

**MEMORANDUM**

September 15, 2011

**To:** Honorable Carolyn Maloney  
Attention: Kristin Richardson

**From:** David H. Carpenter, Legislative Attorney, 7-9118

**Subject:** **How Fannie Mae and Freddie Mac Typically Handle Requests to Create Oil, Gas, or Mineral Leases on Residential Properties**

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You have asked for an explanation of the typical process by which Fannie Mae (the Federal National Mortgage Association)<sup>1</sup> and Freddie Mac (Federal Home Loan Mortgage Corporation)<sup>2</sup> evaluate requests from mortgage borrowers to establish oil, gas, or mineral leases on properties for which Fannie Mae and Freddie Mac own or guarantee the mortgage secured by such properties.<sup>3</sup>

Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that are congressionally chartered to help maintain a secondary mortgage market. Fannie Mae and Freddie Mac do not originate mortgages. Rather, their primary line of business involves purchasing mortgages originated by other financial institutions as a way to create liquidity in the mortgage market and, thus, encourage lenders to originate more mortgages. The GSEs either hold these mortgages in their own portfolios or convert the income streams of pools of mortgages into mortgage-backed securities and guarantee the performance of these securities for investors.<sup>4</sup>

Generally, the mortgages that are held or guaranteed by the GSEs must conform to various statutory and regulatory standards. In order for institutions to sell conforming mortgages to either Fannie Mae or Freddie Mac, those institutions must meet certain eligibility requirements and sign binding contracts with the GSEs promising, among other things, they will comply with extensive seller guidelines established by the two companies.<sup>5</sup> Fannie Mae and Freddie Mac have developed uniform mortgage documents, which take into account variances in state law, that lenders use for loans they intend to sell to either of the GSEs.<sup>6</sup> When Fannie Mae and Freddie Mac purchase a mortgage, they acquire all of the rights that the

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<sup>1</sup> 12 U.S.C. §§ 1716, *et seq.*

<sup>2</sup> 12 U.S.C. §§ 1451, *et seq.*

<sup>3</sup> Per your request, this memorandum does not address situations in which Fannie Mae and Freddie Mac acquire mortgages secured by properties that are subject to antecedent oil, gas, or mineral leases.

<sup>4</sup> For more information on the general operations of Fannie Mae and Freddie Mac, see CRS Report R40800, *GSEs and the Government's Role in Housing Finance: Issues for the 112th Congress*, by N. Eric Weiss.

<sup>5</sup> Fannie Mae 2011 Single Family Selling Guide, pub. Aug. 30, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/sg/pdf/sel083011.pdf>; Freddie Mac Single-Family Seller/Service Guide, available via the AllRegs link at <http://www.freddiemac.com/sell/guide/>.

<sup>6</sup> Fannie Mae/Freddie Mac Single Family Uniform Security Instruments, available at (continued...)

originating lender had under the mortgage, including the right to foreclose on the property upon an act of default as provided for in the mortgage and under state law.<sup>7</sup>

Fannie Mae and Freddie Mac also contract with financial institutions to service the mortgages the GSEs own or guarantee. These servicers work directly with mortgage borrowers on behalf of the GSEs performing tasks such as receiving and appropriately distributing monthly mortgage payments and responding to borrower questions about their mortgages. Institutions that service GSE mortgages also must meet certain eligibility requirements and sign contracts that bind them to comply with Fannie Mae and Freddie Mac's extensive servicer guidelines, as well as applicable laws and regulations.<sup>8</sup>

Although Fannie Mae and Freddie Mac engage in substantially similar activities and subject sellers and servicers they work with to very similar standards, the contracts they enter into with, and the guidance they provide to, sellers and servicers vary to some degree.

Typically, when Fannie Mae and Freddie Mac acquire mortgages, those mortgages are secured by both the surface and subsurface portions of a particular plot of land, plus all buildings and fixtures on the land at the time the mortgage was originated and any buildings or fixtures that are erected in the future.<sup>9</sup> A standard term of most mortgages, including Fannie Mae or Freddie Mac's uniform mortgage documents, prohibits a borrower from selling any portion of the mortgaged property without the prior approval of the lender.<sup>10</sup> Such a provision is intended to protect the property interests that lenders acquire when they enter into a mortgage loan. Leasing the rights to a property's subsurface minerals without the approval of the lender generally will be in violation of this mortgage term.<sup>11</sup> Because Fannie Mae and Freddie Mac

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<https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/> and <http://www.freddiemac.com/uniform/unifsecurity.html#highlights>.

