

Three Bedrooms, Two Baths, and a Gas Lease

by Sue Smith-Heavenrich

Broader View Weekly, March 20, 2009

Kristin Ahlness, a realtor with Audrey Edelman RealtyUSA of Ithaca, has been selling properties in Tompkins County and the surrounding area for a number of years. Usually Ahlness has no problem matching a home buyer with that perfect country dream house, but last year she had trouble closing the deal on a 32-acre parcel in West Danby.

The land had no house built on it, but this didn't bother the first buyers. They signed a contract and were looking forward to building their home in the country. When their attorney advised them against buying property with a gas lease, they backed out of the deal.

A second buyer took a "build package" to her loan officer at Bank of America to work out a mortgage. The bank denied a loan because there was a gas lease on the property. A letter from the attorney indicated that the title insurance company would not provide insurance on the land without a 5-acre release of surface rights for the home site.

Ahlness rifled through her file, and then pulled out a copy of a letter from Chesapeake Energy. Dated November 6, 2007 the letter advised attorneys that the company would not release surface rights.

Has Ahlness asked Chesapeake to release surface rights to facilitate a sale? Yes, but with no success. Chesapeake Energy did not respond to phone calls requesting clarification about their policies.

It took nine months for Ahlness to finally connect the land with the right people. The buyers, when advised of the gas lease, figured that they could build a house before the gas company drilled any wells. They trusted the energy company to comply with lease terms dictating that there be no drilling within 200 feet of any structure.

"People should call their attorney before signing an oil or gas lease," Ahlness advised. "In these uncertain economic times, most people don't know where they will be five years from now," she pointed out. "They need to make sure that they protect their ability to sell their property should they need to."

Liens, Leases, and Surface Rights

The biggest question when it comes to buying, selling, and getting mortgages on leased land is whether the energy company has surface rights or not, explained Elmira oil and gas attorney Christopher Denton. The bank always wants the first lien, and a gas lease is an encumbrance like a lien.

Homeowners need to read the small print in their mortgage agreements, Denton stressed. Most banks do not allow a mortgage-holder to place other liens on the property, including other mortgages or mechanic's lien. Also, Denton pointed out, a homeowner looking for a second mortgage would have a harder time convincing the bank to give him a loan if he has signed a gas lease.

As for those purchasing a house and land with an existing gas lease, the energy company holding the lease holds the first lien on the property. If the lease gives away surface rights, the gas company becomes the effective owner of the property and can, if they choose, remove buildings in order to drill a well. For this reason, banks will often request that an energy company release the surface rights to the dwelling site.

"A lease, by its very words, includes surface rights even if they are not spelled out in common language," Denton said. These rights are given over in the first clause when the landowner gives, grants, and remises the land to the Lessee – unless the lease is written to specifically exclude all surface rights.

On occasion landowners have worked with an energy company to get the surface rights released for a five-acre home site. According to realtors interviewed for this article, many banks are comfortable with that arrangement.

Another option is to ask the energy company to subordinate their interests for a particular piece of the land. That means that the energy company would agree to put its interests behind those of a mortgage lender in the case of a sale or foreclosure.

"These are complex things," Denton explained. "But they can be worked out."

Ralph Kelsey, Senior Vice President of credit services for Tioga State Bank emphasized that every situation has to be reviewed on its own merits. The newer leases tend to be more landowner-friendly, delineating minimum distances from building to a well site.

However, tendering a mortgage often comes down to the recommendation of counsel and the title insurance company, Kelsey said. Whether the bank will finance a parcel depends on the terms of the gas lease and the age of the gas lease.

"Now that there's more gas activity in the area, banks will be taking a harder look at those leases," Kelsey said. They also want to know how the landowner is covered from a liability standpoint.

Speculating on Land, Gas

Last summer, when the natural gas rush was at its height, Dave Knudsen fielded at least two calls a week from investors and potential land buyers looking to purchase 100 – 200 "leaseable acres".

“They were asking for land near the pipeline,” said Knudsen, a Sullivan County realtor with the Catskill Buyer Agency. His usual clients, downstaters looking for a quiet country second home, had other priorities.

“When I showed home buyers a property, they wanted to know whether the neighbors had a gas lease,” Knudsen said. If Sullivan County were to see a lot of gas activity, his clients would look for properties farther east, in Ulster County. Knudsen’s concern is that their defection to the neighboring county would cause property values to fall.

“Before September natural gas prices were up,” Knudsen said. “Gas company stocks were high and landowner groups were quite active.” But in mid-September Lehman Brothers went bankrupt, the price of natural gas went south, and energy companies weren’t executing the leases they’d signed up over the summer.

“I think the lack of leasing and gas activity has more to do with the economic downturn than with the DEC,” Knudsen said. “The price of natural gas went from \$14/mcf to \$4 or \$5; given the cost of extraction in the shales, there’s no way they can say the decline in gas activity is not related to gas prices.”

Sue Nogaret, a certified appraiser and real estate broker in New Berlin (Chenango County) has also noticed the recent decline in real estate activity. She observed that a rising number of landowners and investors are trying to sell parcels without gas rights.

“They are not having much success,” Nogaret said. She pointed out that right now it is too early to determine whether and how gas leases will affect the price and marketability of properties.