

RAÚL M. GRIJALVA
7TH DISTRICT OF ARIZONA

COMMITTEE ON NATURAL RESOURCES
Subcommittee on Water and Power
Subcommittee on Parks, Forests and
Public Lands – *Ranking Member*

COMMITTEE ON EDUCATION AND THE WORKFORCE
Subcommittee on Early Childhood,
Elementary and Secondary Education
Subcommittee on Higher Education and
Workforce Training

CONGRESSIONAL PROGRESSIVE CAUCUS,
Co-Chair



Congress of the United States
House of Representatives
Washington, DC 20515-0307

November 22, 2011

1511 Longworth HOB
Washington, DC 20515
Phone: (202) 225-2435
Fax: (202) 225-1541

District Offices:
738 N. 5th Avenue, Suite 110
Tucson, AZ 85705
Phone: (520) 622-6788
Fax: (520) 622-0198

201 Bingham Avenue, Suite 2
P.O. Box 4105
Somerton, AZ 85350
Phone: (928) 343-7933
Fax: (928) 343-7949

<http://grijalva.house.gov/>

Steve Linick
Inspector General
Federal Housing Finance Agency
1625 Eye Street, NW
Washington, DC 20006

Dear Mr. Linick,

As a senior member of the House Natural Resources Committee, I have followed the regulatory and economic complications arising from the proliferation of corporate oil and gas leases on private land with great interest. This is an issue in which the Federal Housing Finance Agency (FHFA) has only recently become engaged, and some of the relevant regulatory framework is in its early stages. The central issue is that oil and gas companies now frequently solicit leases from private homeowners whose properties sit atop valuable resource deposits, and those homeowners are unaware of the implications of signing those leases. This has grave implications for FHFA when properties drop in value or become worthless because of the impacts of oil and gas drilling.

This is particularly important today because of the expanded use of fracking, a process for releasing and extracting natural gas. The use of fracking has grown since Congress exempted the practice from several federal environmental laws in 2005. Fracking has drawn a great deal of scrutiny from local legislators, especially in states like New York and Pennsylvania where large natural gas deposits have been discovered. Fracking carries not only great environmental risks for groundwater, but inevitably disrupts the property on which it is employed.

The potential for large-scale property value degradation brings FHFA into the picture. When oil and gas drilling diminishes the value of a piece of property, either through outright environmental damage or harming its potential for future development, the mortgage on that property may no longer meet the standards of Fannie Mae or other federal lending agencies. In such cases, the lending agency would no longer want that mortgage on its books and would attempt to push it back to the local lender that originated the mortgage. This problem could become especially acute if Fannie Mae or another federal agency has resold such mortgages to international investors or speculators, who would likely demand compensation for mortgages after they drastically decrease in value. This scenario and the related risks to our economy, as described in publications as various as *The New York Times*¹, *Reuters*² and the New York State Bar Association Journal, greatly concern me.

¹ http://www.nytimes.com/2011/10/20/us/rush-to-drill-for-gas-creates-mortgage-conflicts.html?_r=3&pagewanted=1

² <http://www.reuters.com/article/2011/10/28/gas-leases-kimmerle-idUSN1E79Q0DX20111028>



After an oil or gas company procures a lease from a private homeowner, as the Bar Association Journal laid out in an article by Elizabeth Radow in its November/December issue:

Homeowners can be confronted with uninsurable property damage for activities that they cannot control. And now a growing number of banks won't give new mortgage loans on homes with gas leases because they don't meet secondary mortgage market guidelines. New construction starts, the bellwether of economic recovery, won't budge where residential fracking occurs since construction loans depend on risk-free property and a purchaser. This shift of drilling risks from the gas companies to the housing sector, homeowners and taxpayers creates a perfect storm begging for immediate attention.³

Compounding the problem is the fact that in many cases these drilling leases are not properly filed with any public agency, making a survey of their terms or even their prevalence difficult. I am told FHFA is currently conducting a review of its internal procedures and external guidance to mortgage lenders to clear up the current state of confusion about how such oil and gas leases are filed and handled, how homeowners are advised of the potential for drilling to affect property values, and other related matters. This internal review is a good sign and prompts today's letter.

