

Across the U.S., thousands of families are moving into new houses where, amid an unprecedented energy boom, their builders or developers have kept the mineral rights for themselves

They own the house, but not what lies beneath

BY MICHELLE CONLIN AND BRIAN GROW



NAPLES, FLORIDA, OCTOBER 9, 2013

Robert and Julie Davidson fell hard for the gleaming new house at the Valencia Golf and Country Club in Naples, Florida. They loved the way the palm-fringed, Spanish-style home backed up to the fifth-hole fairway. And they were taken with the three-bedroom's high ceilings and open plan. Plus the neighborhood – with its power-washed driveways, blooming hibiscus and guarded gatehouse – seemed all “dressed up.”

But when the Davidsons paid \$255,385 in 2011 for the house on Birdie Drive, they didn't know that they had, in essence, bought only from the ground up, and that their homebuilder, D.R. Horton, had kept everything underneath.

“Wait a second, wait a second,” Robert Davidson said after a reporter told him that a search of county records showed that D.R. Horton still owned the oil, natural gas, water and other natural resources beneath his and his neighbors' homes. “Let me sit down a minute here. They

WHO KNEW? Robert Davidson and his wife learned that they didn't own the mineral rights under their Naples, Florida, home only after a reporter told them. **REUTERS/JOE SKIPPER**

have the mineral rights to the land I'm on?"

In golf clubs, gated communities and other housing developments across the United States, tens of thousands of families like the Davidsons have in recent years moved into new homes where their developers or homebuilders, with little or no prior disclosure, kept all the underlying mineral rights for themselves, a Reuters review of county property records in 25 states shows. In dozens of cases, the buyers were in the dark.

The phenomenon is rooted in recent advances in extracting oil and gas from shale formations deep in the earth, fueling the biggest energy boom in modern U.S. history. Horizontal drilling and the controversial practice of hydraulic fracturing, or "fracking," have opened vast swaths of the continental United States to exploration.

As a result, homebuilders and developers have been increasingly—and quietly—hanging on to the mineral rights underneath their projects, pushing aside homeowners' interests to set themselves up for financial gain when energy companies come calling. This is happening in regions far beyond the traditional American oil patch, which has a long history of selling subsurface rights.

"All the smart developers are doing it," says Lance Astrella, a Denver lawyer who represents mineral-rights owners, including homebuilders, in deals with energy companies.

Among the smart ones are private firms like Oakwood Homes in Colorado, the Groce Companies in North Carolina, Wynne/Jackson in Texas, and Shea Homes, which builds coast to coast. Publicly traded companies that engage in the practice include the Ryland Group, Pulte Homes and Beazer Homes, according to oil and gas attorneys and public land records.

HEAVY USER

D.R. Horton, the biggest U.S. homebuilder, is a heavy user of the practice. The Fort Worth, Texas, company has separated the mineral rights from tens of thousands of



SIGN OF THE TIMES: An approved plan to drill adjacent to a Naples neighborhood near the Davidsons prompted one resident to put up a sign in protest at the site. REUTERS/JOE SKIPPER

“All the smart developers are doing it

Lance Astrella

A Denver lawyer who represents mineral-rights owners

homes in states where shale plays are either well under way or possible, including North Carolina, Alabama, Mississippi, Virginia, New Mexico, Nevada, Arizona, Oklahoma, Utah, Idaho, Texas, Colorado, Washington and California. In Florida alone, the builder has kept the mineral rights underneath more than 10,000 lots, a review of county property records shows.

In most states, sellers aren't legally required to disclose to home buyers whether they are severing the mineral rights to a property. Builders sometimes flag the move in sales contracts or deeds and other documents they are required to file with local authorities. But buyers don't necessarily review their paperwork very closely, especially if, as real-estate agents say happens often, they don't hire a lawyer to help them with the transaction.

"This is a huge case of buyer beware," said Professor Lloyd Burton, professor of law and public policy at the University of

Colorado Denver. "People who move into suburban areas are really clueless about this, and the states don't exactly go out of their way to let people know."

Multiple builders declined to respond to questions about severing minerals under lots. Pulte said of its mineral-rights business: "While not zero, it's immaterial in our history and is not typically a component of land acquisition transactions." Beazer Homes said its standard sales contract in the Dallas-Fort Worth area includes a clause that carves out mineral rights. The company said that it does not always retain those rights and that it is not in the business of leasing them out. It would not comment on whether it keeps mineral rights in other parts of the country.

Wynne/Jackson said that, as a developer, it wouldn't be in a position to disclose reserved mineral rights since it sells its lots to homebuilders long before a home buyer enters the picture.

