



Gas Leases and Mortgages

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Our last entry dealt with emerging legal battles in the Marcellus Shale region. This week, we turn our attention to natural gas drilling and mortgages. As natural gas has become more important and vital to the future of energy, homeowners have signed more than a million leases that give energy companies the right to drill on their land.[1] Most of these homeowners also have mortgages or will want one in the future. Mortgage lenders, however, favor low-risk activity on the mortgaged premises when granting mortgages.

Homeowners in upstate New York with gas leases are finding it extremely difficult to obtain mortgages. Banks are reluctant to grant mortgages to those properties leased for gas drilling because many leases allow drillers to operate in ways that violate the rules set forth in residential mortgages. As most people with mortgages are aware, residential mortgages contain rules on how the mortgaged properties can be used. In order to preserve the value and marketability of the mortgaged property, banks prohibit borrowers from committing any acts that would damage, destroy or cause substantial change to the mortgaged property or allow a third party to do so either. These prohibitions include gas drilling.[2]

Conflicting gas leases and mortgage rules will most likely not result in foreclosures but many of the gas leases entered into by homeowners without the prior approval of the banks in upstate New York constitute a “technical default” under the mortgage. A mortgage default could mean that the lender can demand that the borrower terminate the gas lease or pay off the loan. Banks have recognized the benefits of drilling as well as the complexity of gas leases and mortgages. It will be difficult but banks will have to promulgate new rules, get lessors/mortgagors to comply with mortgage rules and it also adds additional obstacles for homeowners looking to refinance or obtain a home loan.

There is also a concern in how gas leases affect the secondary mortgage market since banks resell more than 90 percent of new residential mortgages to institutions like Fannie Mae, Freddie Mac, and Ginnie Mae.[3] These institutions establish lending guidelines that must be followed in order to attract investors and it is unclear how many of the mortgages held by the secondary lenders or investors have oil or gas leases on them that do not comply with mortgage rules.

Conflicts between leases and mortgages are likely to increase in New York due to the uniqueness of the state’s rules for how close to homes drilling may be undertaken, as compared to other states in which drilling has been occurring for many years. Before New York issues gas permits, these issues will need to be addressed so that gas drilling can coexist with homeownership.

1. <http://www.nytimes.com/2011/10/20/us/rush-to-drill-for-gas-creates-mortgage-conflicts.html?pagewanted=all>

2. <https://org2.democracyinaction.org/o/7139/images/Fracking-the-Homestead.pdf>
3. <http://www.nytimes.com/2011/10/20/us/rush-to-drill-for-gas-creates-mortgage-conflicts.html?pagewanted=all>