

MEMORANDUM

From: GCFA Legal Department
Re: Leasing of Church Property
Date: April 17, 1991

From time to time, local churches and other church organizations will encounter the opportunity to rent or lease church real property to another organization. This memo considers some of the legal, tax, zoning and practical issues involved in church property rentals.

The leasing of church property on an occasional basis typically will not create any problems with the Internal Revenue Code 501(c)(3) *federal income tax exemption*. Unless rental activities not related to the organization's exempt purpose (religion) become "substantial," the federal tax exemption is not affected. Although rentals of church property do give rise to unrelated business income (UBIT), Internal Revenue Code Section 513 specifically exempts rental income from being taxable UBIT.

However, 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 make sure there is no question of jeopardizing the exemption by a non-religious use. Some states, counties or municipalities have statutes which mandate "exclusive religious use" in order 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 timely report 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* which would disallow the rental use. For example, a church in a residential area may not be property zoned to be used as a school or child care facility. Before any significant lease negotiations are entered into, the zoning restrictions should be checked and, where desired, variances or zoning modifications may be considered.

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

1. The renting/leasing group should, if possible, be a not-for-profit organization.
2. The lessee should further the cultural, civic, spiritual or educational goals of the church and/or community.
3. The lessee's activities should not supersede or interfere with the programs of the church.
4. The lessee should submit a properly completed application form including an explanation of the structure of the lessee's organization and the general uses which it intends for the rental including hours, access desired and any special needs.
5. The lessee should sign a lease spelling out the rights and liabilities of the parties. 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 lessee.
6. As part of its duties under the lease, the lessee should be required, prior to occupancy, to submit a certificate of insurance from the lessee's liability insurer naming the church as an additional insured under that policy.
7. All legal documents should be reviewed and approved by an attorney and necessary Disciplinary approvals for use of the property should be obtained. Consultation with the local church board of trustees is very important to identify needs and concerns and to avoid unproductive conflicts.
8. The church should review the state and local laws relating to zoning and tax exemptions prior to executing a lease.
9. 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 which may be incurred can be offset by adjusting the terms of the lease or requiring the lessee to pay for the increase. The church may also wish to review the adequacy of its own insurance policy's 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. *If any insurance claim or lawsuit should arise, make sure you immediately give written notice to your agent and the insurance company.*

10. 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.

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 as well as 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 which are permitted and the time the occupancy is allowed. The lessee should not be allowed to make changes in the building or improvements without the written consent of the church. Zoning, safety and licensing requirements required when the rental use is for schooling, day care or elder care facilities may involve additional costs. The lease should cover the duty of the lessee to comply with zoning, make safety inspections and obtain licenses and permits. The party required to pay for any required 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.

When evaluating a potential lessee, churches should make sure that it is a legitimate organization which 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. Typically the lease term 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.

After the lease is executed, the church must monitor and enforce it. It must be prepared to act appropriately if the lessee is violating the lease. It is unpleasant to "evict" a lessee but that is one of the negatives landlords should consider. Should problems arise with improper usage, breaches of security, non-payment 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 renting organization so 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 in the church enough to become members. If all of the ramifications, legal and practical, are carefully considered and dealt with in advance, such arrangements can be mutually beneficial.