

Gas and Oil Leases as they relate to Residential Lending

By Tompkins County Council Of Governments (TCCOG) - Task Force on Gas Drilling
Assessment and Land Valuation Subcommittee

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NOTICE

The information in this presentation relates to the impact of gas and/or oil leases on residential mortgage lending. Consult with a Real Estate Attorney to address specific issues as they relate to a specific property or lease.

No opinion is being expressed or implied on the practice of leasing mineral rights, environmental impact or regulations surrounding gas and/or oil leases (referred to as gas leases or leases hereafter) by the members or presenters of these findings. The issues listed are summarized to highlight potential conflicts for residential mortgage lending in an effort to facilitate consideration of these issues.

Any use of this document or summary points must include the above notice.

- 1) Surface or sub surface rights within 200 feet of a residential structure would not be acceptable for conventional financing in the secondary market per Fannie Mae and Freddie Mac requirements published in their manuals. (Freddie Mac manual section 39.4, various subsections)
- 2) Title insurance has become a requirement for the vast majority of residential mortgages. If standard title insurance is relied upon to secure traditional mortgage financing for a property with a gas lease, the coverage is ineffective to protect against activities authorized and commonly undertaken pursuant to a gas lease.
- 3) There is not a cost effective or reliable way to determine if a residential property has a gas lease to allow an Appraiser to establish an appraised value based on comparable sales of similar properties. To determine if a property (a comparable) has a gas lease, a title examination of each property would be necessary and add significant cost to each transaction.
- 4) Since there is limited historical data on sales of properties with leases, NYS licensed Appraisers are not able to determine or consider the impact on value or marketability if a gas lease exists as noted in item #3 above. Since the impact on value and marketability can not be determined, the Appraisal would not meet traditional secondary market requirements or commonly accepted lender requirements.
- 5) Section 18 of the standard Fannie Mae/Freddie Mac Mortgage prohibits transfer or sale of any portion of, or rights in, a mortgaged property without prior written consent of the lender and/or Fannie Mae/Freddie Mac. Grant of a gas lease is the transfer of rights in the mortgaged property. This mortgage security document is the commonly accepted and used document for lenders.

- 6) Section 21 of the standard Fannie Mae/Freddie Mac Mortgage prohibits environmental hazardous substances, specifically naming gas, from being stored, used, disposed of, discharged or released on the mortgaged property. The borrower also agrees to not allow another entity to do any of these prohibited actions on the mortgaged property. This mortgage security document is the commonly accepted and used document for lenders.
- 7) Traditional home owners insurance (fire insurance) generally would exclude coverage if a property has active commercial operations occurring on the property. In addition, some companies are now adding “pollution exclusion” language that would not cover seepage or leakage damage coverage as a result of commercial activities.
- 8) Surface or sub surface rights within 300 feet of a residential structure OR within 300 feet of property boundary lines would not be acceptable for FHA (Department of HUD) financing. HUD Minimum Property Standards, section 4150.2.
- 9) Standard gas leases provide the gas company with permanent easements on the property to drill, maintain, operate, plug, use roads, electric, construct pipelines...etc. Such rights survive the term of the lease and would impact the ability for potential future owners to secure traditional financing for the reasons noted above.
- 10) Gas leases are, at times, pledged by the holder of the lease, to secure financing for the company with a lien being placed on the property’s sub-surface rights. These liens may impact the ability for a homeowner to sell or use the property as security for traditional financing since many municipalities and title companies are not able to separate surface and sub-surface ownership and liens in an effective way. A standard title search that shows such liens would create confusion or delay in distinguishing between the homeowners and gas companies rights in the property.
- 11) Lenders are responsible to warrant that loans they sell in the secondary mortgage market meet investor requirements. If a lease exists on a property, it would be difficult for a lender to warrant the loan meets all investor requirements.