

B. Information about Property Generally and Church Property

1. Special Issues with the Leasing of Church Property

From time to time, local churches and other church organizations will have the opportunity to rent church real property to another organization. There are legal, tax, zoning, and practical issues that should be considered before any leasing decisions are made.

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.

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.

In addition to the above concerns, there are other points that churches should consider when renting property. They are as follows:

- a. Obtaining presbytery’s approval to enter into a lease. See G-4.0206.
- b. The renting/leasing group (tenant) should, if possible, be a not-for-profit organization.
- c. The tenant should further the cultural, civic, spiritual, or educational goals of the church and/or community.
- d. The tenant’s activities should not supersede or interfere with the programs of the church.
- e. The tenant should submit a properly completed application form including an explanation of the structure of the tenant’s organization and of the general uses that it intends for the rental including hours, access desired, and any special needs.
- f. The tenant should sign a lease spelling out the rights and liabilities of the parties.
 - i As part of that lease, there should be an indemnification and a hold harmless agreement in favor of the church. The church should carefully draft the lease in conjunction with its legal counsel so that the church requirements and needs become lease obligations of the tenant.
 - ii It would be wise to state in the lease that the tenant must also follow and comply with all policies of the congregation, including sexual misconduct and child and youth protection policies.
 - iii 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.
 - iv 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.
- g. The tenant 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 tenant works with minors (ex. Boy Scouts, Girl Scouts, Indian Guides), the tenant’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 tenant 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 tenant who should use your property or buildings and the significant risk the tenant may create for your congregation. Having a tenant 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. And do not take the tenant's word for it that its insurance is adequate. Send the tenant's certificate of insurance 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 tenant.
- h. 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.
 - i. All legal documents should be reviewed and approved by a local attorney.
 - j. The church should review the state and local laws relating to zoning and property tax exemptions prior to executing a lease.
 - k. There should be an inquiry made in writing to the current church's liability insurer to make sure the insurance company provides coverage for any liability resulting from the proposed rental and that there will be no premium increase or any exclusion due to the proposed rental. Any increase that may be incurred can be offset by adjusting the terms of the lease or requiring the tenant to pay for the increase. The church also may wish to review the adequacy of its own insurance policy limits in light of the new activity. If supplemental or specialized coverages are needed, they should be obtained prior to lease execution and property occupancy. Ask the agent to send you a binder or endorsement showing coverage is in effect for the new occupancy. The lease should not be signed until you receive written confirmation. If any insurance claim or lawsuit should arise, give immediate written notice to your agent and the insurance company.
 - l. You may wish to consider adding a lease provision to protect the church in the event of a dispute and litigation. Such a provision may provide that in the event of a lawsuit, the prevailing party shall be entitled to attorney fees and costs.
 - m. The lease should obligate the tenant to pay for any damage or disrepair to the property and/or its contents.
 - n. Beware of any new obligations to comply with state or federal disability statutes because of this rental.
 - o. The lease should be as simple and clear as possible. The church should make best efforts to determine the appropriate rent for the uses of the property involved. 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 the lease. 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.
- p. When evaluating a potential tenant, the church should make sure that it is a legitimate organization that can fulfill its obligations under the lease. Special consideration should be given to security when outside individuals are to be given keys and access to the building. The responsibility for locking the building should be fully understood. Alternatively, the church may designate trustees or other persons to open and close the building.
 - q. Typically, the lease terms should be short enough to allow periodic evaluation of the rental amount and other terms. There should also be provision for cancellation of the lease and for prior notifications of intent to terminate the lease.
 - r. All leases and tenant records should be maintained in a separate file and kept locked so they can be quickly and easily accessed when needed.

After the lease is executed, the church must monitor and enforce it. It must be prepared to act appropriately if the tenant is violating the lease. It is unpleasant to evict a tenant but that is one of the negatives landlords 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 tenant so that all parties understand the relevant concerns and are aware of the consequences for failure to rectify them.

Through rental of church property, churches can generate additional income and increase their outreach into their communities. Persons involved with the renting organization may become interested enough in the church to become members. If all ramifications, legal and practical, are carefully considered and dealt with in advance, leases can be mutually beneficial.