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CHURCH REAL ESTATE ISSUES

THOMAS J. FADOU, JR.*

INTRODUCTION

Notwithstanding the magnitude of issues such as abortion and liability currently confronting the Church,¹ real estate remains a significant aspect of diocesan attorney practice. Specifically, attorneys are frequently concerned with the manner in which property is acquired and held by dioceses.

I. DIOCESAN PROPERTY ARRANGEMENTS

Fundamental to any diocesan real estate transaction is an understanding of canonical considerations. Each transaction requires a valid canonical act that is implemented in a civilly valid manner.² The diocesan attorney must review canon law with two things in mind. First, the

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¹ See Ed Vulliamy, *US at War Over Life and Death Abortion Issue*, OBSERVER, Feb. 19, 1995, at 18 (describing Catholic Church as "central pillar[]" of anti-abortion movement); John-Thor Dahlburg, *Faiths Disagree on Morality of Abortion*, L.A. TIMES, Jan. 24, 1995, at A5 (discussing disagreement among Catholics and pressure on Church to relax its moral teachings on abortion); Randall Samborn, *Priest Playing Hardball to Battle Abuse Charges*, NAT'L L.J., July 4, 1994, at A1 (reporting that, in past decade, churches have paid over \$60 million in settlements and verdicts in suits for sexual abuse by clergy); Jorge Aquino, *The Limits of Religious Freedom: Should Churches be Entitled to First Amendment Protection When Civil Laws are Broken?*, RECORDER, Apr. 6, 1994, at 1 (discussing possible erosion of First Amendment protection of internal Church investigations and its effect on suits against Church for fraud and clergy misconduct).

² See 1983 CODE c.1284, § 2, in THE CODE OF CANON LAW: A TEXT AND COMMENTARY 875 (James A. Coriden et al. eds., 1985) (requiring that Church administrators "observe the prescriptions of both canon law and civil law") [hereinafter THE CODE OF CANON LAW]; 1983 CODE c.22, in THE CODE OF CANON LAW, *supra*, at 38 (mandating that "[c]ivil laws to which

procedures followed by the ordinary must be valid;³ second, there must be a civil law counterpart to the canon law.

Civil law arrangements such as implied, constructive, or express trusts⁴ can be created to reflect the canon law principles of Church real estate schemes. This may be accomplished with express documents such as administrative acts within the canon law, or by custom in the absence of a written document. The Diocese of Arlington, for instance, creates trusts through custom. The Diocese simply takes legal title in the name of the ordinary,⁵ and the ordinary holds legal title for the ultimate benefit of the separate juridical body that owns equitable title—the parish.

In some cases, however, the ordinary may own both legal and equitable title. For instance, the high schools in the Diocese of Arlington are diocesan-run schools. They are not owned or controlled, equitably or legally, by any separate juridical person. Thus, both forms of title are held by the ordinary.

The ordinary generally has veto power over most decisions. While such actions by the ordinary will rarely be subject to review in a typical transaction, much consideration should be given to the scope of the ordinary's powers. As with the trustee, these powers should be delineated carefully and memorialized when a property acquisition is planned, or certainly by the time it is executed.

Some lawyers prefer not to think of Church real estate in terms of a trust because of the implications of fiduciary duties created by a trust; though, of course, an ordinary would hold fiduciary duties under canon law. Moreover, in some states, developments in the common law make it less advantageous to create a trust. Alternatively, dioceses could create a life estate in Church property,⁶ whereby the reversionary interest is

the law of the Church defers should be observed in canon law with the same effects" unless otherwise specified).

³ At common law, an ordinary is one with "exempt and immediate jurisdiction in causes ecclesiastical." BLACK'S LAW DICTIONARY 1097 (6th ed. 1990). Canon 134 specifies that an ordinary "refers to the diocesan bishop and his vicars general and episcopal vicars." THE CODE OF CANON LAW, *supra* note 2, at 386 (referring to 1983 CODE c.124, § 1).

