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Can Associations Have Priority over Fannie or Freddie?

By R. Wilson Freyermuth and Dale A. Whitman

In the typical common interest development, an owners’ association has a lien on each unit or lot within the development to secure the payment of delinquent assessments. In states that have enacted section 3-116 of the Uniform Condominium Act (UCA) or its successor, the Uniform Common Interest Ownership Act (UCIOA), this lien is entitled to priority over an otherwise-first mortgage lien, for six months of unpaid assessments based on the association’s annual budget. (States vary in their adoption of the uniform statutes and a few have changed the six-month period; for example, the applicable period in Nevada is nine months.) Statutes in approximately 20 states give this limited priority to an association’s lien. Several recent state court cases interpreting these statutes have held that the association’s lien has not only a payment priority (that is, not merely a right to first payment following a foreclosure by the first mortgage lender) but a “true lien priority” over an otherwise-first lien mortgage—such that the foreclosure of the association’s lien places the otherwise-first mortgage lien at risk of being extinguished. If the association forecloses its lien, and the otherwise-first mortgage lender does not step forward and redeem its interest by paying off the priority portion of the association’s lien before the sale, the association’s sale of the unit or lot will extinguish the first mortgage lien. See, e.g., SFR Investments Pool 1, LLC v. U.S. Bank, N.A., 334 P.3d 408 (Nev. 2014); Chase Plaza Condo. Ass’n, Inc. v. J.P. Morgan Chase Bank, N.A., 98 A.3d 166 (D.C. Ct. App. 2014); Summershill Village Homeowners Ass’n v. Roughley, 270 P.3d 639 (Wash. Ct. App. 2012).

An association’s six-month lien priority is sometimes termed a “superlien,” but there is nothing particularly “super” about it; the statute simply provides that an association has a lien with priority over the first mortgage, much like the lien of property taxes in nearly all states. An association’s total lien is effectively split into two components: a lien before the first mortgage for six months of assessments and a lien junior to the first mortgage for any delinquent assessment amount over six months’ worth. In this way, section 3-116 was intended to strike “an equitable balance between the need to enforce collection of unpaid assessments and the obvious necessity for protecting the priority of the security interests of lenders.” UCIOA § 3-116, cmt. 1; Joint Editorial Board for Uniform Real Property Acts, The Six-Month “Limited Priority Lien” for Association Fees Under the Uniform Common Interest Ownership Act (June 1, 2013), available at www.uniformlaws.org/shared/docs/jeburpa/2013jun1_jeburpa_UCIOA%20Lien%20Priority%20Report.pdf.

This careful balance is in jeopardy, however, as the result of challenges from the Federal Housing Finance Authority (FHFA), claiming that associations cannot foreclose on assessment liens without the FHFA’s consent if the property is subject to mortgages held by Fannie Mae or Freddie Mac. After explaining the basis for the FHFA’s novel defense, this article gives several reasons why courts should reject the defense.


In SFR Investments Pool 1, LLC v. U.S. Bank, N.A., 334 P.3d 408 (Nev. 2014), the Nevada Supreme Court ruled that an association’s foreclosure of its limited priority assessment lien extinguished the otherwise-first mortgage lien when the mortgagee failed to redeem its position by satisfying the priority portion of the association’s lien before the association’s foreclosure sale. Following this result, Fannie Mae and its conservator, the FHFA, have now sued in the U.S. District Court for the District of Nevada.
Fannie Mae and FHFA argued in Fannie Mae v. SFR Investments that because the association foreclosed its assessment lien without the prior consent of FHFA, the association’s foreclosure sale was invalid under federal law.

By its terms, nothing in 12 U.S.C. § 4617(j)(3) negates the association’s lien or reduces the extent to which it is entitled to priority under state law. Instead, according to Fannie and FHFA, the statute purportedly prevents the association from foreclosing its lien without FHFA’s consent while the GSEs are in conservatorship. Presumably, if Fannie or Freddie foreclosed its first mortgage, acquired title to the unit, and subsequently sold it, the superpriority portion of the association’s lien would survive all of these transactions and remain enforceable against the unit’s purchaser. If this is correct, then obviously any purchaser aware of the association’s priority lien would reduce the amount they would be willing to pay for the property by the amount of the priority lien, and eventually the association would recover that amount. But if the association is in significant financial difficulty—as is often the case with associations facing significant numbers of assessment delinquencies—it may be unable, as a practical matter, to wait out these events.

