Greetings!

We are pleased to issue this newest edition of our newsletter.

I am truly honored to have served as the Section Chair this year and I am extremely thankful for the hard work of our Section Council members and liaisons.

As you begin to read the newsletter, there are a few items of which I would like to make you aware: (1) Consumer Protection Counsel; (2) Forms Manual Update Coordinator; (3) Legislative Items; and (4) 2018-19 Real Property Annual Meeting Brief Recap.

Consumer Protection Counsel

After several years of serving as our Section’s Consumer Protection Counsel, Ben Kuhn (Ragsdale Liggett PLLC) has determined it is time for someone else to pick up the mantle. Ben has done a tremendous job in this capacity and we appreciate his dedicated service. Going forward, we envision this role will continue to respond to consumer protection complaints as well as review and offer recommendations on legislative matters and ethics opinions touching on consumer protection issues. We will circulate a complete job description for this role within the next few weeks, so please watch for that announcement in case you are interested or have someone in mind.

Map Act Q&A: July 11, 2018 May Be a Deadline for Your Clients

By Paul Stam

Questions, challenges and nuances arise after Kirby v. NC DOT, 368 NC 847 (2016) construing the Map Act, Article 2E of Chapter 136. While the Map Act had the goal of reducing excessive cost of land acquisition for future highway projects, it ran afoul of fundamental constitutional rights.

The Kirby court held that tying up property indefinitely constituted a “taking” from the time of the recording of corridor maps. The Map Act was passed in 1987. Maps were rescinded by SL 2016-90, Section 18 effective July 11, 2016. The statute of limitations for inverse condemnation is 2 years – hence the July 11, 2018 deadline to decide.

Kirby held:

“Property” clearly includes the rights to improve, develop and subdivide, which were severely and indefinitely restricted here by the Map Act. The Map Act’s indefinite restraint on fundamental property rights is squarely outside the scope of the police power...

A taking effectuated by eminent domain does not require ‘an actual occupation of the land’ but need only be a substantial interference with elemental rights growing out of the ownership of the property... These elemental rights are generally considered ‘an important feature’ of the land and, as such, are accounted for within the valuation of the land, See Town of Midland v Wayne, 368 NC 55,66, 773 SL2d 301,309 (2015) (stating that ‘development rights’ are ‘an important feature of the condemned land and not a separate compensable property right.’

Questions?

1. Does NC DOT get credit for the reduction in property taxes that owners paid since recording of the Corridor maps in 1996 (date maps recorded for I-540)? It was local governments that were out the money. GS 105-277, 9 and 9A.
2. Does NC DOT get credit for continued occupation of the land by the landowner from 1996 (for 540) until the date of trial?
3. What property or rights in property is taken by the filing of the corridor map? Some have argued that only development rights were taken and not the fee. But Kirby is clear that the land itself was taken. (“Development rights” are “an im-

Continued on page 2

Continued on page 3
The Chair’s Comments, continued from the front page

Forms Manual Update Coordinator
The Real Property Section Council has decided to engage an attorney to coordinate a review of and update to the NC Real Property Forms Manual (2003 + 2011 Supplement). The engagement will involve solicitation (with the assistance of the Forms Committee) and oversight of a team of volunteer attorneys throughout the state in the review, revision and/or replacement of the various forms contained in the manual to bring it up to date with current law and customary practice. We will circulate a full job description for this role within the coming months.

Legislative Items
The 2018 Short Session of the North Carolina General Assembly will convene on May 16. There are several items that we expect to arise during the Short Session, some of which I will highlight below:

Deed of Trust Margins - Some of our county Register of Deeds would like to introduce legislation changing document recording standards for real estate documents (including deeds and deed of trust) to ½ inch margins on all sides other than the top margin on the first page. The current standard in G.S. 161-14(b)(2) is ¼ of an inch on all sides other than the top margin on the first page. Their reasoning for the proposed change is that some document content is being lost in the process of scanning with ¼ inch margins.

Chapter 55A Amendments – The Chair of our Community Associations Committee, Tim Sellers (Sellers Ayers Dortch Lyons) is leading the Section’s efforts in proposing amendments to Chapter 55A - The Nonprofit Corporation Act (the “Act”). This Act is of particular interest because nearly every community association in the State is formed as a nonprofit corporation. A committee had previously been formed to primarily consider the merger provisions of the Act; however, under Tim’s leadership, we will also consider updates to the governance sections of the Act. Should you have any comments or wish to provide any assistance, please feel free to contact Tim at TSellers@sellersayers.com.

Corrective/Curative Statute – As you are likely aware, S.L. 2017-110 is scheduled to take effect in August. There are some areas within the statute which would like clarified before implementation. Steve Brown (Investors Title) is leading the effort to consider what clarifications may be needed. He may be contacted at sbrown@invtitle.com.

Should you have any comments concerning any legislative matter, we invite you to reach out to our Legislative Committee Chair, John McLean (BridgeTrust Title Group) at jtmclean@Bridge TrustTitle.com.

2018 Real Property Section Annual Meeting Brief Recap
We just completed the 2018 Real Property Section Annual Meeting in Wrightsville Beach. We had approximately 165 attorneys in attendance and all the CLE presenters received excellent reviews. If you did not attend, I encourage you to watch the playback of the Annual Meeting CLE once it becomes available. During the meeting, we announced that we have selected Kiawah Is-

We look forward to the leadership our officers will provide for the coming year.

We hope to see you in Wilmington for the NCBA Annual Meeting (June 21-24) and we trust you will have an enjoyable summer.