Generally, a juridic act is valid if "the person has proper authority, posits what the act essentially requires, and observes the formalities and conditions required by law for validity." *Id.* (citing 1983 CODE c.124, § 1).

⁴ Generally, under a trust arrangement, a trustee takes title to property that it protects and conserves for the use and benefit of the named beneficiaries. See BLACK'S LAW DICTIONARY 1508-09 (6th ed. 1990); 1 RICHARD A. WESTIN, FEDERAL TAX PLANNING § 3.38 (2d ed. 1990).

⁵ The Virginia Constitution prohibits churches from incorporating or buying property in the name of corporations. VA. CONST. art. IV, § 14. See Reka Potgieter Hoff, *The Financial Accountability of Churches for Federal Income Tax Purposes: Establishment or Free Exercise?*, 11 VA. TAX REV. 71, 73 (discussing incorporation of religious societies).

⁶ The owner of a fee simple estate can convey a life estate by an instrument clearly indicating such an intent. See ROGER A. CUNNINGHAM ET AL., THE LAW OF PROPERTY § 2.11 (2d ed.

given to the ordinary in the event of termination of the juridical person. While it is not very appealing to think of parishes being terminated, this is a reality being confronted in some dioceses and archdioceses in the United States.⁷ When parishes terminate, the equitable title to the property should not be allowed to simply trip off into oblivion. Rather, attorneys should arrange for it to quickly revert back to the ordinary where life estate property arrangements are used by the diocese.

II. REAL ESTATE ACQUISITION, DEVELOPMENT, AND CONSTRUCTION

One of the most critical elements in the acquisition, development, and construction of Church property is pre-acquisition planning. When a prospective sponsor comes forward with a particular project, it is essential that a purpose, needs, and means statement be established before even looking for a piece of property. Particularly, planning is critical because it sets out the constitution and essence of what the sponsor ultimately wishes to accomplish through the project. Most would agree that a successful project entails meeting the goals set out in the original purpose clause, while keeping expense and delay to a minimum.

A. Proposed Process

Prior to the acquisition of property, an architect should be consulted to create what are called "bubble" drawings—amorphous sketches which lack structure and dimension and do not relate to specific property. From these bubble drawings, "block" drawings, blueprints, and construction drawings are ultimately created. This is accomplished through three basic phases: the planning phase, the design phase, and the construction phase. Each of these phases is permeated with financial and political considerations, as well as the constant attention that must be devoted to the diocese's goals.

1. Planning Phase

The importance of planning becomes apparent when the planning, design, and construction phases interface with the finances, goals, and politics of the situation. To move toward the finished product, it is necessary to constantly review the budget, assess whether critical goals are being met, and ensure concessions to the political processes that must be

1993). Under a life estate, the life tenant essentially makes beneficial use of the property and, upon termination, the beneficial interest reverts to the grantor. *See id.*

⁷ The Archdiocese of Chicago, for example, has closed 52 parishes and schools since 1990. Michael Hirsley, *Bernadin Sends Dire Warning on Chicago Archdiocese's Finances*, CHI. TRIB., Sept. 25, 1993, at 5. *See* Nicola Miner, *S.F. Advocate Appeals to Victim for Unusual Holy Order*, RECORDER, July 18, 1994, at 2 (discussing attempted appeals of San Francisco Archbishop's order to close 11 churches).

satisfied, such as securing special permits, zoning approvals, or support from local politicians. Attention to each of these considerations will create the four corners of a successful plan.

Thus, in the planning phase, the budgetary concerns, political figures, approval processes, architects, and engineers must constantly be bathed together under the "percolator" theory: Like a coffee percolator, the issues flow up and down, constantly moving toward the finished product, but never without passing up through the screens and sieves of the four corners of the plan. Unless all three factors—budgets, diocesan goals, and the political arena—are constantly kept in mind, the project will ultimately reflect one or two, but not all of the stated objectives. Typically, it is the failure to keep these factors in mind that results in dissatisfaction with the final product.

