13 the U.S. District Court for the Eastern District of California. This is a core proceeding as
14 defined in 28 U.S.C. §§ 157(b)(2)(A) & (L).

15 **BACKGROUND AND FINDINGS OF FACT.**

16 The Property is encumbered by two mortgage liens. The first trust deed is held by
17 Deutsche Bank. Deutsche Bank filed a secured proof of claim in the amount of
18 \$383,291.57. It stated in the proof of claim that the value of the Property was sufficient
19 to fully secure the claim. It now acknowledges that the Property is worth less than its
20 claim. The second priority lien is held by Bank of America, N.A. Bank of America did
21 not respond to the Debtors’ motion to value the Property and the court has already ruled,
22 based on the evidence presented in this matter, that Bank of America’s claim is wholly
23 unsecured for purposes of its treatment in the Debtors’ chapter 11 plan. The purpose of
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26 ²Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy
27 Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-
28 9036, as enacted and promulgated *after* October 17, 2005, the effective date of The Bankruptcy
Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat.
23.

1 this motion is to determine the amount of Deutsche Bank's secured claim for "cramdown"
2 treatment in the chapter 11 plan, with the balance to be treated as an unsecured claim.

3 The Debtors contend that the Property has a fair market value of \$275,000. In
4 support of this value, they offered an appraisal prepared by John Friend ("Mr. Friend"),
5 an experienced and licensed real estate appraiser who specializes in appraising residential
6 properties in Merced County. He has been doing that for about twelve years.

7 Conversely, Deutsche Bank contends that the Property has a fair market value of
8 \$370,000. Deutsche Bank offered the appraisal and testimony of Carolyn Breeding ("Ms.
9 Breeding"), also a licensed and experienced real estate appraiser, who specializes in the
10 appraisal of residential properties, primarily for lending institutions. Ms. Breeding has
11 been appraising properties in Merced County for about 18 years.

12 Both experts generally agreed on their description of the Property. The Property is
13 situated in an unincorporated portion of Merced County, near the town of Winton. Ms.
14 Breeding described the location as "rural in nature, but suburban in location." The
15 Property is surrounded by smaller, older houses and agricultural land, but it is near
16 enough to the town to enjoy its attendant facilities, including schools, shopping and
17 "community services." The Property comprises approximately one acre of land. The
18 primary structure on the Property is a large residence which is about 2,450 square feet in
19 size. The residential structure is about eight-years-old. It has eight rooms, including four
20 bedrooms and two and one-half bathrooms and a three-car garage. The structure has a
21 large front yard. However, behind the main structure, are a smaller, older unattached
22 guest house and two remote workshops, all in good condition. Both sides agree that the
23 Property is "unique," meaning that the primary residential structure is similar in size and
24 quality to homes normally found in more exclusive residential developments, but it is
25 surrounded by smaller, older dissimilar homes and agricultural land. The existence of the
26 guest house and the two shop buildings gives the Property a more "industrial" quality.

27 The expert testimony and evidence on both sides were excellent. However, the
28 appraisers utilized two distinctly different methodologies to arrive at their respective

1 opinions. The court must decide which of those methods is more and likely to yield the
2 result that is appropriate in the context of this motion. In relative terms, the parties are
3 substantially far apart in their respective opinions of value. The court must choose, based
4 on the evidence presented, between one of the suggested values. There is no evidence or
5 “sliding scale” formula upon which the court can arrive at a “middle ground” value.

6 **ANALYSIS AND CONCLUSIONS OF LAW.**

7 The Debtors seek to value Deutsche Bank’s interest in the Property based on
8 § 506(a)(1), which states:

9 An allowed claim of a creditor secured by a lien on property in
10 which the estate has an interest . . . is a secured claim to the extent of
11 the value of such creditor’s interest in the estate’s interest in such
12 property . . . and is an unsecured claim to the extent that the value of
13 such creditor’s interest . . . is less than the amount of such allowed
claim. *Such value shall be determined in light of the purpose of the
valuation and of the proposed disposition or use of such property,
and in conjunction with any hearing on such disposition or use or on
a plan affecting such creditor’s interest.* (Emphasis added.)

14 When the debtors intend to occupy their house, the proper valuation of the house
15 under § 506(a) is the fair market value (“FMV”). *Taffi v. United States of America (In re*
16 *Taffi)*, 96 F.3d, 1190, 1192 (9th Cir. 1996). The FMV is not the “replacement” value
17 because the house is not being replaced. Neither is it the “foreclosure” value because no
18 foreclosure is intended in the chapter 11 plan. *Id.* The FMV is “the price which a willing
19 seller under no compulsion to sell and a willing buyer under no compulsion to buy would
20 agree upon after the property has been exposed to the market for a reasonable time.” *Id.*

21 The debtor bears the initial burden of proof of overcoming any presumption
22 established by the stated value in the secured creditor’s proof of claim. However, the
23 secured creditor has the ultimate burden of persuasion to demonstrate by a preponderance
24 of the evidence the value of the collateral which secures its claim. *In re Southmark*
25 *Storage Associates Ltd. Partnership*, 130 B.R. 9, 10 (Bankr. D.Conn. 1991).