Sincerely,
Frankie T. Jones Jr.
important feature of the condemned land and not a separate compensable right.

Kirby is not clear whether it is referring to a partial take, say 10 acres in the corridor out of a total of 15 acres, or to the entire tract of a portion that was shown on the 1996 (for 540) map.

4. Effective July 11, 2016 with the passage of SL 2016 – 90, Section 18(b) the rate of interest to be used in NC DOT condemnation cases is the prime rate in effect when the case is filed or eight percent, whichever is less. Under cases such as *Lea v NC Board of Transportation* 317 NC 254,263-264 (1986) and *Concrete Machinery Co. v City of Hickory* 134 NC App 91 (1999) this limit is probably not constitutional. If evidence is accepted as to the true market rate of interest and/or that simple interest is insufficient for just compensation, the jury should consider it.

5. Kirby makes clear that “such determination (of damages) must be made on an individual property by property basis.”

Attorneys who wish to help their clients should always be aware of after-tax considerations. This article looks at different ways value can be approached. The extent of the taking of each person’s property and tax bracket and effects is different. **One size does not fit all.**

What amount of the property will be taken? When will value be determined? Will I be paid interest? At what rate? Will interest be compounded? What taxes will apply? How will the option to avoid or defer taxes by “like kind” exchanges under section 1033 be affected by my choice? Are attorneys’ fees treated differently under inverse condemnation rather than by a usual condemnation initiated by NC DOT? What are the deadlines?

Possible answers to these questions are suggested on the attached chart (page 4).

Paul Stam can be contacted at paulstam@stamlawfirm.com.

Documents: Kirby vs NCDOT

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**SAVE THESE DATES:**

**Real Property Section Fall 2018 Advanced/Specialization CLE**

Sept. 21 at the N.C. Bar Center in Cary

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**Hot Topics Winter 2019 CLE**

Feb. 15 at the N.C. Bar Center

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**Real Property Section Annual Meeting**

May 2019
My property was included in a Corridor Plan under the Map Act. As a result of the Kirby case should I: file an inverse condemnation action; OR, wait for NCDOT to pursue its Usual Condemnation?

<table>
<thead>
<tr>
<th>Key factors owners should consider in determining their answer to the questions.</th>
<th>Effects of Inverse Condemnation</th>
<th>Effects of Usual Condemnation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Which acreage will be taken?</strong></td>
<td>The current understanding from the resolution of the Kirby case by the NC Supreme court is that the Entire Parcel was taken. The protected corridor is 1000 feet wide, thus the entirety of any parcel that is wholly or partially within the corridor would be taken. There are those who contend that only “development rights” were taken and not the entire property.</td>
<td>Only the portion necessary to construct the highway, typically a 300 foot wide right-of-way, will be taken. Any balance will remain with the property owner.</td>
</tr>
<tr>
<td><strong>How will the value be determined for the land that is taken?</strong></td>
<td>Land Values will be determined based upon the highest and best use of the land immediately BEFORE and AFTER the date the corridor map was recorded (August 1996 for Southern Wake County).</td>
<td>Current land values will be used to determine the value of the property taken based upon its highest and best use immediately BEFORE and AFTER the date NCDOT files the condemnation action (date of the taking).</td>
</tr>
<tr>
<td><strong>Will I be paid interest on what I am awarded?</strong></td>
<td>Yes. Interest will be paid from the date of taking (August 1996 for 540 across southern Wake County).</td>
<td>Interest will be paid on the difference between the amount of the deposit and the amount of the court award from the date of the deposit to the date of judgment.</td>
</tr>
<tr>
<td><strong>What rate of interest will I be paid? Will it be Simple or Compound interest?</strong></td>
<td>The statutory rate in NC has been 8%. However, in 2016 the Legislature enacted measures to use the lower rate between the Prime Rate or 8% at the time of the taking. However, that is not constitutional. Simple interest is usually paid. You may request through expert testimony both a higher rate of interest and for compound interest. There are court precedents for each.</td>
<td>The statutory rate in NC has been 8%. However, in 2016 the Legislature enacted measures to use the lower rate between the Prime Rate or 8% at the time of the taking. However, that may not be constitutional. Simple interest is usually paid. You may request through expert testimony both a higher rate of interest and for compound interest. There are court precedents for each.</td>
</tr>
<tr>
<td><strong>Will I have to pay any taxes on the money I receive?</strong></td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>What taxes will apply that I may have to pay?</strong></td>
<td>Capital Gains Taxes (usually 20% federal and 5.499% state) will apply on the difference between your basis in the property and the value that is awarded for the land either through settlement or court action.</td>
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</tr>
<tr>
<td><strong>Personal Income tax at your applicable rate will be required for interest. The state rate is 5.499% and the federal rate could be as high as 40.8%.”</strong></td>
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<td></td>
</tr>
<tr>
<td><strong>Can I avoid paying taxes by doing a like kind exchange?</strong></td>
<td>Yes, but on a very limited portion of the total amount that is received. For funds received via condemnation you may do a 1033 exchange. However, under IRS publication 544 only the portion that was awarded for the value of the land may be exchanged. Interest that is paid may not be exchanged. For an inverse condemnation the large majority of the award will be for interest.</td>
<td>Yes. For funds received via condemnation you may do a 1033 exchange. However, under IRS publication 544 only the portion that was awarded for the value of the land may be exchanged. Interest that is paid may not be exchanged. For a usual condemnation the large majority of the award is for the value of the land.</td>
</tr>
<tr>
<td><strong>How much will an attorney cost me?</strong></td>
<td>In an inverse condemnation action you can be reimbursed for your attorney fees. Attorneys generally charge a percentage of the entire amount awarded.</td>
<td>In a usual Condemnation you are responsible for your own legal fees. Attorney fees are usually charged only on the difference between the amount of the deposit made by NCDOT and the amount of the final award.</td>
</tr>
<tr>
<td><strong>Is there a deadline by which I must act?</strong></td>
<td>Yes. There is a two year Statute of Limitations from the date of the repeal of the Map Act within which Inverse actions must be filed. The effective date of the repeal was July 11, 2016. Thus if you choose to file an inverse action you must do so before July 11, 2018.</td>
<td>When NCDOT files its action per G.S. 139-107 you will have 12 months in which to file an answer. Do not delay.</td>
</tr>
</tbody>
</table>
You’ve just inherited the family home, where you’ve not lived for many years, after the unfortunate but inevitable passing of your last living parent. You know there is a mortgage loan for the property. You have many questions, which may generally be summarized “What are my options, how does this work, and what happens now?” The primary focus of this article is to explore the legal and practical factors which play key roles when heirs attempt to deal with the mortgage loan and the mortgage loan servicer.