As yet, no reported cases construe 12 U.S.C. § 4617(j)(3). Its language was borrowed directly from the statute governing the rights of the Federal Deposit Insurance Corporation (FDIC) in its capacity as receiver of insolvent banks, enacted in 1989 as part of FIRREA (the Financial Institutions Reform, Recovery, and Enforcement Act of 1989):

No property of the Corporation shall be subject to levy, attachment, garnishment, foreclosure or sale without the consent of the corporation, nor shall any involuntary lien attach to the property of the corporation.

12 U.S.C. § 1825(b)(2). Courts have routinely upheld this FDIC statute. In Matagorda County v. Russell Law, 19 F.3d 215 (5th Cir. 1994), the U.S. Court of Appeals for the Fifth Circuit concluded mortgages acquired by the FDIC as receiver were its “property” and were thus subject to the bar on foreclosure of any prior lien without the FDIC’s consent. The prior lien at issue in Matagorda County v. Russell Law (and in virtually all other reported cases) was a local government’s property tax lien.

Because the language in 12 U.S.C. §§ 1825(b)(2) and 4617(j)(3) is essentially identical, Fannie Mae and the FHFA have claimed in Fannie Mae v. SFR Investments that an association likewise cannot foreclose its priority assessment lien on units covered by mortgages held by Fannie Mae or Freddie Mac without the consent of the FHFA. In the authors’ view, however, numerous important contextual differences merit judicial rejection of the FHFA’s effort to use 12 U.S.C. § 4617(j)(3) as a legal ground to invalidate association lien foreclosure sales in Nevada and other states that have adopted the UCIOA limited priority association lien.

First, the FDIC statute applies to bank receiverships, and there is a substantial difference between the FDIC’s receivership of a failed bank and FHFA’s conservatorship of the GSEs. An FDIC receivership is relatively short-lived; the FDIC will either sell the assets of the failed bank or get another bank to take them over, and this will ordinarily occur within a matter of weeks or months. In this context, one can argue that 12 U.S.C. § 1825(b)(2) appropriately prohibits foreclosures of FDIC property without the FDIC’s consent during the pendency of the receivership. Effectively, the statute functions as a temporary stay, enabling the FDIC to do its job as receiver quickly and without the distraction of having to respond to creditor enforcement of competing liens. By contrast, the FHFA’s conservatorship of the GSEs is now nearing seven years and shows no signs of being brought to a close soon. If 12 U.S.C. § 4617(j)(3) is given the same broad effect, an association could be stayed for years from foreclosing its assessment lien on a unit encumbered by a Fannie or Freddie mortgage, unless FHFA granted its consent to the association’s foreclosure. The burden on an association unable to foreclose its assessment lien would be commensurately much greater in this context than in an FDIC receivership.

The effect of HERA’s statutory language is likely to be much more onerous on a homeowners’ association in a common interest community than the effect of the similar language governing FDIC’s receiverships on
local governments. A local government’s property taxes apply to a wide variety of nonresidential real estate and to housing, and hence the delay in the local government’s ability to foreclose its tax lien on a few residential properties on which FDIC holds mortgages will probably have only a minor economic effect on the local government’s collection of tax revenues. Even if HERA’s language prevents tax lien foreclosure of all properties on which the GSEs have mortgages, the local government will still have many other properties available for foreclosure. By contrast, the delay in an owners’ association’s ability to foreclose on properties with mortgages held by the GSEs will often mean the great majority of all of its liens are temporarily (though who knows for how long) unenforceable. For an association with many delinquent owners—hardly an unusual situation today—the economic results could be catastrophic.

Second, the longer delay associated with the FHFA’s conservatorship is compounded by HERA’s providing no procedure or standards by which the holder of a prior lien can obtain authority to foreclose its lien over FHFA’s objection. In the context of bankruptcy, the harshness of the automatic stay against creditor enforcement actions is tempered by (1) the Bankruptcy Code’s standards for a secured creditor to obtain relief from the stay and (2) the creditor’s ability to obtain appellate review of a decision by the bankruptcy court denying relief from the stay. Not only does HERA purport to require FHFA’s consent before a foreclosure can extinguish its interest, but also HERA provides no standards by which FHFA’s decision to withhold its consent can be evaluated.