2. Site-Selection and Site-Acquisition Phases

The critical elements to consider during site selection and acquisition are the physical characteristics of the property, existing zoning restrictions, and any special site-development costs. Such property should be analyzed parcel-by-parcel in order to assemble a fine-tuned list of target parcels. Failure to appreciate the importance of these factors during the site-selection process will generate future difficulties in terms of added cost and delay.

Canon law requires that two appraisals be procured before purchasing or selling any property.⁸ Theoretically, this appraisal system prevents the diocese from overpaying or underselling any property. Recently, dioceses have been able to acquire properties at below their appraised values. This may be a result of current market conditions, or just plain luck. At the site-acquisition phase, the architect should begin to translate the amorphous bubble drawings into the block drawing. Although the dimensions are laid out in the block drawing, the sketches will not yet resemble a workable schematic of the final facility. Ultimately, the block drawings will be converted to actual building blueprints, which are in turn converted to construction drawings that are approved and sent to the contractor.

In the site-acquisition phase, while simultaneously moving toward the block drawings, contingencies must be identified and defined, including the site plan approval contingency and the special zoning requirements contingency. Attorneys must also maintain representations and warranties by the seller that survive the settlement on the contract, especially in light of the rapid development and strict enforcement of envi-

⁸ See 1983 CODE c.1293, § 1, in THE CODE OF CANON LAW, *supra* note 2, at 881 (requiring expert estimate of property value before alienation).

ronmental laws and regulations. The site-acquisition phase is completed with a solid contract that takes all of these factors into consideration.

3. Approval and Construction Phases

An overlapping phase follows in which zoning permit and site-plan permit applications are prepared for approval. Because, in most cases, filing is accomplished through local, city, or county governments, filing requirements vary among jurisdictions. The facility with which filing is accomplished will depend on the nature of the laws in a given jurisdiction. It is, however, something that must be focused on because of the different requirements which attach to the Church during the site-plan approval process.

The final phase is the actual construction phase. At this point, construction drawings are completed, bidding documents are created, and the project is ultimately constructed.

B. *Diocese's Relationship With Architect and Contractor*

Most architects will not even consider taking a project without memorializing the agreement in a standard American Institute of Architects ("AIA") contract. There are five phases of an architect's contract: the original schematic drawings; design development, such as placing the windows on the building; preparation of the construction drawings, which add detail; preparation of the bidding documents; and the construction-administration phase, which involves the cursory supervision of the actual construction.

1. Construction Management

One should not overestimate or depend on the architect's duties at the construction-administration phase. The construction-administration provision in the typical AIA contract lacks substance. Architects are often reluctant to go to the site, oversee the project, interfere with the builders, or in any way keep the critical path moving.⁹ Moreover, the diocese may not want to rely on the construction-management clause of the general construction contract, which requires the general contractor to hire and oversee other contractors.¹⁰ Essentially, the diocese may not

⁹ See Justin Sweet, *Standard Construction Contracts: Some Advice to Construction Lawyers*, 40 S.C. L. REV. 823, 837 (1989) (stating that, under American Institute of Architects ("AIA") contract, architect may take passive role in construction phase and is not expected to conduct "intense inspections" until after work is substantially completed) [hereinafter Sweet, *Advice to Construction Lawyers*].

¹⁰ See Justin Sweet, *The Use of Standard Forms for Construction Management Contracts*, 18 REAL EST. L.J. 74, 85-89 (1989) (comparing treatment of construction manager responsibilities in forms published by AIA and Association of General Contractors) [hereinafter Sweet, *Standard Forms*].

want the architect or general contractor to be its representative overseeing the construction phase.

An alternative to the use of an architect or general contractor for this purpose is the increasingly popular concept of hiring a construction manager.¹¹ The diocese can use the construction manager to facilitate the direct privity between the subcontractors and the owner and generally manage the construction project.

Traditionally, however, the construction manager's contract does not incorporate the idea of the critical path. Therefore, if the diocese wants the construction manager or general contractor to have responsibility for critical-path planning, it must be incorporated into the general and management contracts. Though the scope of the construction manager's supervision may be limited if the construction-management contract does not incorporate the critical-path method, the use of a construction manager is generally less expensive than the use of the general contractor.