Oakwood Homes, the Ryland Group and Shea Homes, all of which county records show have reserved mineral rights under housing developments, declined to comment. D.R. Horton also declined to comment.

Homeowners, once they find out they don't

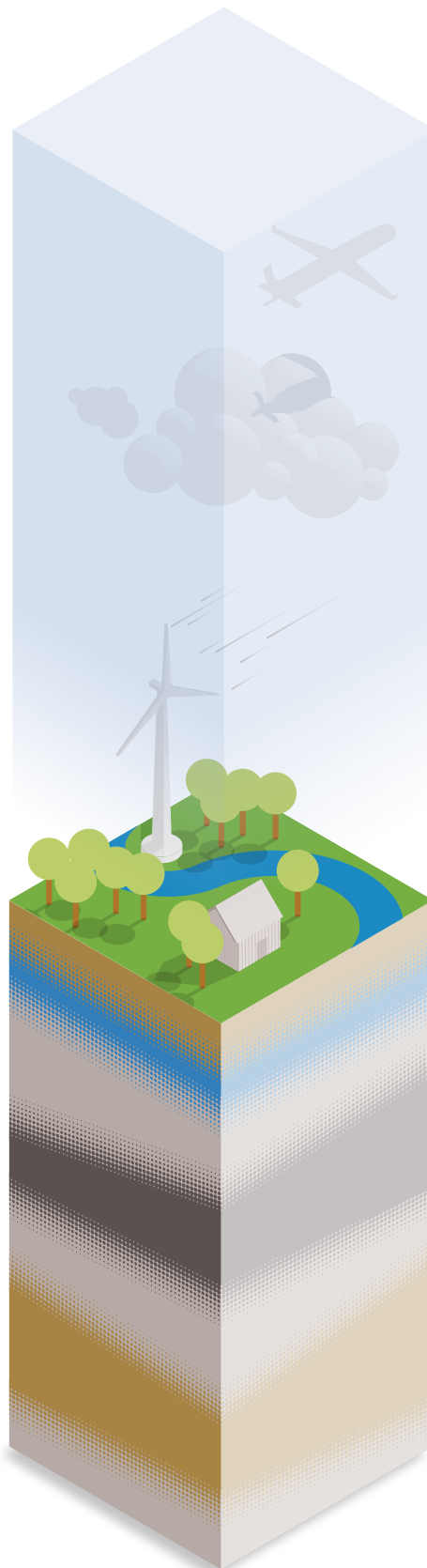
own the earth under their feet, are typically not pleased. Many worry about the potential health and environmental effects of fracking. Research has yet to resolve the fierce debate over whether the process leads to ground, air and drinking-water contamination.

Janet Damon lives in a Denver community where builder Oakwood Homes leased out the underlying mineral rights to Anadarko Energy. And though drilling has yet to occur, Damon says, the possibility alone “has caused so much anxiety for families living in this radius that people started having health issues, panic attacks, because they’re so concerned about their kids and families.” Anadarko said it has since assigned the lease to ConocoPhillips as a part of a larger transaction. ConocoPhillips confirmed that it holds the lease.

Others homeowners are angry that they cannot exploit for financial benefit something they thought they owned. Richard Goodrich, another Valencia Golf and Country Club homeowner in Naples, noticed D.R. Horton had severed his mineral rights while he was negotiating to buy his house in November 2011. He says he told the local sales rep that he wanted to keep the rights. “If somebody wanted the mineral rights, then obviously there was a value,” says Goodrich, a retired transportation executive. He was rebuffed. “It wasn’t negotiable. We either (gave up the minerals) or we didn’t get the house.”

Loss of mineral rights isn’t the only hit homeowners take. Property-tax assessments don’t take into account severed mineral rights. And “lenders may not be willing to extend mortgage loans on property that is subject to intensive gas extraction activities,” according to a report last year by the North Carolina Department of Justice.

Wells Fargo, the nation’s largest home lender, sometimes denies mortgages to homes encumbered by gas leases. And for the past year, Sovereign Bank has been including clauses in mortgages allowing it to declare borrowers in default if any part of



Divided rights

Surface rights are only a slice of what comes with a home purchase – or not

AIR

The right to the empty space above a property — except for upper airspace, which the government controls as a “public highway” for aircraft. In cities like New York and Chicago, air can be severed from the underlying property and then sold for development.

WIND

The right to earn royalties if, for example, wind is “developed” by a wind farm to generate electricity. Practices vary from state to state. In Texas, California and North Dakota, landowners are increasingly severing wind rights when selling a property. Oklahoma has banned that practice, and a handful of other states have restricted it, too.