FHFA has claimed that actions taken in its role as conservator of the GSEs are not subject to any judicial review. FHFA’s position is reflected in recent litigation over the legality of FHFA’s actions on Property Assessed Clean Energy (or PACE) loans. When authorized, PACE loans would permit a secured lender financing certain energy-efficiency-related renovations to obtain priority over a prior-recorded mortgage lien. Based on its concern that an expansion in PACE lending could cause the subordination of mortgage liens held by the GSEs (and a threat to the solvency of the GSEs), FHFA issued a directive to Fannie Mae and Freddie Mac to protect themselves against these risks. Fannie Mae and Freddie Mac did so by announcing they would no longer purchase mortgages on property subject to PACE loans. In response, the town of Babylon, New York, filed an action in federal court challenging the authority and constitutionality of FHFA’s directive regarding PACE loans. The U.S. Court of Appeals for the Second Circuit rejected this challenge, noting that as a conservator, FHFA was expressly empowered to take “such action as may be—(i) necessary to put [Fannie Mae and Freddie Mac] in a sound and solvent condition; and (ii) appropriate to . . . preserve . . . [their] assets and property.” 12 U.S.C. § 4617(b)(2)(D). Directing protective measures against perceived risks is squarely within FHFA’s powers as a conservator.

**Town of Babylon v. Federal Housing Finance Agency**, 699 F.3d 221 (2d Cir. 2012). Likewise, other circuits have held actions taken by the FHFA within the scope of its powers as conservator are not subject to judicial review. See, e.g., **County of Sonoma v. FHFA**, 710 F.3d 987, 992 (9th Cir. 2013).

In **Fannie Mae v. SFR Investments**, FHFA is taking the position that an owners’ association, despite its state law priority under UCIOA, cannot foreclose its assessment lien on a unit or lot covered by a Fannie or Freddie mortgage without FHFA’s consent—and FHFA can withhold its consent to such a foreclosure in its sole and unreviewable discretion, for the indefinite duration of the FHFA’s conservatorship. For the reasons explained below, the authors believe the courts should reject this argument.

### 12 U.S.C. § 4617(j)(3) as a Deprivation of Due Process

The Fifth Amendment prohibits the federal government from depriving a person of property without due process of law. A deprivation occurs when a governmental actor significantly alters or eliminates property rights recognized by state law.

Although federal courts have not yet addressed a due process challenge to 12 U.S.C. § 4617(j)(3), they have addressed a comparable due process challenge to FDIC’s invocation of 12 U.S.C. § 1825(b)(2) as a bar to actions by municipalities to foreclose real property tax liens during FDIC receiverships. A representative case is **Matagorda County v. Russell Law**, 19 F.3d 215 (5th Cir. 1994). In **Russell Law**, Matagorda County and several other municipal taxing authorities (the “Taxing Units”) sought to enforce their liens for unpaid real estate taxes on a parcel owned by Russell Law and covered by a deed of trust held by Bay City Bank & Trust Co. After Bay City failed and was placed into FDIC receivership, the Taxing Units joined the FDIC as a party to the tax lien foreclosure proceeding. The U.S. District Court for the Southern District of Texas held the Taxing Units could not foreclose their liens absent the FDIC’s consent, which the FDIC would not give unless the foreclosure was subject to the FDIC’s lien. The Taxing Units argued that by prohibiting them from foreclosing without awarding them any recovery against the FDIC for the value secured by the tax liens, the FDIC had effectively taken the property of the Taxing Units without just compensation.
The court in *Russell Law* ultimately rejected this argument, but its statements in doing so bear close review:

The indeterminate postponement of the Taxing Units’ ability to collect on their tax lien, while not a “physical invasion” or a “permanent appropriation” of their assets, is certainly a severe impairment of those assets. The Taxing Units make a persuasive argument that their ongoing viability—the ability to provide necessary community services, schools, fire and police protection, etc.—is greatly compromised by their inability to collect delinquent taxes. This argument does not fall on deaf ears.

