

Legal Counsel for Churches

Corporate Governance for Churches and Their Leaders



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Church Loans Come With Strings Attached.



If your church ministry needs to expand, you may be feeling growing pains. This is the time many churches decide it's time to build a new facility. Perhaps, your church is considering the purchase of new equipment or another vehicle. If your church needs a loan to finance its growth, you should be aware of some common covenants found in bank loans.

A loan covenant is a promise. The promise most people think of is the promissory note where the Church obligates itself to repay the loan. If the loan is not repaid as agreed, the bank may declare the loan in default and take action against the church. To help ensure the bank gets its money back, it often includes other promises in the loan documents. These covenants are just as enforceable as the repayment promise.

Here is a list of common covenants a church may face when it receives a bank loan.

Annual Appraisals

Banks want to know that the value of their collateral has not diminished during the term of the loan. Church property market values can change based on the location and the condition of the property. Banks often require periodic appraisals to make sure someone is inspecting the property conditions. Also, the appraisal lets the bank reassess its risk exposures with the church.

Cash On Hand

One of the signs of a borrower who is at risk of defaulting is declining levels of cash. This can be a signal that expenses are increasing or congregation support is waning. Banks may place a covenant in the loan that requires a minimum level of cash be kept at all times.

Financial Reporting

Creditors want to know how the church is performing. The loan may include a covenant that the church will provide regular financial reports to the bank. The financial reports may include balance sheets and income statements. The bank may require the financial statements be submitted in a particular format.

Annual Audit Requirement

Some churches get annual audited financial statements from an accounting firm. The bank may ask that the audited statements be provided each year. Churches should speak with the auditor to ensure the firm is aware the bank may be relying on the reports.

Annual Budgets

Banks will often require their church borrowers to submit an budget for each year. The bank wants to see that the church is prudently planning ahead and has a strategy to stay financially fit.

Key Man Life Insurance

For most churches, the pastor is the key leader. It is often felt that the untimely loss of the pastor could temporarily hobble the church and its congregation. Banks who recognize this may require a life insurance policy on the pastor. The insurance proceeds could help stabilize the church through an unexpected transition.

Debt Service Coverage

Banks may require a church borrower to maintain a certain level of profitability. In this case, profitability is measured by a tool called the debt service coverage ratio. The ratio indicates the amount of net income available to repay the loan obligation. Churches who face this loan covenant should measure their ratio as often and the loan requires. ■



Maurice R. Smith | Attorney & Counselor at Law

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Post Office Box 27461, Raleigh, North Carolina 27611 919.362.0744 (voice) 888-321.9047 (fax) maurice.smith@msmithlaw.us
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Does Your Church Have Adequate Liability Insurance?

If your church carries liability insurance for its officials, you should review the policy every year. When conducting an annual review of your liability insurance policy, the church should look at the coverage amounts and limitations. This is important because you want to ensure you have adequate coverage for potential claims.

Most insurance policies state the maximum the policy will pay for claims in a period. The maximum amount is often phrased as an aggregate total for all claims. To determine if the maximum is adequate, consider the number of officials under the policy and how much coverage is available for each.

In a real life example, let's think about a church that has an aggregate \$1 million limit on its liability insurance policy. The policy covers the pastor, trustees and deacons. Altogether, twenty persons share the same aggregate coverage. If all of the officers of this church are named in lawsuits in one year, the average coverage available for each official is \$50,000.

Lawsuits can take a long time to resolve. It is not unusual for a law firm to charge \$200 per hour for representation. At the rate of \$200 per hour, the \$50,000 coverage for each church official will buy 250 hours of defense. Depending on the risks a church faces, church officials could believe that this amount of protection may be inadequate.

Taking this example further, a church should look at limitations in their policies. Some policies include a limitation of liability coverage for each individual claim. So in spite of the aggregate limit, the claim limitation further curbed how much resources would be available for each official.

In one case, I found a church policy with a \$5,000 limitation per claim. At \$200 per hour, the number of hours available for each officer is further reduced to 25 hours. The church officials had reason to believe the liability insurance coverage was inadequate.

Every church should review their liability insurance policy annually. Talk with your insurance agent and attorney to help determine if you have the right amount of coverage. ■



Some Risks Are Bigger Than They Appear.



Some legal issues are not as small as you might think at first. Some risks start small, but wind up becoming very big deals.

We help churches understand legal issues and develop strategies to shrink the risks to manageable levels. If you want to stay clear of your risks, give us a call today.

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**Legal
Counsel**
for Churches



Legal Counsel for Churches is a service provided by M Smith Law, PLLC for members of the religious community. This periodical is intended to help churches and their officials become better prepared to address important legal and governance issues. We hope you find *Legal Counsel for Churches* a valuable resource. For each issue, we try to raise relevant issues and offer some practical alternatives. We welcome your comments and input. If you have questions, feel welcome to contact us.

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