A Commonplace Scenario

Dad passed years ago, and Mom inherited his interests in the family home. Mom just passed away, and Daughter has inherited all interests in the family home, although she has not lived there for 20 years. Mom was debt free except for the mortgage loan on the family home. Daughter knows of the existence of the mortgage loan, with an associated lien on the family home, but she doesn’t know much more and doesn’t have any specialized knowledge or experience with mortgage loans, deeds of trust, or similar issues. Daughter never wanted to be the executor, so Cousin Sally is performing that role.

Daughter finds a mortgage loan statement from Questionable Loan Servicing, LLC. It appears that Mom had not paid the mortgage for the last few months before her death; the loan statements list the account as delinquent to the tune of $5,000.00, with an overall unpaid balance of $225,000.00. A week later, Daughter calls Questionable Loan Servicing, LLC, who won’t speak to her without Mom’s authorization. The fact that Mom isn’t alive to give that permission doesn’t seem to have the impact it should with Questionable’s customer service representative. However, good news! Since Daughter says she inherited the house, she must be the Executor; if the Executor provides certain formal documents, Questionable will speak to the Executor about the mortgage loan status, options, and any other relevant issues. “No, I’m not Executor, but I’ve been told by the attorney that I own the property and should be able to deal with the mortgage loan.”

Questionable’s earnest and well-intentioned customer service representative promises to look into the situation and send written information which will clarify if and how Daughter may be able to deal with the mortgage loan and get access to the loan account. Daughter confirms her own mailing address and says she’ll wait for the documents. Three weeks later, Daughter finds five different letters from Questionable, all sent to the family home; they are:

1. a letter to Mom which says that $232,500.00 is now due and that the matter has been referred to an attorney to initiate foreclosure proceedings;
2. a letter to Mom which says that Questionable may be able to assist with foreclosure-avoidance options;
3. a letter to Daughter which says Questionable cannot talk to her until she provides proper legal authorization;
4. a letter to the Executor which says that the Executor should provide Questionable with Mom’s death certificate, a copy of the trust (but there was no trust!), and the property deed which shows who the new owner is (but there is no such deed!); and
5. a letter to Mom’s Estate which reminds everyone that the loan has a “due upon conveyance” clause, and that if ownership of the home is transferred without the mortgage loan note-holder’s permission, the loan could be accelerated and be called due in full.

Daughter, now completely discouraged, begins to slowly knock her head against the nearest wall and contemplates opening another bottle of Mom’s scotch. What can she do? What should she do? Will they ever talk to her? Can they foreclose? Does she need to refinance? Does she really own the home? Can they sue her over the unpaid mortgage? What a mess.

Heirs Interacting with the Mortgage Loan Servicer

It’s almost impossible to figure any of this out if the mortgage loan servicer won’t provide information and recognize you as the owner, or at least as an individual authorized to have access to the loan account, so getting that access almost always needs to be the first step. Here is the most relevant part of the Code of Federal Regulations on the issue of a mortgage loan servicer’s duties in such scenarios:

(a) Reasonable policies and procedures. A servicer shall maintain policies and procedures that are reasonably designed to achieve the objectives set forth in paragraph (b) of this section.

(b) Objectives. (1) Accessing and providing timely and accurate information. The policies and procedures required by paragraph (a) of this section shall be reasonably designed to ensure that the servicer can:

(vi) Upon notification of the death of a borrower, promptly identify and facilitate communication with the successor in interest of the deceased borrower with respect to the property secured by the deceased borrower’s mortgage loan.

The Consumer Financial Protection Bureau (the “CFPB”) has defined “successor in interest” in this context to mean “the spouse, child, or heir of a deceased borrower or other party with an interest in the property.” The CFPB requires loan servicers to follow the requirements as explained in the above-referenced CFR, and has formally observed that the existence of and compliance with such policies and procedures in scenarios involving transfer of ownership due to death is important to “reduce the number of unnecessary defaults and foreclosures...."
The same CFPB bulletin provides practical examples of actions the loan servicer should take to be in compliance, thus also providing successors in interest like Daughter insight into what can be done from the other side of the equation. In summary, Daughter should at a minimum provide a copy of the death certificate, and any and all documents which evidence her as the heir / new owner (no, in North Carolina this would not include a deed in her name, which shouldn’t exist), and even copies of the CFR and CFPB items cited herein.