<sup>7</sup> See, e.g., Fannie Mae Single Family 2011 Selling Guide § A2-2.1, pub. Aug. 30, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/sgpdf.jsp> (“By submitting any loan to Fannie Mae under any execution, including MBS, whole mortgage loan, or a participation pool mortgage to Fannie Mae as a whole loan, the lender represents, warrants, and agrees that all right, title, and interest in the mortgage loan is sold, transferred, set over, and otherwise conveyed by the lender to Fannie Mae as of the date Fannie Mae funds the purchase proceeds.”) and Freddie Mac Single-Family Seller/Servicer Guide § 22.27, available via the AllRegs link at <http://www.freddiemac.com/sell/guide/> (“The Seller must have the full legal authority, must have taken all action required by law and by its organizational documents and must have obtained any consents required, to sell, transfer and assign a Mortgage to Freddie Mac free and clear of all claims, security interests or other encumbrances. The Note and the Security Instrument must be enforceable by the Seller. Transfer of the Note and the Security Instrument in whole or in part to any subsequent purchaser must not detract from their enforceability.”).

<sup>8</sup> See, generally, Fannie Mae Single Family 2011 Servicing Guide, pub. June 10, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp> and Freddie Mac Single-Family Seller/Servicer Guide, available via the AllRegs link at <http://www.freddiemac.com/sell/guide/>.

<sup>9</sup> See, e.g., Fannie Mae/Freddie Mac Single Family Uniform New York Mortgage, Form 3033, p. 3, available at <https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/> and <http://www.freddiemac.com/uniform/unifsecurity.html#highlights>. See, also, N.Y. Pub. Auth. Law § 351 (“**The term ‘real property’ shall mean** lands, waters, rights in lands or waters, structures, franchises and interests in land, including lands under water, riparian rights, **property rights in air space and/or subsurface space** and any and all other things and rights usually included within the said term and includes also any and all interests in such property less than full title, such as easements permanent or temporary, rights-of-way, uses, leases, licenses and all other incorporeal hereditaments and every estate, interest or right legal or equitable.”) (emphasis added).

<sup>10</sup> See, e.g., Fannie Mae/Freddie Mac Single Family Uniform New York Mortgage, Form 3033, p. 14, available at <https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/> and <http://www.freddiemac.com/uniform/unifsecurity.html#highlights> (“Lender may require Immediate Payment in Full of all Sums Secured by this Security Instrument if all or any part of the Property, or if any right in the Property, is sold or transferred without Lender’s prior written permission.”).

<sup>11</sup> It also may violate other provisions of the mortgage agreement, such as provisions that require borrowers to maintain and (continued...)

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generally acquire all of the rights that were held by a lender of a mortgage they purchase,<sup>12</sup> entering into an oil, gas, or mineral lease on a property that is subject to a mortgage owned or guaranteed by Fannie Mae or Freddie Mac without prior approval generally will be considered an act of default under the mortgage. Such a violation could trigger certain Fannie Mae and Freddie Mac rights pursuant to the mortgage such as the power to demand the immediate payment of the full amount owed on the mortgage and the right to foreclose on the property if the borrower is unable to pay in full.<sup>13</sup> Additional remedies also may be available to the GSEs under state law depending on the facts and circumstances. For example, the GSEs may be able to successfully raise trespass claims or receive damages for physical damage caused to the property as a result of a drilling, excavation, or exploration activities that occur subject to an oil, gas, or mineral lease entered into without Fannie Mae or Freddie Mac's approval.<sup>14</sup> For these reasons, oil and gas companies may choose to perform title searches on properties before entering into leases. A title search will help them determine the existence of outstanding mortgages or other interests in the property that could negatively impact the property rights they are seeking to acquire, as well as the identities of parties whose approval they would need to enter into a binding and enforceable oil, gas, or mineral lease.

There may be circumstances under which Fannie Mae and Freddie Mac would be willing to relinquish the property rights that they hold in order for an oil, gas, or mineral lease to be duly executed on the same land. Both Fannie Mae and Freddie Mac's uniform mortgages only prohibit borrowers from selling any portion of the mortgaged property without their prior approval.<sup>15</sup> Thus, borrowers of mortgages owned or guaranteed by Fannie Mae and Freddie Mac may request their approval for the creation of an oil, gas, or mineral lease on a property to which they own or guarantee a mortgage.

