



10-24-2024

(Updated 4-3-2025 – Corrected 4-10-2025)

FORECLOSURES WITH SUBORDINATE MORTGAGES OR DEEDS OF TRUST HELD BY FEDERAL AGENCIES

Please note this analysis is not limited to HUD subordinate mortgages. It may apply to all Federal subordinate liens or encumbrances and should be treated as such.

In *Show Me State Premium Homes, LLC v. McDonnell*, 74 F.4th 911, the 8th circuit said that under 28 USC § 2410(c) subordinate HUD mortgages could not be extinguished by foreclosure of a superior interest without either a judicial sale in which the US was made a defendant or a release by HUD.

The court held that an action to foreclose a mortgage or other lien, naming the United States as a party under this section, must seek judicial sale. A sale to satisfy a lien superior* to one of the United States shall be made subject to and without disturbing the lien of the United States, unless the United States consents that the property may be sold free of its lien and the proceeds divided as the parties may be entitled. (“The Show Me rule”)

As such, we believe that **The Show Me rule also applies to property in North Carolina**. When there is a junior federal deed of trust, judgment, or other lien held by a federal agency (other than IRS notice of federal tax lien which has clearly laid our rules for application under 26 U.S.C. 7425), we will require either:

- (1) The senior deed of trust, judgment, or other such lien to be foreclosed by a judicial foreclosure in which the US is named and served as a defendant; or
- (2) The US to voluntarily release its lien of record.

The US has the right under 28 USC § 2410(c) to redeem the foreclosed property even when the US has been properly joined as a defendant in a judicial foreclosure. The redemption period under this statute is one year. If title is coming out of a judicial foreclosure in which the US has been joined as a defendant, we will raise an exception for the US’s right of redemption, unless the US waives this right in writing. Waiver of the US’s right of redemption is distinct from, and must be separately waived in addition to, any voluntary release of the US’s lien rights.

In response to this, HUD has released Mortgagee Letter 2024-17 to address the process of obtaining a release of HUD Secretary held mortgages/liens:

<https://www.hud.gov/sites/dfiles/OCHCO/documents/2024-17hsgml.pdf>

The procedure outlined by HUD for requesting a release is as follows:

“Mortgagees may only request release of a subordinate Secretary-held lien where a nonjudicial foreclosure sale resulted in no Surplus Funds where nonjudicial is the Preferred Method of Foreclosure. If the Property is subject to federal non-Secretary-held liens, the Mortgagee must comply with applicable law for those federal liens, including proceeding with a judicial foreclosure if required. To request HUD release of the Secretary-held lien, the Mortgagee must log into HUD’s Single Family Mortgage Asset Recovery Technology (SMART) Integrated Portal (SIP), access the Foreclosure Dashboard, and submit the following for each Mortgage:

- the FHA Case Number;
- the date the foreclosure sale occurred;
- the Mortgagee’s final bid amount;
- the winning bid amount;
- the foreclosure attorney’s name, address, phone number, and email;
- whether the winning bidder was the Mortgagee or a third party;
- the method of foreclosure; and
- certification that there were no Surplus Funds from the foreclosure sale.”

It appears that HUD is ready to facilitate a release in situations where there are no surplus funds resulting from the foreclosure but requires a detailed list of information.

Per the Letter, for loans held by HUD, this does not apply where a nonjudicial foreclosure sale results in surplus funds. For subordinate loans held by HUD, HUD is developing a permanent policy to provide clarity for mortgagees proceeding with foreclosures.

*Corrected to change from “inferior” to “superior” 4-10-2025