...[T]his Court is not convinced that the [Taxing Units] have been deprived of a sufficient property interest to create a compensable taking. Congress was presented with the phenomenal task of addressing an impending catastrophe in the failure of financial institutions and in response enacted FIRREA. Certain provisions therein are the classic example of a “public program that adjusts the benefits and burdens of economic life to promote the common good.” *Penn Cent.*, supra, 438 U.S. at 124. As the Court has stated, “Legislation designed to promote the general welfare commonly burdens some more than others.” *Id.* at 133. This Court has found that delay in the exercise of a valuable property right alone is not sufficient to create a compensable taking. That finding is tempered, indeed limited, by the acknowledgment that *delay to this point* is not sufficient to constitute a compensable taking. Unmitigated delay, coupled with diminishment of distinct investment-backed expectations, may, at some point, infringe on the entire “bundle” of rights enjoyed by the [Taxing Units] to the point that a compensable taking occurs.


In the wake of the housing crisis prompted by the Great Recession, many owners’ associations would not recover anything in an association lien foreclosure if its lien foreclosure remained subject to the lien of the GSE mortgage.

The Fifth Circuit’s admonition against unmitigated delay in *Matagorda County* is squarely appropriate to the FHFA’s position on 12 U.S.C. § 4617(j) (3). The FHFA’s conservatorship of the GSEs is now approaching seven years in duration, with no end in sight—which unquestionably constitutes “unmitigated delay.” Further, in the wake of the housing crisis prompted by the Great Recession, many owners’ associations would not recover anything in an association lien foreclosure if a lien foreclosure remained subject to the lien of the GSE mortgage (the balance of which often exceeds the value of the home). As a result, the association’s loss of the ability to foreclose its priority position threatens the association’s finances and its ability to preserve and maintain common elements, diminishing the investment-backed expectations of the association’s owner members. If the FHFA can refuse to consent to the foreclosure of an association’s limited priority lien under UCA § 4617(j)(3) deprives the association of its limited priority lien without due process of law.

**FHFA’s Behavior as “Consent” to Association Foreclosures**

FHFA now argues that 12 U.S.C. § 4617(j) (3) prohibits an association from foreclosing its limited priority lien to extinguish a conflicting GSE mortgage lien without FHFA’s prior consent. But FHFA’s consistent conduct as conservator for the GSEs has manifested FHFA’s effective consent to state law lien priority and enforcement rules validating association lien foreclosure sales like the ones being attacked in *Fannie Mae v. SFR Investments*.

FHFA functions as conservator for the GSEs in their roles (among others) as purchasers and securitizers of single-family residential mortgage loans, the terms of which are explicitly governed by state law. In authorizing the GSEs to purchase and securitize such loans, FHFA should be understood to have impliedly consented to the state law priority and lien enforcement rules applicable to those mortgages under state law.

FHFA’s implied consent to an association’s limited priority lien under UCA and UCIOA, and to an association’s foreclosure of such a lien, is manifested in the servicing guidelines published by the GSEs. The 2015 *Fannie Mae Servicing Guide* directs Fannie’s servicers to “take all reasonable actions to prevent new liens that would be superior to Fannie Mae’s mortgage lien from being attached against property.” *Servicing Guide: Fannie Mae Single Family* (Jan. 14, 2015), at 391. This language explicitly acknowledges the risk that a Fannie mortgage can occupy a subordinate position under state law and directs Fannie’s servicers to take steps (including the payment of delinquent taxes or association liens) as necessary to prevent the attachment of a lien that would take priority over Fannie under state law. Similar language appeared in Fannie’s servicing guidelines during prior years. See, e.g., *Fannie Mae Single Family 2011 Servicing Guide* (June 10, 2011), at 302-2 (“When the HOA of a PUD or condo project notifies the servicer that a borrower is 60 days’ delinquent in the payment of assessments or charges levied by the association, the servicer should advance the funds to pay the charges if necessary to protect the priority of Fannie Mae’s mortgage lien. If the project is located in a state that has adopted the Uniform Condominium Act (UCA), the Uniform Common Interest Ownership Act (UCIOA), or a similar statute that provides for up to six months of delinquent regular condominium assessments to have lien priority over the mortgage lien, Fannie...”)

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Mae will reimburse the servicer for up to six months of such advances."); Fannie Mae Single Family 2012 Servicing Guide (Mar. 14, 2012), at 302-2 (same).