Daughter needs to be persistent, be patient (to a certain extent), to maintain good documentation, and to try to make sure the loan servicer’s various departments are appropriately communicating with each other and with external parties (such as any substitute trustee and/or law firm retained to handle a foreclosure of the family home). If the loan servicer fails to effectively cooperate, Daughter should consider filing a complaint with the CFPB and perhaps the North Carolina Commissioner of Banks. The bureaucratic roadblocks are often formidably Byzantine, and I can personally vouch for some of the horror stories which arise from dealing with loan servicers.

**Does the Heir, as new Owner, Need to be “Approved” by the Creditor in Order to Avoid Foreclosure?**

Most people don’t realize that mortgage loan agreements and/or deeds of trust often have a “due upon conveyance” clause (often called a “due on sale” clause, with such description being an incomplete one). These contractual clauses, in essence, allow the creditor to call the mortgage loan due if ownership of the associated real property is conveyed to someone else without creditor’s permission. There are good and understandable reasons for such clauses. However, for your typical residential property, these clauses are not enforceable when the conveyance occurred due to death of the previous owner and the resulting conveyance was to a relative. In our scenario, the creditor cannot call the loan due and/or foreclose merely because Daughter is now the owner, with the creditor not having approved her ownership.

Independent of any due on conveyance clause, the heir’s ownership of the property does not in any way need to be approved by the mortgage loan creditor or anyone else in relation to the loan or the deed of trust. The rights to own real property and to pass it down to subsequent generations are very strongly protected ones.

**Must the Heir Pay the Mortgage Loan?**

In our scenario, Daughter may wonder if, merely by becoming the owner, she has now somehow become obligated to pay the mortgage loan. The answer is no, but barring some other agreement, if the loan isn’t paid in accordance with the contractual loan terms, the creditor can accelerate the loan and foreclose via the deed of trust just as if Mom was still alive and still the owner. Unfortunately, mortgage loan agreements typically don’t contain any type of “grace period” which allows for missed payments during times of confusion and transition such as the death of the borrower.

So the bad news is that the loan does need to be paid if Daughter wants to keep the property. However, unless Daughter has formally agreed to become personally liable for the loan, the creditor cannot pursue her personally for money or any other damages if the loan is not paid as agreed.

One somewhat miscellaneous factor to consider is that a foreclosure case may contain the Daughter as a respondent, and if a foreclosure occurred it is at least possible that her credit report (arguably incorrectly / illegally) would reflect a “foreclosure.”

**Can the Heir Refinance or Modify the Loan? Can the Heir Sell the Property or Otherwise Dispose of it?**

Although most people seem to think of refinancing as just restructuring the loan, of course a refinance is an entirely new loan, even if it’s with the same lender. By contrast, a modification is an amendment of the current loan terms. Refinances are treated very differently as compared to modifications in the context of inherited properties.

In our scenario, the mortgage loan is delinquent and a foreclosure case appears to be in the works. Daughter’s right to refinance the family home is not restricted due to the mortgage loan being delinquent, and even the existence of a foreclosure case would not restrict said rights. She, as owner of the property, is free to refinance the property by seeking a new loan which would pay off the pre-existing loan and result in the pre-existing deed of trust being canceled. This new loan would presumably have Daughter as the borrower and the fact that she inherited the property would be of little to no relevance.

With regard to modifying the loan Mom had on the property, yes, Daughter can try to negotiate a modification of the same. In almost every instance in which Daughter seeks a modification of the loan, the creditor will require her to personally become an obligor on the loan in exchange for offering modification terms. We might normally say the creditor would require her to “assume” the loan, but word choice matters in this context, as explained in a following section.

Daughter can sell the property whether the loan is current or not, but the loan will need to be paid off as part of the sale (barring some other agreement). Daughter also has the power to enter into other types of transactions, such as a discounted payoff (“DPO”) of the loan which allows her to own the property free and clear, or a deed-in-lieu (“DIL”) of foreclosure which transfers ownership of the property to the mortgage loan creditor. In some instances, Daughter may not bother negotiating a DIL, as the primary advantage of that resolution compared to a foreclosure is usually the waiver of the creditor’s right to seek damages from the borrower, something Daughter would not need to worry about as long as she had not formally agreed to become personally obligated on the loan.

Of course, any real property-related transaction an heir considers entering into must take into account whether there is a risk of the real property being pulled into the estate to be liquidated to obtain cash to pay creditors besides the mortgage loan creditor. In our example scenario, Mom has no other creditors and thus Daughter is not concerned with this issue.

**Should the Heir Agree to Become Personally Obligated on the Mortgage Loan?**
Obviously, what someone in Daughter’s situation “should” do depends on many factors. Let’s assume Daughter wants to maintain ownership of the family home. If she can reinstate the loan directly, typically by paying the entire amount the servicer quotes for reinstatement, she will then avoid having to consider a modification and the personal liability on the loan which would likely be required. She would then have the benefits of ownership without some of the potential negatives of having a mortgage loan.

If Daughter needs to modify the loan and the creditor will allow that without requiring her to become personally obligated on the loan, great -- but there is almost no chance of that happening. The creditor will almost certainly require her to become personally obligated in exchange for that modification.

I have been involved in cases in which the creditor would not commit to a loan modification before the heir agreed to become personally obligated. In other words, the loan servicer said “If Daughter formally agrees to become personally obligated on the loan, we will then *consider* a modification.” My response included indignant laughter and (with client’s approval) a professional commentary similar in theme to “When pigs fly.” Under almost no circumstances would I advise a client to become personally obligated on a loan unless that came along with a guaranteed outcome which suited the client’s wants and needs.