Where general and construction management contracts do not provide for critical-path planning, the diocese or archdiocese must have a construction management office—an in-house organization with at least one civil engineer to create the critical-path plan. It is essential to address the critical path in some way to keep within the project budget. In the Diocese of Arlington, there is an office of construction management with three qualified engineers that save the Diocese fortunes every day.

It should be noted that a construction manager that is under contract with the diocese will not insulate it from privity with the subcontractors for damages they may seek beyond their fees. For instance, the diocese may be exposed to large money damages caused by delay. However, it is a risk the diocese must take in return for using the cheaper, construction-manager scenario over the general-contractor approach. Opting for the lower price on the construction manager deal is not always desirable. The diocese must look behind the price and make a qualified decision based on covering issues beyond the mere price of the project. Nevertheless, the diocese should simply have someone in-house or on contract to crack the whip and be at the site everyday, rather than rely on the architect or general contractor to protect its interests in construction management.

2. Customizing AIA Contract Forms

Another basic concept which is often overlooked by diocesan attorneys is that the diocese, as a party to the contract, is free to bargain for

¹¹ See generally Sweet, *Standard Forms*, *supra* note 10, at 82-88. Sweet describes the "birth" of the construction manager: "a swaddling infant equipped with computers (critical path methods of scheduling, etc.) and applying the vaunted efficiency of the schools of business administration to the wondrously unmanaged construction process." *Id.* at 84.

the most favorable terms possible. While it is true that dioceses are essentially bound to use AIA forms,¹² these forms can be modified to reflect terms consistent with the diocese's interests.¹³

Simple changes can completely restructure the relationship between the architect and the diocese. Often, because the changes are on the basic AIA forms, they will be readily accepted by architects. However, it is important that modifications are conspicuous on all retyped AIA forms to provide adequate notice of the changes and avoid disputes over contract interpretation.¹⁴ This may include initialling changes in the margin or attaching a list of supplemental conditions that is incorporated into the contract.

Specifically, the Diocese of Arlington has had problems terminating architects, primarily because their standard contracts provided for liquidated damages upon termination. Also, the added costs of switching architects in midstream made such changes nearly prohibitive. As a result, the Diocese now tries to divide the architect's contract into five stages and make the contract terminable at the end of any one of the stages without penalty or liquidated damages.

In addition, dioceses should base payments on hourly wages, rather than a percentage of the final product. The Diocese of Arlington found

¹² See Sweet, *Advice to Construction Lawyers*, *supra* note 9, at 831. As Sweet observes, [o]ften it is assumed that the owner can dictate the contract language and choose any form he wishes. By the same token, the choice of form with which the contractor is unfamiliar or one that has a poor reputation can generate a price increase by the carefully pricing contractor and can create additional administrative burdens. These are some of the reasons AIA contracts have been so successful.

Id. See also John D. Hastie, *Architectural and Construction Contracts: The Developers Perspective*, 181 A.L.I.-A.B.A. 1721, 1725 (1993) (suggesting that, though developers are criticized for modifying AIA forms, such criticism pales when compared to refusals by architects and contractors to use any other form).

¹³ See Beverly M. Wolff, *Checklist for Construction and Architectural Contracts for Museum Buildings*, C479 A.L.I.-A.B.A. 361, 363 (1990) (stating that standard AIA forms provide better starting point than attorney could achieve independently, but suggesting that terms be revised and supplemented). *But see* Sweet, *Standard Forms*, *supra* note 10, at 81 (maintaining that use of customized construction contract forms results in greater drafting and negotiation costs).