Under FHFA's proffered interpretation of 12 U.S.C. § 4617(j)(3), such directives would be unnecessary. If property of the FHFA (including a Fannie mortgage lien) is not subject to lien attachment or foreclosure without FHFA's consent, Fannie's servicers would not need to act to protect Fannie's priority. The directives that mandate Fannie's servicers to act as needed to protect Fannie's lien priority manifest FHFA's "consent" to the operation of state law priority rules that accord a limited priority to association liens under UCA or UCIOA.

Furthermore, the current Fannie servicing guidelines make clear that servicers must inform Fannie of "non-routine" litigation, including any action that "challenges the validity, priority, or enforceability of a Fannie Mae mortgage loan or seeks to impair Fannie Mae's interest in an acquired property," including "an attempt by another lienholder to assert priority over Fannie Mae's lien or extinguish Fannie Mae's interests." Servicing Guide: Fannie Mae Single Family (Jan. 14, 2015), at 561, 563. This duty includes the opportunity to "periodically update Fannie Mae on the progress of non-routine litigation as necessary and appropriate" and to "provide Fannie Mae with sufficient opportunity in advance of any deadline or due date to review and comment upon proposed substantive pleadings." Id. at 562. If an association lien foreclosure conducted without FHFA's express consent is illegal and void, as FHFA now claims, these directives would serve no purpose. These directives likewise manifest FHFA's implied consent to state law proceedings in which a holder of a conflicting lien entitled to priority under state law seeks to foreclose its lien and extinguish Fannie's mortgage lien.

Finally, at no point during the first six years of FHFA's conservatorship did the FHFA assert (or instruct the GSEs to assert) 12 U.S.C. § 4617(j)(3) as a basis to prevent association lien foreclosure sales or to challenge the validity of such sales. By contrast, participation by the FHFA and the GSEs in litigation over the validity and priority of mortgage liens vis-à-vis association liens has demonstrated the FHFA's general consent to the operation of state law lien priority and enforcement rules as they relate to GSE mortgages. For example, in Trademark Properties of Michigan, L.L.C. v. Federal Nat'l Mortg. Ass'n, No. 313296, 2014 WL 6461712 (Mich. Ct. App. Nov. 18, 2014), Fannie Mae purchased a condominium unit in Manor Homes of Troy at a judicial foreclosure sale of a MERS mortgage in May 2010. After Fannie acquired the unit, association dues went unpaid for the ensuing six months, and, in December 2010, the condominium association filed a notice of lien and subsequently foreclosed that lien by advertisement. At the sale in February 2011, Trademark Properties of Michigan, L.L.C. (Trademark) purchased the unit for $6,761.45. Fannie Mae did not act to redeem the unit during the redemption period, but just before the redemption period expired, GMAC (the original lender) recorded an affidavit in the land records purporting to expunge the May 2010 foreclosure deed to Fannie Mae. This affidavit asserted the May 2010 foreclosure sale was void based on the law at the time of the sale. The Michigan Court of Appeals reversed, holding the May 2010 sale was valid and rejecting Fannie Mae's alternative arguments that it had not received notice of the association's lien foreclosure. At no point did Fannie Mae raise the argument that the association's foreclosure sale was invalid because the association did not obtain FHFA's consent. The active participation in this case by Fannie and its servicers confirms the view that the FHFA, in its role as conservator, has consented to the operation of state law lien priority and enforcement rules as they apply to Fannie and Freddie mortgages.

12 U.S.C. § 4617(j)(3) Does Not Apply to Private Parties

As discussed above, 12 U.S.C. 4617(j)(3) is fashioned after the comparable

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FDIC consent provision enacted in 12 U.S.C. § 1825(b)(2) as part of FIRREA. If judicial interpretation of § 1825(b)(2) provides a meaningful template for understanding the intended scope of § 4617(j)(3), § 4617(j)(3) does not invalidate association lien foreclosures under UCA and UCIOA. In fact, previous court decisions interpreting the FDIC consent provision in § 1825(b)(2) have concluded it precludes only tax lien foreclosure sales by state and local taxing authorities, not foreclosure sales by private parties.