**Does the Creditor have to Evaluate the Heir’s Ability to Repay the Loan?**

In general, mortgage lenders are required to evaluate someone’s ability to repay (“ATR”) the loan in determining whether to allow that person to assume the mortgage loan, similar to the evaluation a loan applicant would be put through when seeking a loan to purchase real property. However, because many new owner heirs have traditionally failed such evaluations, and at least certain aspects of the federal government wanted to change that, the CFPB has formally distinguished an heir becoming obligated on the mortgage loan versus an assumption of the loan by someone in a different scenario. Heirs who come to own real property due to death of the previous owner and then seek to modify a loan are not subject to the ATR rule.

If Daughter wanted to modify the loan, and Questionable Loan Servicing, LLC (acting on behalf of the loan note-holder) wanted her to become obligated as a borrower on the loan in exchange for modified loan terms and the loan being considered back in good standing, the ATR rule need not be considered and need not serve as an obstacle. Daughter would not be “assuming” the loan for purposes of the ATR rule, although what she would be doing very much looks, sounds, and smells like an assumption and would be considered one in almost any other context.

**Best Practices for Heirs (and their Representatives)**

Heirs should act assertively and persistently when dealing with mortgage loan servicers and other creditor-side entities instead of passively waiting for the servicer to guide the heir forward. The more information the heir can obtain about the status of the mortgage loan and related options, and the more quickly the heir can obtain this information, the better-positioned the heir is to make decisions. If the overall circumstances indicate that the heir can’t afford the loan (perhaps even as potentially modified or refinanced) and/or if the heir doesn’t want to keep the property, it may be best to sell it “now” – before making payments toward the loan or at least before a delinquency eats further away at any equity.

Jason McGrath of Charlotte is licensed in three states, and his law firm McGrath and Spielberger, PLLC focuses on real property and business law matters in the Carolinas.
Your client schedules an appointment to tell you he is finally ready to build his dream home, and he’s found the perfect spot—a tract of land on Gold Mine Road with an actual mine shaft still in place. The client thinks he’s hit the jackpot. His new property will be a source of interesting stories and potential exploration, if not real gold nuggets. But as a real estate attorney, your first reaction might be more of a cringe and shake of your head. The presence of the gold mine means the title is more likely to present an issue of severed mineral rights.

History of Mining in North Carolina

The first documented discovery of gold in the nation happened in North Carolina in 1799 when a 17-pound nugget was discovered in the waters of Little Meadow Creek on the Reed farm in Cabarrus County. In the years that followed, gold mining spread throughout the piedmont and mountain regions, a mint opened in Rutherfordton and North Carolina became a top producer of gold in the United States. Mines dotted the central and Western parts of the state. In more than a dozen North Carolina counties, at least one state-maintained road still bears the name Gold Mine or Goldmine Road.

School children still make the day trip to Reed Gold Mine, now a state-owned historic site, where they pan for gold in creek sediment and learn about the history of gold mining in North Carolina. Although gold production is no longer a significant industry in our state, production and capture of other subsurface materials is ongoing. North Carolina contains deposits of lithium, feldspar, phosphate rock, mica, olivine and corundum, among other minerals. According to the Department of Environmental Quality, North Carolina’s mineral production exceeds $500 million annually.

The state also has the potential for production of shale gas that may be located in underground shale rock formations in the Deep River Basin located in the middle of the state and the Dan River Basin in Rockingham County. Changes to the state’s energy and mining laws in 2012 and 2014 have opened the door to potential extraction of the shale gas through hydraulic fracturing.

Today the law regarding mineral rights, mining and oil and gas extraction continues to evolve, and real property practitioners in North Carolina may come across the issue at some point in their careers.

Severance of Mineral Rights

Accessing potentially valuable deposits of minerals, oil and gas found underground is an expensive and regulated process that most landowners would struggle to afford. By separating the ownership or right to access and use subsurface materials from the right to use the property’s surface, an owner of real property can sell, lease or otherwise transfer the rights to drill, mine, explore and remove the minerals, oil or gas underneath his land, while retaining the surface for residential, commercial or agricultural use. Similarly, a land owner can sell or convey the surface rights of the land to another while retaining the subsurface rights or a right to receive royalties from future extraction. The land owner may limit the rights conveyed or retained to just one type of mineral or lease the rights to someone else only for a limited period of time. The language in the instrument conveying or retaining the mineral rights may provide these details, or it may be a broader grant.

Severance of the surface and subsurface rights usually begins when a property owner executes and records a deed either conveying or retaining the mineral, oil or gas rights. Once the surface rights and subsurface rights are severed from each other, they are independently taxable and transferable and have distinct chains of title. Instruments effecting the transfer or retention of subsurface rights may contain details about how, when and where the holder of the subsurface rights will be able to access the subsurface materials. If the instrument is silent about access, a reasonable right of access to the surface to reach the subsurface deposits is implied. The intent of the parties at the time of severance of the mineral rights determines what type of access is appropriate or necessary.

Required Disclosures and Dormant Mineral Statutes

Residential real estate attorneys may have faced an uptick in questions from clients about mineral rights after the North Carolina legislature passed Session Law 2014-120, modifying the Residential Property Disclosure Act. Similar to a 2012 change requiring disclosure of any known severance of oil and gas rights, the law effective as of January 1, 2015 also required every seller of residential real property to disclose any known or intended severance of mineral rights. The disclosure applies to new construction and cannot be waived by the parties, although the seller can choose to make “no representation” about severance of the rights by former owners.