In recent weeks, based on a variety of media reports and staff discussions with interested parties, I have become concerned that important issues in this area are being left in limbo by FHFA authorities. For instance, FHFA says it is waiting to finalize a new guidance to mortgage lenders on oil and gas leases until the Environmental Protection Agency publishes an analysis of fracking's environmental risks. Such a delay is clearly unnecessary. Fannie Mae already considers the presence of a drilling lease agreement an important consideration in whether to purchase or support the refinancing of the underlying mortgage. As represented at the *New York Times* Web site, the "Fannie Mae Single Family 2011 Servicing Guide," Part III, Chapter 7, includes the following⁴:

A property owner may want to lease oil, gas or mineral rights to a property to a drilling firm or partnership in return for a royalty interest equal to a designated percentage of the value of the oil, gas, or other minerals that are removed from the property. When requesting Fannie Mae's approval of the leasing of oil, gas, or mineral rights, the borrower must submit a copy of the proposed lease agreement to the servicer for review. Before agreeing to a release of oil, gas, or mineral rights, the servicer must consider the extent to which the property (and neighboring properties) may be affected by the exercise of the rights covered in the lease. In particular, the following should be taken into consideration:

- ***The extent to which the rights granted by the lease infringe on the property owner's rights.*** For example, if the lease permits removal of deposits by directional exploration from an area outside of the property, there may be little or no adverse effect, depending on the location of the exploration area and the attitude of the community. On

³ <https://org2.democracyinaction.org/o/7139/images/Fracking-the-Homestead.pdf>

⁴ <http://www.nytimes.com/interactive/us/drilling-down-documents-8.html#document/p108/a33445>

the other hand, *if the lease allows for complete ingress and egress to explore any part of the property or to store or install equipment on it, the property may no longer have any real value as a residential property.* [My emphasis.]

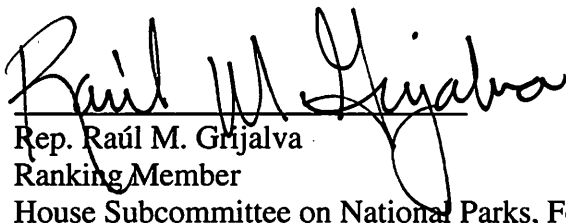
• **Any hazards, nuisances, or damages that may result from the exercise of the rights granted by the lease.** [. . .] In oil-producing areas, hazards, nuisances, and damages can result from drilling operation, ingress and egress, storage, pipeline transportation, fire, explosion, or gusher wells. The effect of these [. . .] on the value of the property would depend on their intensity and closeness and the community's attitude toward such hazards or nuisances. For example, in areas in which oil exploration is a major part of the economy, the risk may be considered acceptable, whereas it might be unacceptable in areas in which such exploration has a minor effect on the economy.

Given the recent expansion of fracking and other extraction methods in rural areas of Pennsylvania, New York and other states not accustomed to drilling as a fact of life, clear guidance is needed now to prevent continued property value degradation. It is clear to me that we cannot wait any longer, and a strictly hands-off "buyer beware" attitude is no longer appropriate. Accordingly, I write to request several steps be taken by the Office of Inspector General.

- 1) I request an audit of mortgages bought and sold by Fannie Mae, Freddie Mac and Farmer Mac over the past five years to determine how many include oil or gas drilling leases as described above. Federal regulations state that these agencies cannot buy such mortgages without performing a proper title search, which should include information about any lease that may exist on the property.
- 2) I request an Inspector General analysis of those leases to ascertain how many include terms that violate current Fannie Mae, Freddie Mac or Farmer Mac guidelines. Please include an explanation of how many properties include leases in violation of such guidelines that were undisclosed prior to this audit.
- 3) I request an inspector general evaluation of whether FHFA is promulgating timely guidance to mortgage lenders on the proper handling and economic evaluation of leased properties, especially as concerns oil and gas drilling leases.
- 4) I request an OIG recommendation to FHFA on whether the agency should provide more comprehensive or prominent information to homeowners and potential borrowers about the legal and economic implications of signing oil or gas leases.

I make these requests with the full understanding that FHFA is conducting its own internal review of these issues. I hope your office can ensure this review is full and impartial and gives full consideration to the appropriate issues.

Sincerely,


Rep. Raúl M. Grijalva
Ranking Member
House Subcommittee on National Parks, Forests and Public Lands