WATER

The right to the water in rivers, streams, lakes, ponds and the ground. Eastern states generally allow those whose land touches the water to use it. Western states usually grant water rights to whoever uses them first. The federal government can also reserve water rights

MINERALS

The right to mine, drill, or exploit natural resources that lie beneath the Earth—hydrocarbons such as oil and natural gas, as well as metals and minerals. In a “split estate,” subsurface owners can lease the rights to drilling companies.

Sources: Bureau of Land Management; University of Oklahoma Law Professor Owen Anderson; Attorneys Lisa Chavarria and Rod Wetsel

the subsurface property has been “leased, assigned or otherwise transferred for use to extract minerals, oil or gas,” according to a copy of the bank’s mortgage addendum. If mineral rights are severed, “we would not move forward with financing a property,” said a bank spokeswoman.

Insurance policies usually exclude damage from “industrial operations,” and some companies are denying coverage altogether for homes where the mineral rights have been severed. Title insurance companies have been exempting anything to do with mineral rights from their policies, too.

“VIRGIN LOCATIONS”

In many countries, only monarchs and governments are entitled to pull resources out of the earth. The United States is one of the few places where private owners hold title to what’s above and what’s below the ground. A handful of oil-rich states, such as Texas and Oklahoma, have a long tradition of split estates, whereby one party can own the surface rights, and another can own the subsurface rights.

Now, once-inaccessible stores of oil and gas – underneath bustling urban neighborhoods and tree-shaded suburbs in places like Denver and Los Angeles – are within reach. Homeowners in these “virgin locations” are often untutored in the nuances of property rights and unaware they may be sitting atop oil and gas deposits that could be worth thousands or even millions of dollars.

In North Carolina, a group of distraught homeowners contacted the state Attorney General’s office last year after they discovered that they had signed away their mineral rights when they bought their homes – just as the state was about to open its doors to fracking. “Everybody started to panic, because we were part of the area where there was potentially going to be fracking,” says Jay Mosesson, a homeowner in the Legend Oaks subdivision in Chapel Hill.

Mosesson says he didn’t learn that D.R. Horton was keeping the mineral rights

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under his home until his closing. “It was kind of hard to get out of it at that point because we had waited months for the house to get built and we were moving out,” he says. “Plus we would have had to give our deposit up. We couldn’t say, ‘Oh, we’re not going to buy the home. We don’t have mineral rights.’”

As part of an inquiry into the matter, the state Department of Justice sent a letter to D.R. Horton, on April 12, 2012, asking for “a description of all oral and written disclosures made to home buyers,” as well as the forms to back them up. “Our feeling was that normally, when North Carolina consumers were buying homes, their expectation was that they were purchasing all the normal rights with the home – as well as the land,” said state Deputy Attorney General Kevin Anderson.

D.R. Horton said in a statement it released at the time that it intended “for its home buyers to be fully aware that the mineral rights under their lot have been severed and retained.” It said it instructed sales agents to disclose the reservations prior to signing a contract. It also said it disclosed them in the deed, title and sales contract. A copy of a sales contract, reviewed by Reuters, showed it has a clause giving D.R. Horton “all geothermal energy and resources” located “on, in or under the Lot.”

D.R. Horton agreed to return the rights to 700 aggrieved homeowners, including Mosesson. It also said it would suspend the practice of reserving the rights until the state legislature implemented a regulatory framework for fracking, which North Carolina is expected to allow in 2014.

“No one is actually reading these real estate contracts,” says James Smith, a real-estate agent with Charlotte-based Executive Sellers Realty. “A lot of homeowners didn’t realize their rights were stripped out.” He and other agents say the problem is compounded because home buyers often don’t hire a lawyer to help them with their deals.

Publicly traded homebuilders aren’t required to disclose details of their oil and gas income or activity until the business becomes “material,” investor relations professionals say. A review of U.S. Securities and Exchange Commission filings turned up no such disclosures, suggesting that the companies have yet to turn their retained holdings into profit centers by leasing to energy companies.

The potential is there. Selling or leasing mineral rights has become a multibillion-dollar U.S. industry. A typical drilling lease can generate bonuses for its owner worth thousands of dollars per acre and a share of production profits as high as 25 percent. In 2012 alone, energy companies paid out more than \$20 billion in natural gas royalties, according to the National Association of Royalty Owners.

As drilling has moved into more densely populated areas, energy companies have typically sent teams of so-called land men to knock on homeowners’ doors to try to persuade them to lease their mineral rights. Each lease can have different terms, depending on the negotiating skill of the homeowner. Now, by dealing with builders and developers, energy companies can lock up entire neighborhoods via a single lease.