Fannie Mae provides extensive guidance regarding the procedures that borrowers should follow to make such a request and standards that servicers should apply to determine whether or not to approve such a request on behalf of the GSE. Fannie Mae's Single Family 2011 Servicer Guide (Fannie Mae Servicer Guide) states:

The security property for a mortgage loan consists of the land, all improvement erected on the land (including any replacements or additions erected after the origination of the mortgage loan), and all easements, appurtenances, and fixtures (including, in some cases, personal property) that are part of the property or the improvements. Occasionally, certain events may occur that make it necessary or desirable to release all or a portion of the security for the mortgage loan, or the release may be requested by a borrower. A request for a release of security can involve ... a release of oil, gas, or mineral rights to the property ....<sup>16</sup>

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protect the property from damage or that prohibit borrowers from placing or allowing others to use or store hazardous substances on the property. See, e.g., Fannie Mae/Freddie Mac Single Family Uniform New York Mortgage, Form 3033, pp. 16-17, available at: <https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/> and <http://www.freddiemac.com/uniform/unifsecurity.html#highlights>.

<sup>12</sup> See *supra* note 7.

<sup>13</sup> The amount of time that a borrower would have to pay off the mortgage, any rights available to the borrower to halt the demand, and the procedures and potential defenses to a foreclosure action vary according to state law and the specific terms of the relevant mortgage.

<sup>14</sup> See, generally, Powell on Real Prop. § 64A.01.

<sup>15</sup> See, e.g., Fannie Mae/Freddie Mac Single Family Uniform New York Mortgage, Form 3033, p. 14, available at: <https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/> and <http://www.freddiemac.com/uniform/unifsecurity.html#highlights>.

<sup>16</sup> Fannie Mae Single Family 2011 Servicing Guide ch. 7 (intro.), pub. June 10, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp>.

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The Fannie Mae Servicer Guide further explains that borrowers who would like to request such a release must complete a standard form<sup>17</sup> and submit it to the mortgage servicer along with a copy of the proposed oil, gas, or mineral lease agreement. The Fannie Mae Servicer Guide explicitly provides mortgage servicers with the authority to approve the requested release on behalf of the GSE if such a lease “is customary in the area and the exercise of the lease will not have a material effect on the value of the property, prevent use of the property as a residence, or expose the residents to serious health or safety hazards.” The Fannie Mae Servicer Guide elaborates on how a servicer should make this determination.<sup>18</sup> It also provides a list of Fannie Mae representatives that the servicer may contact to help with the decision to approve or deny the request and allows the servicer to forward the request on to these Fannie Mae representatives, rather than make the decision itself.<sup>19</sup> The servicer also may be required to obtain approval from third parties whose interests may be impacted by the release, such as mortgage insurers.<sup>20</sup>

Unlike Fannie Mae, Freddie Mac does not provide explicit guidance in its Single-Family Seller/Service Guide on how borrowers should request a release of security for the purposes of an oil, gas, or mineral lease or how such requests should be approved or denied. However, Freddie Mac servicers are under the general requirement to promptly respond to borrower inquiries about their mortgage, which would seem to include requests to release security interests to duly execute oil, gas, or mineral leases.<sup>21</sup> Freddie Mac’s property and financial interests are substantially similar to those of Fannie Mae, so Freddie Mac likely would apply similar, though not necessarily identical, considerations as Fannie Mae to any request to release part of its security interests for an oil, gas, or mineral lease.

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<sup>17</sup> Fannie Mae Application for Release of Security, Form 236, available at <https://www.efanniemae.com/sf/formsdocs/forms/236.jsp>.

<sup>18</sup> Fannie Mae 2011 Single Family Servicer Guide § 702, pub. June 10, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp>.

<sup>19</sup> Fannie Mae 2011 Single Family Servicer Guide ch. 7 (intro.) and § 702, pub. June 10, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp>.

<sup>20</sup> Fannie Mae Single Family 2011 Servicing Guide ch. 7 (intro.), pub. June 10, 2011, available at <https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp>.

<sup>21</sup> Freddie Mac Single-Family Seller/Service Guide § 2.11, available via the AllRegs link at <http://www.freddiemac.com/sell/guide/>.

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