If subsurface property interests have been severed from the surface rights, locating the current holder of the subsurface interest could be a daunting task, depending on how much time has passed since the severance of the two estates. Dormant mineral rights statutes codified in N.C.G.S. 1-42.1 through 42.9 aid in eliminating potential title problems arising from mineral rights that were severed from property in the distant past. These statutes extinguish ancient mineral rights that have not been exercised or listed with the county for ad valorem taxes within certain periods of time.

If enacted, a current proposed bill in the North Carolina Senate would add another potential sunset provision for mineral rights not exercised or registered in the prior 10 years. These rights would be deemed to have “merged” with the fee simple estate if not registered or listed for ad valorem taxes. The proposed law (Senate Bill 203 from the 2017 Session) is currently in committee.

When a title search for a residential or commercial property discloses that subsurface rights have been severed but not extinguished by the dormant mineral statutes, it may be necessary to track down the
current owner and negotiate to obtain the interest. Since the subsurface and surface rights have independent chains of title, additional title abstracting may be required.

**Potential Extraction of Minerals, Oil and Gas**

In June 2014, the North Carolina legislature enacted the Energy Modernization Act in Session Law 2014-4. This law created the North Carolina Mining Commission and established a severance tax payable to the state upon the extraction of oil and gas from the land. The Energy Modernization Act, in combination with changes made to the North Carolina Oil and Gas Conservation Act in Session Law 2012-143, allows for hydraulic fracturing, or “fracking,” for the extraction of natural gas from shale. As of May 2017, no fracking had occurred in North Carolina, but the Act allows for the exploration of potential natural gas and oil extraction using this method.

In the latest legislative session, the General Assembly passed Session Law 2017-209, which included changes to the Mining Act of 1971 found in Article 7 of Chapter 74 of the General Statutes. The Mining Act regulates mining, requiring potential extractors of minerals to obtain a permit, post a bond and develop a reclamation program for any mining project that will affect more than one surface acre of land. The Mining Act includes sand, gravel and clay in the definition of “mineral” and regulates their extraction also. The recent bill modified the Mining Act to extend the duration of permits from 10 years to the life of the site. The permit holder is still required to submit to inspections and make reports each year with the Department of Environmental Quality.

**Title Insurance for Mineral Rights**

For real property lenders and owners, title insurance can provide some coverage against losses related to subsurface rights. The ALTA 9-06 and 9.7-06 endorsements provide coverage for lenders for a loss resulting from damage to an improvement existing on the date of the policy caused by future exercise of the right to use the surface of the land to extract or develop minerals. The ALTA 35 series of endorsements, created in 2012, provide similar coverage to property owners.

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Wisdom of the Ages

By Phillip Lewis

How long did it take man to become wise? When did Homo sapiens—literally, but dubiously, “wise man,” or “man the wise”—begin to accrue and abide by wisdom earned from the despair of his own folly and error?

If you believe the science books, the earliest known hominin ancestor of modern humans dates to about seven million years ago, but these simple, large-molared creatures had no language, no art, and most importantly, no holdings in real property. Lucy, the famed Australopithecus afarensis, who was apparently bipedal but likewise without a permanent address, lived between three and four million years ago. At some point thereafter, the hominin tree forked dramatically, with one of the two branches producing the genus Homo. These hapless folks appeared in Africa as recently as 200,000 years ago, where the beginnings of a system of real-property ownership was in its earliest stages.¹

Somewhere along the way on this journey to the present, our more proximate ancestors began to compile and pass down little bits and pieces of wisdom to younger generations as rules and guideposts for daily living. Through the advent of papyrus, rudimentary writing implements, and now Snapchat, this wisdom has been distilled over time into innumerable axioms and proverbs that we live by, teach our children, and largely ignore when it comes to transactions in real property. “An ounce of prevention is worth a pound of cure” is one such example. “Penny wise, pound foolish” is another.

This article, admittedly avant-garde and quite groundbreaking in its own right, courageously seeks to tread where others have historically dared not go, to wit—to boldly pair such classical time-honored words of wisdom to modern concepts of real-property law, and thereby find common application between the two disparate worlds that so rarely come together. We’ll begin with an aphorism from an ancient Roman poet of the Augustan period.

“The Road to Hell is Paved with Old Restrictions” ²

If you have a buyer interested in property in an old residential subdivision, it is wise to anticipate that somewhere way back in the chain of title there are restrictions on record. If you have any inkling that the subject property was at one time carved up and sold by a developer, no matter how remote in time, the safest course is to go beyond the standard 40- to 60-year search and track down the restrictions.

A lot of issues I’ve seen lately (as a litigator) involve developers buying lots and blocks out of these old residential subdivisions and trying to develop the property into apartments or townhomes. As we all know, this course of action calls readily to mind that old shopworn cliché, “Hell hath no fury like a group of people subject to a single-family residential restriction when a builder comes in and tries to start a multi-family use project.”³

Here’s a typical case: What was once a purely residential subdivision has changes on its periphery—some commercial use here; a little multi-family use there. Part of the property has even been zoned for mixed-use development. A developer interested in buying the property looks at all this on the street level and assumes (wrongly) that the property cannot possibly be encumbered by uniform residential restrictions, and likewise believes (again wrongly) that if there are restrictive covenants, they cannot possibly be enforceable.

The first step, of course, is to search the title and determine whether the property and the surrounding subdivision were once made subject to restrictions. Even if the restrictions were put on in 1912, or 1928, or anytime well before the period prescribed by the Marketable Title Act, you still need to find them if they exist. The Marketable Title Act, which could provide a defense to enforceability, may not, as a practical matter, help you as much as you’d like to think, which I’ll discuss further below.

