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DRILLING DOWN

Rush to Drill for Natural Gas Creates Conflicts With Mortgages



Andrew Harrer/Bloomberg News

A natural gas drilling rig next to an impoundment pit in Washington County, Pa. Such pits are often used to store toxic drilling waste.

By IAN URBINA

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As natural gas drilling has spread across the country, energy industry representatives have sat down at kitchen tables in states like Texas, Pennsylvania and New York to offer homeowners leases that give companies the right to drill on their land.

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The Fine Print

Articles in this series examine the risks of natural gas drilling and efforts to regulate this rapidly growing industry.

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And over the past 10 years, as natural gas has become increasingly important to the nation's energy future, Americans have signed more than a million of these leases.

But bankers and real estate executives, especially in New York, are starting to pay closer attention to the fine print and are raising provocative questions, such as: What happens if they lend money for a piece of land that ends up storing the equivalent of an Olympic-size swimming pool filled with toxic wastewater from drilling?

Fearful of just such a possibility, some banks have become reluctant to grant mortgages on properties leased for gas drilling. At least eight local or national banks do not typically issue mortgages on such properties, lenders say.

A credit union in upstate New York has started requiring gas companies to promise to pay for any damage caused by drilling that may lead to devaluation of its mortgaged

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Heather Ainsworth for The New York Times
Like many landowners, Marie McRae, who has a farm in Freeville, N.Y., says she was not aware she needed her lender's permission for a gas lease.

properties. Another will make home loans only to people who expressly [agree](#) not to sign a gas lease as long as they hold the mortgage.

More generally, bankers are concerned because many leases allow drillers to operate in ways that violate rules in landowners' mortgages. These rules also require homeowners to get permission from their mortgage banker before they sign a lease — a fact that most landowners do not know.

Last year, Jack and Carol Pyhtila spent several weeks working to refinance the mortgage on their roughly 30 acres in Tompkins County, N.Y. But when they arrived to **sign the mortgage**, the lender, Visions Federal Credit Union, had taken a closer look at the lease on their land and revoked its offer, said Mr. Pyhtila, 72.

"They told us there was not enough information yet to know how the lease would affect the property value and they were not sure if it followed the mortgage rules," he said. Another bank agreed to refinance their loan several months later.

Lenders predict that the conflicts between leases and mortgage rules are not likely to cause foreclosures, nor have they resulted in broad litigation or legislation. But many of the leases do [constitute](#) "technical defaults" on the mortgages, lenders say, and will likely result in new rules from local banks and additional hurdles to getting a home loan or refinancing a mortgage.

Some real estate agents have started raising red flags.

"When you decide to sell your house you may find it difficult to do so because many banks, here and elsewhere, will not mortgage properties with gas leases, which, in turn, limits the number of buyers willing and able to buy your property," [wrote](#) Linda Hirvonen, an agent in Ithaca, N.Y., in a newsletter last month.

Banks establish rules for how mortgaged properties can be used, to help ensure that they will hold their [value](#). Banks also need to guarantee that their mortgages meet certain standards so that they can sell them to institutions like Fannie Mae and Freddie Mac, which bundle and sell these mortgages to investors.

"In terms of litigation, there is a real potential for a domino effect here if lenders at each step of the way made guarantees that are invalid," said Greg May, vice president of residential mortgage lending at Tompkins Trust Company, headquartered in Ithaca.

Banks resell more than 90 percent of new residential mortgages in the United States to institutions like Fannie Mae, Freddie Mac and Ginnie Mae. It is not clear how many mortgages held by major secondary lenders or investors have [oil](#) or gas leases on them that do not comply with mortgage rules.

But if even a small percentage do, tens of billions of dollars in mortgages might be affected, raising new concerns for an industry that has suffered in recent years from home loans that proved much riskier than expected.

Some lawyers who specialize in oil and gas leases said they were not worried.

"The leases have not created any practical conflict or issue with mortgages," said Adam J. Schultz, a lawyer in Syracuse, adding that there are thousands of gas leases on mortgaged properties in New York and Pennsylvania and that state environmental regulations helped protect property values.

Most of the bankers and mortgage experts interviewed also emphasized that they were not opposed to expanded drilling. The surge in such drilling has created thousands of jobs, bolstered American energy supplies and turned some landowners into millionaires, they said.

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However, the banking industry is only starting to appreciate the complexity and possible consequences, they added.

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"It's truly Pandora's box," said Cosimo Manzo, a vice president of First Heritage Financial, a mortgage services company in Philadelphia, during a [presentation](#) to Pennsylvania lenders posted online in July by a state credit union association. He also compared getting leases to comply with mortgage rules to solving a Rubik's Cube.

If local banks do not require that leases comport with mortgage rules, Fannie Mae and Freddie Mac may stop buying mortgages from these banks, Mr. Manzo said. Other experts warned that the two institutions, or investors who bought mortgage-backed securities, may also force local lenders to buy back noncompliant mortgages.

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Kitty Bennett contributed research.

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