



Dear Stewart Partners,

Welcome to November. We hope you are all adjusting to the earlier sunsets and the slightly brighter mornings. In this week's Midweek Update we are providing some background and historical information relating to how junior federal liens impact senior foreclosures and why a 2023 federal court decision changed how we handle those liens. We hope this article provides some further context on the Underwriting Bulletin that was recently issued.

We have also included an article on Bankruptcy and Real Estate Sales and in case you missed it, we are republishing two Special Alerts that were distributed last week.



Senior Lien Foreclosures on Non-IRS Junior Federal Liens – What is the Big Deal? By: Jutta R. Deeney, Esq., New England Regional Underwriting Counsel & Michelle Radie-Coffin, Esq., New Hampshire State Counsel

It is probably fair to say that most attorneys and title examiners presume that the foreclosure of a senior mortgage will eliminate or “wipe-out” the junior encumbrances of record. This statement, in most cases, is entirely accurate; however, there is a caveat when it comes to federal liens that many may not be aware of, and given the significant increase in the past 10 years of government sponsored mortgage modification programs to help distressed borrowers, and the prevalence of partial claim mortgages held by HUD, understanding the impact of a foreclosure of a senior encumbrance when these junior liens exist on title is critical.

We issued a Bulletin a few weeks ago that set forth mandatory requirements relative to junior federal liens in a foreclosure context. These requirements may be significantly different than what you may have previously done in the context of insuring titles derived from a foreclosure. These new requirements and the underwriting guidance stem from the federal court decision in [Show Me State Premium Homes, LLC v. McDonnell](#), 74 F. 4th 911; 2023 U.S. App. LEXIS 18406 (8th Cir. July 20, 2023) (“Show Me Case”). The Show Me Case highlighted the need to follow federal law, specifically 28 USC § 2410 when title is encumbered by junior federal liens.

Prior to the Show Me Case, underwriting protocols and guidance relative to insuring land subject to a foreclosure where the United States held a junior interest was guided by state

law based on the holding in *United States v. Brosnan*, 363 U.S. 237 (1960). The Brosnan decision provided the support for the underwriting guidance that a foreclosure completed in compliance with state law, would extinguish junior liens held by the federal government. As a result of the Show Me Case, underwriting standards required reevaluation. The results of the reevaluation are captured in **Bulletin [SLS2024016 \(virtualunderwriter.com\)](#)** – **UNDERWRITING – Non-judicial Foreclosures Involving Junior Federal Liens.**

The new underwriting standard set forth in the Bulletin will most immediately impact those jurisdictions where mortgage foreclosures are non-judicial. In New England, this includes Massachusetts, New Hampshire, and Rhode Island. It is important to remember that the Show Me Case didn't limit the application of 28 USC § 2410 to mortgages or other voluntary liens, but applies to lien enforcement where junior liens to the federal government exist; however, mortgage foreclosures are the most commonly seen lien enforcement actions from a title perspective.

The key takeaway from the **SLS20240016 Bulletin** is that if the search discloses that title was derived from a non-judicial foreclosure and the title was encumbered by a junior lien held by the federal government, which lien is anything other than a federal tax lien, if the foreclosure was conducted via the power of sale contained in the mortgage, the lien of the federal government may not be extinguished, and remains a valid encumbrance on the property. As a lien that survives a non-judicial foreclosure, the title remains encumbered by the federal lien post foreclosure. As a result, unless a release or discharge is obtained, a third-party purchaser will be purchasing subject to the lien and any mortgage placed on the property will not take priority over the federal lien.

As mentioned above, given the prevalence of second lien mortgages granted to HUD through various government sponsored mortgage modification programs, it stands to reason that many more homeowners have junior liens held by the federal government through HUD (the Secretary of Housing and Urban Development). Therefore, a careful review of all junior creditors in a non-judicial mortgage foreclosure must be undertaken.

If the title discloses a junior lien held by HUD, and the sale does not produce surplus funds, there exists an opportunity for the foreclosing lender to request a release of the junior mortgage held by HUD from title. The process at present, however, is limited to the foreclosing lender and not subsequent third-party owners and is for a limited group of HUD mortgages. Consequently, this process needs to be pursued prior to the transfer of title to a third-party buyer. HUD's interim guidance on this process can be viewed here: [Interim Procedures for Nonjudicial Foreclosures with Secretary-Held Liens \(hud.gov\)](#)

This is a complex and, at times, confusing area of the law. We welcome any questions you may have whenever your title discloses a foreclosure which may be impacted by junior federal liens. Please don't hesitate to reach out to any of our New England underwriting attorneys for navigating this area of title law and underwriting requirements.