Let’s say you find that the property was once owned by M. Garren & Sons Construction, Inc., and that this wily but mostly astute developer subdivided the property in 1933. Assume for this hypothetical that the restrictions are otherwise enforceable. One of the first questions to ask is whether the restrictions were imposed in connection with a common scheme of development. This is relevant for a number of reasons, one of which is to determine who may be entitled enforce the restrictions.

As we all know, a common scheme of development exists when a developer has, pursuant to a general plan of development, subdivided property and conveyed out lots subject to substantially similar restrictions, whereby the restrictions may be enforced among similarly situated owners.

In general, all owners of similarly restricted lots under a common scheme of development can enforce the restrictions against all other similarly restricted lots. You therefore cannot safely assume that you only have to check the restrictions for the lots that appear in close proximity to the subject property, or only on the plat that contains the subject property. It is possible that the surrounding property that appears on one or more separate plats was part of the common scheme of development, such that these owners may have the right to enforce the restrictions.

Hawthorne v. Realty Syndicate, Inc. ⁴ is an instructive case in this regard. In Hawthorne, the Court of Appeals held that owners in two different subdivision blocks that were separated by a four-lane road were entitled to enforce “substantially similar” restrictive covenants against an owner in one of the blocks because the subdivision was developed according to a common scheme of development. In finding that there was a common scheme of development, the court examined several factors, none of which were determinative standing alone. The court stated: “Blocks 7 and 9 were platted together. Sales of the lots in each tract began at substantially the same time. The restrictions imposed by the deeds to the lots in both tracts are substantially similar. These and other factors . . . support the conclusion that the two blocks were developed as one parcel, subject to common restrictions intended for the mutual benefit of the property owners in both tracts.” The court noted that “differences in the general phraseology [in the CCRS] do not themselves defeat the inference of a common plan . . . .” This suggests that minor differences in the wording and content of the CCRs do not necessarily mean that there is not a common scheme of development.
In a recent case I was involved in, what first appeared to be a relatively small restricted area with about ten lots turned out to be part of a sprawling residential subdivision that contained hundreds of similarly restricted lots on dozens of plats. Each of the plats said, “A Portion of Worthmore Subdivision,” and it was clear that the developer intended for this to be one large community. Because it would have been next to impossible to amend the restrictions given the sheer numbers involved, it became necessary to file a declaratory-judgment action to establish that the subject property was no longer subject to the restrictions due to a change in circumstances (which happened to be the case).

Whether there is a common scheme of development, and how far the common scheme extends, is not an easy, color-by-numbers analysis. The moral here is to be aware of the possibility of a common scheme of development that might include other similarly restricted owners who could potentially bring an enforcement action against your client if the restrictions are not otherwise resolved.

“Be the Radical Change You Wish to See in the World.”
So your client says to you, “There’s no way these restrictions can be enforceable, is there? On this lot there’s a body shop. On that lot, there’s a triplex operating a daycare and tattoo parlor. Over there is a parking lot for an exotic-pet store.” For a subdivision with a single-family residential restriction, it seems obvious that there’s been a change of circumstances that would render the restrictions unenforceable, but this is not always as straightforward as it seems. Whether there has been a “radical change of circumstances,” such that the restrictions are no longer enforceable due to changes within the covenanted area, is an issue that is fraught with misunderstanding and confusion.

North Carolina law holds that restrictive covenants that do not otherwise end by their own terms may be terminated “when changes within the covenanted area are so radical as practically to destroy the essential objects and purposes of the agreement.” Medearis v. Trustees of Myers Park Baptist Church, 148 N.C. App. 1, 6, 558 S.E.2d 199, 203 (2001). “A change in the character of the neighborhood which was intended to be created by restrictions has generally been held to prevent their enforcement in equity where it is no longer possible to accomplish the purpose intended by such covenant . . . .” Muilenburg v. Blewins, 242 N.C. 271, 275, 87 S.E.2d 493, 496 (1955).

What I’ve found is that the average developer’s perception of whether there has been a radical change of circumstances, and whether there has actually been a radical change of circumstances, are vastly different things. Under the case law in North Carolina, a “radical change of circumstances” is quite a difficult standard to achieve.

I litigated a case a few years ago up in Blowing Rock, in an old subdivision known as Mayview Park that was up behind the municipal park in town. The restrictive covenants for Mayview Park first appeared on record in 1919 in the individual conveyances of lots by the developer, W. L. Alexander. There were 104 original lots. The restrictions prohibited these lots from being further subdivided, and also imposed a limitation of only one house per original lot. There was also a single-family residential restriction.

Despite the restrictions being on record, a buyer (who eventually became my client) bought a beautiful view lot for the purpose of subdividing it and putting two houses on it. At the time of closing, he believed that the restrictions were no longer enforceable because they had been violated so often, and to such a significant extent. Of the 104 original lots, at least 40 had been subdivided, such that after various reconstructions and so forth, there were 96 subdivided lots. Nearly 70 homes had been constructed on subdivided lots despite the restriction imposing a limitation of only one house per original lot. Furthermore, there had been a hotel built on a residential lot, as well as 32 condominium units, a townhouse project, and a restaurant (Bistro Roca). The violations had spanned for decades upon decades, with the first lot subdivision occurring in 1927.

Despite all these open and obvious violations, not a single person complained a single time until 2007 when this one unwitting guy came along, at which point six or seven of his neighbors jumped up and down, filed a lawsuit, and got an injunction preventing him from moving forward with construction. In response to the lawsuit, I raised a defense that the restrictions were no longer enforceable, and soon we had to name every lot owner in Mayview Park as parties to the litigation.