¹⁴ See *Emor, Inc. v. Cyprus Mines Corp.*, 467 F.2d 770, 775 (3d Cir. 1972) (holding that, if party enters contract with reason to know other party attaches different meaning to contract, then first party is bound by meaning of other party); *Perry & Wallis, Inc. v. United States*, 427 F.2d 722, 725 (Ct. Cl. 1970) ("A party who willingly and without protest enters into a contract with knowledge of the other party's interpretation of it is bound by such interpretation and cannot later claim that it thought something else was meant."); *see also* Hastie, *supra* note 12, at 1725 (describing parties' lack of knowledge of AIA form provisions as major problem with enforcement of construction contracts as written); Sweet, *Advice to Construction Lawyers*, *supra* note 9, at 824 (suggesting contract interpretation problems are more difficult when contract is prepared by third party like AIA).

that payments based on a percentage tended to result in a windfall for the architect and often lead to a design that ran outside the parameters of the purposes, needs, and means statement. The best thing to do, if possible, is to convert a percentage fee into either a flat fee or a consulting fee based on hours worked, especially during the bubble and the block stages. Typically, the diocese will be able to defer flat or percentage fee compensation to the second and third parts of the design phase. Prior to that stage, the diocese still has the chance to decrease the size of the project or make needed changes without too much expense. Therefore, it will be to the diocese's advantage to retain the architect on a terminable, at-will hourly basis.

One provision that can save the diocese a lot of money stipulates that the architect acknowledges the budget for the project. If the lowest bid is above the budget, the architect agrees to redraft his plans to fit the budget at no extra cost. It is also important to confirm that the diocese has control over the final redesign.

Another AIA contract term that should be focused upon is the two-year requirement. This clause usually provides that, if the project is not completed within twenty-four months, all architectural services will be charged as additional services. Most dioceses only realize this term exists after they are charged for the delay. In one case in the Diocese of Arlington, as a result of an architect's error, the plan came in above the budget. Though the contract contained a clause requiring him to meet the budget at his own expense, it slowed the project and a half-developed Church site remained untouched for three or four years. When the diocese was finally prepared to return to the project, the architect pointed out the twenty-four month clause. His position was that everything would be double the price from that point on because the work had gone beyond twenty-four months. The diocese eventually arbitrated this claim successfully, but clearly there is potential danger with such a provision.

3. Architect Quality Control

A diocese can ensure it receives the high quality work for which it is paying by maintaining an "accepted" list of architects. It is important to note, however, that some dioceses using such lists have been threatened with litigation by architects who were removed from approved lists. In all likelihood, this is a frivolous claim, as there is no discrimination against a protected class, and the Church is a private institution. Nonetheless, disgruntled architects could attempt to form a legal argument

under a blacklisting theory.¹⁵ Therefore, before removing an architect from an approved list, one should have substantial justification for doing so which is memorialized in a manner that can be later used if necessary. While threats of litigation may never materialize, it is a good idea to take as many precautions as possible.

C. Buyer's Broker

Recently, it has become common for the real estate broker to have a legal duty to the buyer rather than the seller.¹⁶ However, these brokers will generally have had experience representing sellers, either as a listing agent or as a non-buyer broker for another party who had a duty to the seller. Because the buyer-broker has an elective position, this broker may have worked with another prospective purchaser prior to working with a diocese. For example, rather than work as a buyer-broker, he or she may have been a co-op broker which co-represented the seller with the listing broker, in which case his duties would have been to the seller. When the diocese enters into a contract with a buyer-broker, an inherent conflict of interest is created because the broker has had prior duties to the seller that may continue. This conflict may arise more often than seems likely, because brokers have a tendency to become familiar with a particular property, and, regardless of who expresses interest in that property, the brokers somehow get involved in representing that person.

The diocese may dispense with using a broker altogether to avoid brokers commissions. In choosing a piece of land, the diocese may want to conduct a parcel-by-parcel analysis that considers the property's physical characteristics and zoning and site development costs. An attorney can conduct this analysis under a normal retainer agreement with the diocese. A study conducted by the Diocese of Arlington on the last several properties it acquired suggested that the cost can be as little as one-tenth of the cost of using a broker. While the seller commonly pays the commission, that fee is actually incorporated into the property's sale price. Because, ultimately, the buyer pays for everything, it is imperative that acquisition costs be kept as low as possible. To the extent that the diocese locates the property through its own efforts, it can simply negotiate for a reduction in the price to reflect that the diocese is represented by its counsel, rather than a buyer's broker.