26 When the debtor plans to retain the real property, selling costs should not be
27 deducted from the FMV when valuing a creditor’s interest in the property. *In re Taffi*,
28 *supra*, 96 F.3d at 1192. (Hypothetical selling costs are not considered when no sale is

1 intended.); *See also United States Farmers Home Administration v. Case (In re Case)*,
2 115 B.R. 666, 670 (9th Cir. BAP 1990) (closing costs should not be deducted when
3 valuing real property under § 506(a) for purposes of chapter 12 plan confirmation).

4 The Debtors are currently renting the Property and intend to keep it occupied as a
5 rental. They have the option in chapter 11 to sell or surrender the Property; however,
6 their chapter 11 plan will propose to retain the Property and amortize Deutsche Bank's
7 claim over a period of time. The "purpose of the valuation" and the "proposed
8 disposition or use" of the Property is to determine its value as a tenant-occupied property.
9 § 506(a)(1).

10 Here, both expert witnesses used a "direct sales" method to value the Property, *i.e.*,
11 they used actual sales of comparable properties, or "comps" as the starting point for
12 determining the value of the Property. Both appraisers estimated adjustments to the value
13 of their comps to reflect the physical differences between the comps and the Property. It
14 is at this point that the appraisal methods differed. Ms. Breeding's appraisals were based
15 on six comps from residential developments located in other parts of Merced County.
16 The nearest comp used by Ms. Breeding was 4.9 miles away from the Property. The
17 farthest comp was 17.5 miles. Ms. Breeding's comps ranged in size from 1.0 acres to 9.9
18 acres and they ranged in value, based on the comp's "sales price" from \$330,000 to
19 \$649,000. Mr. Friend described two of Ms. Breeding's comps as "estate lots," meaning
20 that they are located in residential developments, nicely landscaped, would tend to attract
21 higher income occupants, and do not have the shop buildings that give the Property a
22 more "industrial" quality. As to Ms. Breeding's other four comps, Mr. Friend expressed
23 his view that they were too large and too costly to qualify as "comparable properties." In
24 other words, Mr. Friend opined that the larger more expensive properties would not
25 attract the same group of "willing buyers." Ms. Breeding testified that she likes to use
26 comps with both higher and lower values than the property she is trying to appraise and
27 then make upward or downward adjustments to arrive at the result. She referred to this
28 process as "bracketing" and believes it yields a better result.

1 In contrast, Mr. Friend's appraisal was based on five comps located around the
2 Property at distances ranging from 2.0 miles to 9.5 miles. Both experts agreed there were
3 no similar comps in the immediate Winton area. Mr. Friend's comps ranged in size from
4 0.7 acres to 1.5 acres and in value from \$189,000 to \$245,000. Ms. Breeding disagreed
5 with Mr. Friend's use of lower value "inferior" comps and argued in favor of the
6 "bracketing" approach. Mr. Friend believed that his comps more closely resembled the
7 Property in size and character and that his method yields a better indication of what a
8 "willing buyer" might pay for the subject Property. Mr. Friend did not select comps from
9 residential developments and testified persuasively that the "industrial" character of the
10 Property would not attract the same kind of buyer as would a property located in a large,
11 well-landscaped residential development, even though the residential structures
12 themselves might be similar.

13 Faced with the choice between the two appraisals, and based on the expert's
14 explanation of their appraisal methods, the court is persuaded that Mr. Friend's appraisal
15 more accurately reflects the Property's fair market value for the purpose to which the
16 Property will be used under the Debtors' chapter 11 plan, a tenant-occupied rural rental.
17 Ms. Breeding's comps would appeal to "willing buyers" with higher incomes who seek
18 the benefits of a rural lifestyle on a large well-landscaped lot. Mr. Friend's selection of
19 comps more closely reflects the character of the Property itself. He testified that the
20 presence of the shop buildings and the guest house on the Property would not appeal to
21 the same kind of buyer as would the homes listed in Mr. Breeding's appraisal. When Ms.
22 Breeding was asked in cross-examination why she chose comps from "posh
23 subdivisions," she was not able to give a persuasive answer.

24 Deutsche Bank argues that Ms. Breeding's method of selecting comps is consistent
25 with established appraisal standards within the lending industry, but the court is not being
26 asked to value the Property for the purposes of securing a new loan. In light of the
27 "willing buyer" test, which the court must apply, it is not clear how "lending industry
28 standards" are applicable to this dispute. The Debtors argue that Mr. Friend's comps are

1 more similar in character and location to the Property, that his analysis is based more on
2 “market driven” factors, and that his appraisal better reflects the price a “willing buyer”
3 would actually pay for the Property. The court agrees.

4 **CONCLUSION.**

5 Based on the foregoing, the court is persuaded that the Debtors’ appraisal more
6 accurately reflects the value of the Property in light of the purpose of the valuation and
7 the proposed use of the Property. Accordingly, the court finds that the fair market value
8 of the Property is \$275,000. Deutsche Bank’s secured claim will be fixed at \$275,000 for
9 the purpose of its treatment in the Debtors’ chapter 11 plan. The balance of the claim
10 may be treated as wholly unsecured.

11 Dated: April 25, 2012

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13 /s/ W. Richard Lee
14 W. Richard Lee
15 United States Bankruptcy Judge
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