After two full days of hearings on the trial level, an experienced trial judge called the attorneys back into chambers. He looked at me and said, “You may well win in Raleigh, but I’m not going to tell the rest of these lot owners that their restrictions are not enforceable.” He went on to say that based on his years as a real-estate practitioner, he believed that restrictions were a valuable property right, and that he wouldn’t be the one to defy the plaintiffs’ expectations that the restrictions were enforceable, notwithstanding the many existing violations of the covenants.

My client ultimately prevailed on appeal, but it was anything but a slam dunk. The moral of this story is that it’s harder than you might think to demonstrate that “changes within the covenanted area are so radical as practically to destroy the essential objects and purposes of the agreement.” Do not assume that restrictions are no longer enforceable just because you have several notable violations. Also be aware that changes outside the covenanted area are irrelevant for purposes of this analysis.

“Nature Abhors the Marketable Title Act”
The Real Property Marketable Title Act (Chapter 47B) sets out that “obsolete restrictions . . . which have been placed on the real property records at remote times in the past often constitute unreasonable restraints on alienation and marketability of real property.” Section 47B-2 provides that if a party has a record interest in real property comprised of a 30-year (or longer) chain of recorded documents and nothing appears of record within that 30-year period that is contrary to the party’s interest, that party has, under the Act, marketable record title to the real property. Subject to specific exceptions set forth in section 47B-3, the party’s interest in the real property is free of any claims or interests which arose or were of record prior to the 30-year period.

I have had several cases recently where there was a good argument that restrictions were unenforceable by virtue of the Marketable Title Act because they occurred so far back in the chain of title, and no reference to the restrictions appeared in the chain for more than 30 years. Still, attorneys for buyers should keep two things in mind: First, there is precious little case law interpreting the Marketable Title Act. In my opinion, there remain important questions in regard to how the Act may be applied—so there is no guarantee of a viable defense under the Act. Second, if your client gets sued over a violation of the restrictive covenants, your assurance to the client...
that she will “likely prevail” under the Marketable Title Act after two or more years of litigation may not be much of a consolation.

The moral here is that even if you feel like you have a good defense under the Marketable Title Act, your client might still be buying into a lawsuit if you do not deal with the restrictions prior to closing.

“Those Who Cannot Remember the Past Are Condemned to Make Title Claims”

It’s important to bear in mind that simply getting title insurance coverage over restrictions is not a panacea. A title policy, while still the very best policy of insurance you can buy, is not designed to solve all your client’s problems if after closing he or she gets nailed with a lawsuit over a set of restrictions.

Let’s say you represent a large homebuilding company. The homebuilder buys three prime acres of property subject to restrictions that haven’t appeared in the chain of title for 65 years. The title company agrees to insure over the restrictions and the closing goes forward.

Your homebuilder client mobilizes and takes $100,000 worth of lumber and building materials to the site, only to get served with a lawsuit seeking an injunction to stop all building until the court decides whether the restrictions are enforceable. You have to tell your client it might be well in excess of a year before the case is decided by the courts. Your client says, “But I have title insurance.” At this point—after closing, and after the lawsuit has been filed—is not the time to have a discussion with the client regarding what title insurance will and will not address. The title company has the option to cure under the policy, and is entitled to litigate the matter to a final adjudication, even if that takes a year or two years or longer. Speaking broadly, if the title company is unable to establish that the restrictions are not enforceable for one reason or another, the insured owner is not, at that point, entitled to damages for all her losses, but is instead only entitled to the difference in value for the property with the restrictions and without (up to the amount of policy). While the litigation is pending, the title insurance does not cover carrying costs or reimburse the homebuilder for lost profits and the like.

The moral here is that your client should clearly understand what title insurance does and does not address so the client can make an informed decision about moving forward with closing when re-strictions exist in the chain of title.

“God Helps Those Who Address Restrictive Covenants Before Closing”

The best and safest way to address restrictive covenants is prior to closing. Yes, there will likely be a cost associated with resolving the restrictions, and yes, it could be time-consuming. Yes, it is possible that some sales may not close because of unresolved issues with re-strictive covenants. But your client will be in a far better position to deal with restrictive covenants before closing than possibly having to address them in the form of a lawsuit after.

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Endnotes

2. Virgil, Aeneid (ca. 19 BC) (“facilis descensus Averno antiqua restrictiones”). According to his biographer, Virgil received the first ever commission for the sale of real property.
3. William Congreve, The Mourning Bride (Act III, Scene 2) (1697), in which the play’s protagonist, a retired government employee with no hobbies and endless time on his hands, leads the valiant charge against an unsuspecting homebuilder who wishes to convert a rundown portion of a residential neighborhood to a series of duplexes.
5. Names have been changed to protect the innocent.
7. This clever aphorism—horror title actum artificium venale—was first attributed to Greek philosopher and scientist Aristotle, himself no stranger to the world of real estate, who is well known to have dabbled with investments in Cypriot time shares and even had a few vacation rentals.
8. George Santayana, The Life of Reason: The Phases of Human Progress (1905-06). Santayana also once famously said, “An idealist is one who, on noticing that roses smell better than cabbage, concludes that they will also make better soup,” Or maybe that was H. L. Mencken.
9. Please send your checks to my attention at 301 S. College St., Suite 2600, Charlotte NC 28202.
10. This venerable phrase most likely originated in Sophocles’ play Philoctetes (ca. 409 BC): “And heaven ne’er helps the men who will not act, nor those who fail to obtain waivers from all owners subject to certain restrictions prior to closing.”