

## Issues with Groups That Use Church Property

Congregations often offer their church property and buildings to be used by outside groups. Sometimes the relationship with that group is set out in a covenant and sometimes in a lease. There are legal, tax, zoning, and practical issues that should be considered when those relationship documents are created, updated, and amended.

Here are a variety of issues to consider in drafting or reviewing a covenant or lease with a third-party property user or renter (“User”).

### INTENDED USES

The User should submit to the session a letter or application explaining its structure, mission, and the general uses it intends for the sections of your property and buildings it needs, including hours of use, access desired, and any special needs. The User group should, if possible, be a not-for-profit organization whose mission is not inconsistent with that of the mission(s) of your congregation. A User’s activities should not supersede or interfere with the mission(s) and programs of the congregation.

The session must get your presbytery’s approval in writing before leasing real property to a User. See *Book of Order* G-4.0206(b). No permission is needed to covenant and allow a group to use your property.

### INSURANCE

**Your insurance** - Make a written inquiry to your liability insurer to make sure that company provides coverage for any liability resulting from the proposed use or rental and that there will be no premium increase or any exclusion due to the proposed use or rental. You may wish to review the adequacy of your own insurance policy limits considering the new activity. If supplemental or specialized coverages are needed, they should be obtained prior to signing a lease or covenant and occupancy. Ask the agent to send you a binder or endorsement showing coverage is in effect for the new User. The lease or covenant should not be signed until you receive written confirmation. If any insurance claim or lawsuit should arise due to conduct or activities of the User, give immediate written notice to your agent and the insurance company.

**User’s insurance** - **The User should be required**, prior to occupancy, to submit a current certificate of insurance from its liability insurer naming the church as an additional insured under that policy. A copy of this certificate should be sent to the church’s insurance agent. If there is a multi-year lease, a new certificate should be submitted each year. The certificate of insurance should show general liability and property coverage for use of church space. If the User works with minors (ex. Boy Scouts, Girl Scouts, Indian Guides), **the User’s insurance coverage should include coverage for intentional acts and sexual misconduct**. If the tenant is conducting a business such as a day care, the certificate should show Worker’s Compensation Insurance for the employees. It should also show property insurance for the tenant’s contents.

If the User refuses to provide a certificate of insurance or if its coverages do not cover risks related to its use of your property (ex. no coverage for intentional acts or sexual misconduct), **your session and your corporate board has a duty to consider whether this is a User who should use your property or buildings and should assess the significant risk the User may create for your congregation**. Having a User without insurance or whose insurance will not provide coverage for risks related to its use of your property and buildings potentially puts all your assets at risk. Do not take the User’s word for it that its insurance is adequate. Send the User’s certificate of insurance (along with the User’s letter or application for use submitted to your session) to your insurance agent and ask if it is adequate for coverage for the User’s activities and your congregation’s risk in hosting the User.

### LEASE OR COVENANT

A rent-paying tenant should sign a lease spelling out the rights and liabilities of the parties. A User not paying rent should sign some sort of agreement, such as a covenant, setting out rights and liabilities of the parties. It is preferable that you and your lawyer prepare the lease. However, if the proposed User provides you with a lease or agreement, make sure you review it carefully, preferably with your legal advisor. Make sure you understand the liabilities you may be undertaking by signing the User's document and allowing it to use your space. Send the draft to your insurer so it is aware of the agreement and can comment on the adequacy of the User's insurance before a lease is signed.

As part of that lease/covenant ("Agreement"), there should be an indemnification and a hold harmless agreement in favor of the congregation and your church corporation. The church should carefully draft the Agreement in conjunction with its legal counsel so that the church requirements and needs become lease obligations of the User. In addition, it would be wise to state in the Agreement that the User and their guests/invitees **must** follow and comply with **all policies** of the congregation, including building use policies and sexual misconduct and child and youth protection policies. Those policies should be named in the Agreement and attached as exhibits so that you can show you provided copies to the User. It is also recommended to include terms in the Agreement regarding the User's ability (or not) to sub-lease the property.