“We thought about it, and thought it was probably better that the mineral rights not be in so many different pockets,” says Van Groce Sr., founder of the Groce Companies, a homebuilder that is currently reserving mineral rights underneath homes in the Copper Ridge Subdivision in Sanford, North Carolina.

D.R. Horton deeds the mineral rights it retains to a subsidiary called DRH Energy.

Backyard, frackyard

Many homeowners in the Fox Run subdivision in Greeley, Colorado, didn't know the developer had leased mineral rights under their homes to Mineral Resources, an energy company that plans to sink wells adjacent to their neighborhood.



Sources: Reuters; Google Earth (image)

The deeds contain language barring the disturbance of the surface of the lot – to a depth of 30 feet – but allowing for “developing, drilling, producing, withdrawing, capturing, pumping, extracting, mining or transporting the minerals, resources and groundwater” under or around the property through “wells or other structures at surface locations situated outside the boundaries” of the property.

In most cases, D.R. Horton appears not to have inked many agreements with energy companies. However, county property

records show that it has done at least four mineral-rights deals in the Fort Worth area, home to more than 1,675 oil wells. The most recent was in February, when D.R. Horton leased the mineral rights under the Fairways at Fossil Creek development to XTO Energy, county property records show. Terms weren't disclosed.

XTO Energy, a unit of ExxonMobil, said it has drilled in the area.

In February, chiropractor Mark Schreibman bought a new house for his family of four in the upscale Fox Run

subdivision in Greeley, Colorado. Having once lived in a 300-square-foot bungalow, he saw the 3,600-square-foot adobe as a palace: two kitchens, five bedrooms, a three-car garage.

Schreibman thought he had considered every aspect of the purchase. “When I was sitting down at my closing, I mean, the last thing I was thinking was: ‘Do I own my mineral rights?’” he says. “That was just a non-issue.”

Two weeks later, a neighbor came to his door handing out leaflets: It was an

invitation from an energy company in Greeley called Mineral Resources to attend a community gathering the next night.

Schreibman and about 65 neighbors gathered at the Family Funplex, where officials from Mineral Resources told them that the company was about to begin drilling under their neighborhood – and that it was putting 22 well heads right across the street (the number has since been reduced to about 16). The officials assured residents that they would have a say in choosing the shrubs and trees to be planted to conceal the drilling operation and minimize noise.

Unbeknownst to the residents, many of whom had missed the mention of the mineral-rights disclosure on their deeds, the developer had spun off the rights and leased them to Mineral Resources. They say they don't remember hearing anything about it when they bought their houses.

"We were shell-shocked," says Schreibman, who is now running for city council. "No one ever thought they would frack here – for any reason."

The residents quickly mobilized, hiring a lawyer and filing an appeal with the city of Greeley. With 425 wells that lie within city limits, Greeley has become a drilling town. But the residents argued that such a sprawling operation, so close to a residential neighborhood, was unprecedented, and that the possible health risks were too great. They also said that they were blindsided by the proposal, that they would never be able to sell their homes once drilling started, and that they feared the consequences of an accident, explosion or flood.

At a packed hearing last spring, the city rejected the appeal, seven to zero, on the grounds that the plan met the criteria under local land-use laws. "The city is committed to continuing to work with the community to find the right balance of land uses," says Brad Mueller, Greeley's director of community development. "It's a balance between competing values."

Since the drilling plan came to light, two



TOO LATE: Mark Schreibman and his neighbors petitioned the city of Greeley, Colorado, to block a company's plans to drill in the field next to – and potentially under – their homes. They lost.

REUTERS/RICK WILKING

“When I was sitting down at my closing, I mean, the last thing I was thinking was: ‘Do I own my mineral rights?’”

Mark Schreibman

Resident of Fox Run subdivision, Greeley, Colorado

neighbors have sold their homes. Two more have put theirs on the market; one just cut the price by \$50,000.

Mineral Resources Chief Executive Officer Arlo Richardson said he wasn't sure when the drilling would begin. "We appreciate and recognize their concerns," he said. "But it doesn't change what the state of Colorado allows us to do."

Fox Run developer Mike Donaldson did not respond to requests for comment.

NO DISCLOSURE

Split estate laws emerged more than 100 years ago, long before any energy company had the ability to drill horizontally for miles. That's why mineral-rights owners in many places can now extract hydrocarbons from beneath a property even if doing so is against the will of the homeowner.

State laws are at best murky on what sellers must tell buyers about mineral rights. A bill expected to be introduced in 2014 in Colorado would require sellers to disclose mineral-rights ownership to buyers before a sale. But for now, all that exists is two sentences in the standard sales contract underneath a section called "Title Advisory," warning the buyer of the possibility that mineral or water rights may have been transferred.