Bankruptcy and Real Estate Sales By: David Piechota, Esq. Connecticut
Underwriting Counsel

Bankruptcy issues are complex, however, all real estate practitioners and title agents should have a basic understanding of bankruptcy law and common terms, given that titles can be transferred out of a bankruptcy estate or by a debtor in bankruptcy under certain circumstances. Depending on the transaction, insuring title during an active bankruptcy may be deemed an extra hazardous risk and underwriting approval may be required. (See Section 5.36 of Stewart's Underwriting Manual on Virtual Underwriter for a description of transactions that may present extra hazardous risks: [Underwriting Manual: Extrahazardous Risks](#))

The below is a brief summary of some basic bankruptcy concepts and things to consider when dealing with a bankruptcy in the chain of title.

What happens when a Bankruptcy Petition is Filed?

Upon filing a bankruptcy petition an "estate" is created, and all property of the debtor, wherever located, becomes part of the estate created along with after-acquired property within 180 days of the filing. Unauthorized transfers of estate property are voidable. As a result, it's essential to determine whether the property is part of the estate and whether the sale was properly authorized. A bankruptcy file can be viewed online through the PACER system (the federal court's electronic record system that provides public access to all federal courts). One does need to create a registered user account to access PACER, and there is a .10 per page charge that is incurred when documents are downloaded. However, PACER waives all fees if the user spends \$30 or less in any quarter. (To obtain login credential for PACER, follow this link: [PACER Pricing: How fees work \(uscourts.gov\)](#))

It is important to know that there is no requirement in the Bankruptcy Code to file notice of a bankruptcy with the land records; however, in some jurisdictions it is the practice of a bankruptcy trustee to record notice, but this practice is not universal. For this reason, it is strongly recommended that a PACER search be completed. If property is sold during a bankruptcy proceeding without appropriate approvals, the new owner may have some defenses based on his or her status as a bona fide purchaser, however, this is a factual inquiry and may be litigated.

The most common types of bankruptcies we see are:

- Chapter 7 – individual bankruptcy, where a trustee is appointed
- Chapter 11 – business and individual bankruptcy reorganization wherein the debtor generally remains in possession of the bankruptcy estate and no trustee is appointed (the Debtor in Possession (DIP) has the same powers as a trustee)
- Chapter 13 - individual reorganization, a trustee is appointed.

What Types of Sales Occur During a Bankruptcy Proceeding?

There are many ways property can be sold during the course of a bankruptcy proceeding. For example, it is possible to see sales by DIPs, bankruptcy trustees, and the debtor. For any sale of real estate during a bankruptcy proceeding, it is necessary to evaluate the authority for the sale. Sometimes the sales will be because property was abandoned, or alternatively, the sale could be in the debtor's ordinary course of business. In some instances, a debtor may be able to sell exempt property without any court approval. It is

also common that the sale could be the result of a specific motion to sell and subject to court order.

Depending on the circumstances of the individual bankruptcy, on the type of sale, the approval sought, and the court's order allowing the sale, the requirements allowing a policy to be issued can vary dramatically. Stewart's Virtual Underwriter (VU) contains an in-depth section on Bankruptcy Sales and provides general guidelines for various types of sales that you may encounter. This section of VU can be accessed here: [Bankruptcy \(virtualunderwriter.com\)](http://virtualunderwriter.com)

Many states in New England also have title standards and guidelines regarding bankruptcy sales. In Massachusetts, the Real Estate Bar Association just adopted an entirely revised Title Standard with respect to sales out of bankruptcy, which was adopted at Monday's November conference. Title Standard 30, as revised, can be accessed by its members through REBA's website. In Connecticut, Standard of Title 27 addresses bankruptcy. Maine has Title Standard 412, which can be viewed here:

http://msba.mainebar.org/title_standards/stnd412.htm Vermont also has addressed bankruptcy sales in its Title Standard 21.2, which can be viewed here: <https://www.vtbar.org/wp-content/uploads/2021/03/Title-Standards-2020-Final.pdf>

Please reach out to your Stewart state underwriting counsel for any questions about insuring title when a bankruptcy is involved. We are here to help guide you.



In Case You Missed It – Special Alerts SA2024334 and SA2024330

Special Alert: Last Wednesday, the Company issued a Special Alert involving property in Providence, Rhode Island and another involving property in Sandown, New Hampshire. Issuing agents are instructed not to issue commitments or policies involving the individuals or properties without approval. To read the full Bulletin for each of the Special Alerts, follow these links:

[Special Alert: SA2024334](#)

[Special Alert: SA2024330](#)



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