The term of an Agreement should be short enough (ex. 1 year) to allow periodic evaluation of the rental amount, conduct of the User, and other conditions of the relationship. There should also be provision for cancellation/termination of the Agreement, a list of grounds for cancellation/termination (ex. failure to comply with church policy, failure to timely pay rent), and notifications of intent to terminate the lease (ex. 30-day notice of termination). The Agreement should also describe the procedures Users must follow when vacating the property, including cleaning the premises, removing all of User's property, and restoring the premises to their original condition.

After the Agreement is executed, the church must monitor and enforce it. You must be prepared to act appropriately if the User violates the Agreement. It is unpleasant to evict a User but that is one of the negatives you should consider. Should problems arise with improper use, breaches of security, nonpayment of rent or other conflicts, it is always best to address them promptly. Written notice on the points of dispute and on the needed resolution of those points should be forwarded to the User so that all parties understand the relevant concerns and are aware of the consequences for failure to rectify them.

### RENT AND USE

The Agreement should obligate the tenant to pay for any damage or disrepair its uses cause to your property and/or its contents. The Agreement should be as simple and clear as possible. The church should make best efforts to determine the appropriate security deposit and rent for the uses of the property if there is a lease. Issues such as increased utility bills, maintenance costs, and other new expenses such as possible property taxes, should be considered when setting the rent or terms of a lease. Language stating that the User accepts the rented property "as is" (except as otherwise expressed in the Agreement) is also recommended.

The lease should spell out specifically the space covered by the lease and the uses that are permitted and the time the occupancy is allowed. The tenant should not be allowed to make changes in the building or improvements without the prior written consent of the church. Special zoning, safety, and licensing requirements may involve additional costs. The lease should cover the duty of the tenant to comply with zoning, make safety inspections, and obtain licenses and permits. The party required to pay for any improvements to the building should be spelled out in the lease. There should be a clear statement that such improvements become property of the church.

### **SECURITY**

When evaluating a potential User, the church should make sure that it is a legitimate organization that can fulfill its obligations under the lease or covenant. Special consideration should be given to security when outside individuals are to be given keys or key cards and access to your buildings. The responsibility for locking/securing the building should be fully understood and stated in any Agreement. Alternatively, the church may designate persons to open and close the building (ex. Sexton).

### **ZONING**

Some churches may be in areas where there are zoning restrictions that prohibit rental of the property. For example, a church in a residential area may not be properly zoned to be used as a school or child-care facility. Before lease negotiations, check your property's zoning restrictions and, where desired, consider variances or zoning modifications. Some churches have successfully challenged zoning restrictions under the free exercise of religion. These challenges, however, involve lawsuits, are uncertain, and may take many years for a final decision.

### **TAX ISSUES**

The leasing of church property generally should not result in loss of the church's 501(c)(3) (federal tax-exempt) status. Unless rental activities unrelated to the congregation's exempt purpose (religion) become more than insubstantial, the federal tax exemption should not be affected. Although rentals of church property do potentially give rise to unrelated business income (UBI), Internal Revenue Code Section 513 specifically exempts most rental income from being taxable UBI. A tax professional should be consulted in advance of the lease to determine what income tax liability may be present at the federal and state level.

A more likely area of complication arises at the state and local tax exemption level. One area of concern relates to local real estate property tax exemptions for charitable and religious use property. Check state and local laws and regulations to determine whether there will be a loss of part, or all, of the property tax exemption enjoyed by the church based on its religious use of the property. Many states, counties, or municipalities have statutes that mandate "exclusive religious use" to maintain tax-exempt status for property. Governmental bodies also require periodic reporting and reaffirmation of the tax-exempt use of the property. Failure to report in time can lead to loss of the exemption. Churches are strongly advised to confer with legal counsel familiar with local property tax law regarding these pitfalls. Be sure to open and respond to mail from the county assessor's office as exemptions have been lost for failure to respond in a timely fashion.

### **STORING AGREEMENTS**

All Agreements and tenant records should be maintained in a separate file and kept locked so they can be quickly and easily accessed when needed. These files should include insurance records, including certificates of insurance from the User. None of these records should be destroyed. Legal claims can be filed years or even decades after an incident occurs. For example, in some states, claims by minors do not have to be filed until a year or more after a minor reaches the age of majority. Someone injured at age 5 may be allowed to file a lawsuit 14 or more years later. Some states allow claims to be filed decades after the events that may create liability. Store tenant records in a safe place and never destroy them.