The disposition of mineral rights is rarely explained to buyers before or during closings, real estate professionals say, and title searches don't always pick up the information, either. Many states also don't require home buyers to have their own lawyer present at closings.

"We were surprised to find that a lot of the laws in other states didn't seem to approach the issue from a consumer protection standpoint," said Deputy Attorney General Anderson in North Carolina, which enacted a law requiring a separate written disclosure about mineral rights for home buyers. "To a large extent, there weren't always good models for us to look at."

Real-estate agents say many buyers

miss any notifications buried in the multipage sales contracts they sign. And even though builders and developers sometimes file mineral deeds with county registrars, homeowners may not know to sleuth through county property records to find that information. Title insurance policies may disclose the reservations, but buyers often miss those, too.

In 2008, drillers moved into the Bossier Parish, Louisiana, area and started to pen leases worth thousands of dollars. In the Golden Meadows development – a quiet community of no-frills, one-story brick homes – energy companies filled residents' mailboxes and dropped flyers on their doorsteps.

Charles Richard Casares was in the middle of negotiating a deal to lease his own mineral rights when an energy company representative informed him that he didn't own them. The builder of his home, James M. Brown Builder, did. Before selling Casares his house in 2006, the company had transferred the rights to company officers and their wives. It had also allegedly inked leasing deals with two energy companies.

Casares and six other residents filed suit against James M. Brown Builder in Louisiana District Court, alleging their deeds made no mention of the mineral-rights reservations. "It was the principle of the thing, is what made me mad," says Casares. "The way they did me."

In 2011, after gas prices crashed, the lawsuit was settled confidentially.

Doug Brown, president of James M. Brown Builder, declined to comment, citing the confidentiality agreement.

Severed rights are usually not factored into tax assessments. Thus homeowners who don't own their mineral rights often end up paying just as much in property taxes as those who do – even though their properties are worth less. Owners of severed mineral rights pay no property taxes at all. Only when minerals are extracted from the

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ground are they usually taxed, according to Jerry Simmons, the executive director of the National Association of Royalty Owners.

Appraisers and tax assessors rarely ask about mineral rights when they assess properties, especially in states with little experience of oil and gas drilling, says John S. Baen, a professor of real estate at the University of North Texas, who has studied the impact of drilling on property values. "The tax offices have no clue what to do," he says. "They don't understand it at all."

FRACKING THE FAIRWAY

Davidson didn't have his own lawyer present at the closing for his house in Naples, Florida. The Vietnam War veteran, who runs a hearing-aid company, says he doesn't remember hearing or reading anything about mineral rights at his closing. Nor did he do his own search of local property records at the Collier County Recorder of Deeds.

If he had, he would have found out that, four years before he bought his house, D.R. Horton filed a mineral deed granting its DRH Energy subsidiary the right to exploit whatever resources it could underneath Davidson's house.

In September, local authorities approved a plan for Dan A. Hughes Co of Texas to begin drilling near Golden Gate Estates, a neighborhood 10 minutes from Davidson's home. It's the first time south Florida has allowed horizontal drilling so close to a residential area. Neighbors there received a letter last April from an emergency preparedness company called Total Safety,

requesting household information for a hydrogen sulfide contingency plan should the area need to be evacuated due to an explosion or leak. Dan A. Hughes Co declined to comment.

Davidson worries that if the project is successful, oil and gas operators will pounce on more mineral-rights leases in suburban Naples, including under his home.

He says he also "would have a problem with them generating income off of something which theoretically I should own." Davidson, who is the secretary of the board of the Valencia Club development, says he and the rest of the club's board plan to contact their lawyer about the mineral rights under their homes and add the issue to the list of grievances they have with D.R. Horton, from unpaid homeowner dues to cul-de-sacs lacking sufficient drainage.

Recently, Davidson unpacked a stuffed plastic file folder that contains all of his house paperwork. He pored over every page. In the title to his home – provided by D.R. Horton's in-house title company – he found minerals mentioned between information about easements and tax parcel numbers. It read: "minerals, resources and groundwater (with rights of egress and ingress, springing surface waiver) in favor of DRH Energy."

Edited by John Blanton

FOR MORE INFORMATION

Michelle Conlin

michelle.conlin@thomsonreuters.com

Brian Grow

brian.grow@thomsonreuters.com

John Blanton, Enterprise Editor

john.blanton@thomsonreuters.com

Michael Williams, Global Enterprise Editor

michael.j.williams@thomsonreuters.com