¹⁵ See, e.g., *Carel v. National Life Ins. Co.*, 603 F.2d 828 (10th Cir. 1979) (discussing blacklisting as antitrust claim); *Andrews v. Stearns-Roger, Inc.*, 602 P.2d 624 (N.M. 1979) (discussing blacklisting as derivative tort claim).

¹⁶ See generally 10 PATRICK J. ROHAN ET AL., *REAL ESTATE TRANSACTIONS: REAL ESTATE BROKERAGE LAW AND PRACTICE* § 3.03 (1994) (discussing broker's fiduciary duty created by contracting with buyer or seller).

Though this approach can be used regardless of whether the property is listed with a broker, there are many fine properties that are simply not listed. They may not even be for sale during the site-selection process. The main concern is to obtain property with the right physical characteristics, zoning, and low site-development cost in the target area. Where such property is not listed with a broker, the diocese can initiate contact with the owner to determine willingness to sell. Typically, when sellers find that the Church is a prospective buyer, they tend not to drive the price above the market rate.

D. Project Financing

Dioceses have developed internal or intra-bank systems in recent years. Based on assessments of various juridical persons within the diocese or archdiocese, there is a depositary available that earns interest at a given below-market rate. As there is little or no spread aside from the actual administrative costs of the intra-bank, there is always a below-market interest rate on the borrower. The borrower is required to be a juridical person within the diocese or archdiocese. This money is available as a source of funds for the acquisition, development, and construction of Church-related facilities. In fact, recently, the interest rate on investments is higher than normal market rate and outside investors have asked to put their money into the diocesan investment loan account to get the benefit of the higher rates.

Of course, there are also traditional methods of financing, such as borrowing from commercial banks and providing required guarantees. However, because civil law incorporates, either implicitly or explicitly, the canon law polity of rules and regulations of the Catholic Church, legal opinion letters are now required by commercial banks in order for loans to be processed to Church-related organizations.¹⁷ Whereas traditionally it was sufficient to present a simple certificate stating that the diocese was in compliance with the laws of its polity, it is now necessary to produce an actual legal opinion attesting to conformance with the rules of the local polity. It is often questioned whether civil lawyers have the right, duty, competence, or authority to render a letter that is more or less a canonical legal opinion. Presumably, a diocesan canon lawyer would be the best person to prepare such an opinion.

It is difficult to accustom oneself to the concept that written legal opinions by canon lawyers must be incorporated into a civil legal opinion in order to obtain funding for Church-related construction activities. Civil opinion letters are a potential source of malpractice liability, and

¹⁷ Cf. THE CODE OF CANON LAW, *supra* note 2, at 875 (suggesting that, if civil documents are "properly constructed, they will require that all canons and regulations of the Roman Catholic Church must be followed" (referring to 1983 CODE c.1281)).

therefore require considerable waivers and disclaimers.¹⁸ This liability may not be as widespread under canon law due to the fact that there are no comparable sanctions under canon law. On this basis, a canon lawyer might be more inclined to render such an opinion. Moreover, because canon law is more open to interpretation than civil law, it may be more difficult for a canon lawyer to commit malpractice. On the other hand, because the canonical opinion letter is such a recent development, it is difficult to find someone who is experienced at writing these opinions, or even able to understand the exact nature of the information sought. There is reason to believe, however, that such letters will eventually become commonplace, especially if commercial bank lending becomes dependent upon them.

CONCLUSION

In conducting Church real estate transactions, diocesan attorneys must be driven by valid canonical acts that are implemented in civilly valid ways. Though each transaction will certainly differ in its own way, hopefully, some of these fundamental concepts will allow dioceses to maximize their interests when acquiring and holding Church property.

¹⁸ See generally 2 M. JOHN STERBA, DRAFTING LEGAL OPINION LETTERS 147-247 (1992) (reviewing liability connected with legal opinion letters).