The prevailing interpretation of 12 U.S.C. § 1825(b)(2) as directed only to state and local taxing authorities is demonstrated by the decision of the U.S. Court of Appeals for the Fifth Circuit in FDIC v. McFarland, 243 F.3d 876 (5th Cir. 2001). Rory McFarland obtained a $2.5 million loan from the Bank of Commerce, secured by a mineral lease mortgage and assignment. When the Bank of Commerce failed, the FDIC was appointed receiver for its assets, including the McFarland note. Thereafter, two judgment creditors obtained judgments against McFarland. When the FDIC sued to collect the debt owed by McFarland, the judgment creditors intervened, seeking to have the proceeds of the mineral leases paid into court. The district court ordered McFarland to pay the FDIC from the proceeds in the court registry and recognized the mortgage as the first priority lien. The FDIC reinscribed the 1984 mortgage and assignment in various Louisiana parishes in July 1995, and in 1997 the FDIC assigned the mortgage and assignment to the Dennis Joslin Company. In 1998 Joslin sought to foreclose the property subject to the 1984 mortgage and to obtain distribution of the proceeds that had accumulated in the court registry. David L. Jump, one of the judgment creditors, objected, contending the FDIC’s failure to reinscribe the 1984 mortgage and assignment within 10 years of its execution resulted in a loss of priority, such that Jump’s judgment lien now had priority. The district court agreed, holding FDIC’s reinscription in 1995 was untimely and thus deprived Joslin of first priority.

Joslin argued that 12 U.S.C. § 1825(b)(2), as enacted in FIRREA, protected the FDIC from Louisiana’s state-law reinscription requirements. The Fifth Circuit rejected this view and affirmed the district court, holding that “[a]lthough failure to reinscribe a mortgage may result in the application of an ‘involuntary lien’ to FDIC property, FIRREA does not provide relief.” The court noted that before FIRREA, 12 U.S.C. § 1825 only exempted the FDIC from taxation while acting in its corporate capacity and that FIRREA added subsection (b) to extend that exemption to FDIC in its role as receiver. McFarland, 243 F.3d at 886 (“[w]e are persuaded that section 1825(b)(2) merely extends the general exemption of the FDIC from taxation to the receivership context”) (citing from the House Report accompanying FIRREA). The court refused to apply 12 U.S.C. § 1825(b)(2) to liens not attached by state and local taxing authorities:

As Jump and Bank One are private entities possessing normal judgment liens, however, their claims are not barred by section 1825(b)(2). We therefore find that FIRREA does not preclude the application of Louisiana reinscription law to the FDIC’s property. Nothing in FIRREA prevents Louisiana law from recognizing either the FDIC’s obligation to reinscribe mortgages or the loss of ranking suffered by the FDIC if it fails to meet this obligation. FIRREA only prohibits state and local entities from taking advantage of the FDIC’s failure to reinscribe by attaching liens and other instruments to satisfy tax judgments.

McFarland, 243 F.3d at 886. If (as FHFA has suggested) interpretive precedent under 12 U.S.C. § 1825(b)(2) is appropriately used to construe 12 U.S.C. § 4617(j)(3), then the decision in McFarland suggests that § 4617(j)(3) does not apply to invalidate a lien foreclosure sale by a private owners’ association in a UCA or UCIOA state. As a result, an association lien foreclosure in such a state would extinguish a Fannie or Freddie mortgage lien—even without FHFA’s consent to the sale—if the priority portion of the assessment is not satisfied before the sale.

Conclusion

The notion that FHFA and the GSEs can thumb their noses at time-honored state law priority rules is deeply offensive. The GSEs themselves have, in the past, consistently acted as though they were fully bound by those rules. From the inception of the uniform Fannie Mae-Freddie Mac 1-4 family mortgage and note instruments, for example, the GSEs have always been careful to obtain reviews by local counsel to ensure that the documents conformed to the varying laws of the individual states. They have asserted no federally preemptive right to disregard state law. Their claim to the power to ignore state priority law under HERA is unexpected. It is not justified by any emergency because—whatever the exigencies of the mortgage crisis—the procedure that allows an otherwise-first mortgage lender to protect its lien from destruction by the foreclosure of a prior owners’ association lien is perfectly clear and simple to employ. Any such destruction is a consequence of nothing more than Fannie’s or Freddie’s servicer being asleep at the switch. There is no reason the homeowners’ association should be punished for the servicer’s carelessness; rather, Fannie or Freddie should seek reimbursement from the servicer for such losses. The authors hope and believe the courts will understand this and will continue to hold the GSEs to the normal standards of state priority law.