

When Churches Face Foreclosure

By Phil Hall on Wednesday 31 October 2012



REQUIRED READING: On Aug. 8, Pastor Steve Munsey addressed his congregants at the Family Christian Center in Munster, Ind., with some very serious news: the church owed \$750,000 in back payments on its mortgage and was facing foreclosure.

The story of the church's problems might seem unusual, if only for the prominence of its subject: Family Christian Center is among the largest congregations in the U.S., and Munsey has been a familiar national presence through commentary and interviews in the mainstream media and by his frequent appearances on the internationally broadcasted program "This is Your Day." However, the problems facing Family Christian Center are anything but unusual.

Since 2010, 270 churches have been sold after defaulting on their loans, according to data compiled by CoStar Group, and 90% of those sales resulted from lender-initiated foreclosures. In comparison, only 24 such sales took place in 2008, while barely a handful of church foreclosures were recorded in the previous 10 years.

In many ways, the spate of church foreclosures can be seen as part of the wider net of economic problems that have plagued the country.

"The essential problem is that churches are caught up in the same real estate bubble as was housing: overvaluation," explains Dr. Gregory Price, chairman of the department of economics at Morehouse College in Atlanta. "Many churches borrowed excessively because of these inflated values. When the financial crisis hit, many parishioners lost their jobs, thus reducing their ability to service the church debt through gifts and tithing."

However, church foreclosures represent a myriad of distinctive challenges that rarely show up with other properties. For default servicers, these challenges can, to borrow a Biblical analogy, require Job-like patience to handle.

For starters, church foreclosures data show no preference to denomination. Michael M. Sandez, associate professor of law at Liberty University School of Law in Lynchburg, Va., notes that it

can be easier to deal with an independent church rather than a congregation that is part of a larger organized religion.

"A local independent church is most likely formed as a nonprofit corporation and is, thus, likely to be the sole owner-borrower," says Sandez. "However, if the local church is part of a hierarchical denomination, then the servicer needs to find out which entity is actually on title - the local church or the national denomination. It is possible that notices of default will need to be sent to both entities."

Sandez adds that default servicing efforts on this property are most successful if they begin with person-to-person communications, rather than with form letters.

"Christian churches are relationship-centered and -motivated," he continues. "While it may be necessary to notify the church in writing at some point, the initial contact should be personal. I think this is in the best interest of both the church and the mortgagee, as it will engender cooperation and communication."

Sandez also stresses that the servicer should not automatically assume that the church's leadership has expertise in financial management.

"The mortgage servicer might want to recommend a financial adviser to sort out the church's poor financial management, assuming that is the case," he continues. "The thought here is that the delinquency could be rectified with an adjustment in the budget or other steps. In other words, it may behoove the servicer and mortgagee to treat this type of church along the lines of residential loan, in that the borrowers are not assumed to be financially sophisticated, which is often the assumption with commercial loans."

However, there could be a problem that is not common with other commercial properties facing default. Joseph Posavec, a former loss-share consultant with the Federal Deposit Insurance Corp., points out the question of the loan's borrower guarantor - or, more specifically, the lack thereof.

"Many times, there is no borrower guarantor," says Posavec, general manager for sales and business development at Ein-Sof Global, an Aliso Viejo, Calif.-based developer of commercial loan portfolio management software. "Often, the minister won't guarantee it. And very often, there is no guarantor involved at all."

Complicating matters further is the length of the troubled loan. Unlike residential mortgages that can run 15 or 30 years, churches have mostly taken out loans with a five-year payback.

Adam Leitman Bailey, a New York-based real estate attorney and law professor at New York University, observes that many of the church mortgages that went sour were originated in years prior to the start of the economic meltdown.

"Before 2008, a monkey could get a loan," he says facetiously.

Prior to the 2008 crash, there was also a small but vibrant niche market of lenders that focused almost exclusively on financing church properties. One of the most prominent was Strongtower Financial, a Fresno, Calif.-based division of the California Baptist Foundation, which made history in 2006 with the first-ever securitization of church bonds with a \$56.3 million offering.

But two years after its securitization, according to a USA Today report, Strongtower Financial's prospectus reported that 10% of its \$119 million in outstanding loans were in default as of March 31, 2008. The passing years saw the lender's problems increase, and in April, the California Baptist Foundation announced that it would dissolve Strongtower Financial by the end of the year.

Seeking another path

Unfortunately for the churches that face foreclosure, the current regulatory environment does not encourage lenders to cut the borrowers generous amounts of slack.

"Lenders are being forced to clean up their portfolios," says Posavec. "Before, they were very comfortable sitting on it and not touching non-performing loans."

Of course, there are alternatives to foreclosure. **Bailey** recalls his legal involvement in cases where churches avoided foreclosure by selling their properties. However, he adds, those churches were based in New York, and state law added an extra hurdle to that solution.

"A lot of times, we had to deal with the state attorney general's office," he says. "As nonprofits, they cannot sell their buildings without the attorney general's approval."

But selling a church is not as easy as selling a house.

"There are start-up churches in shopping malls or local hotels, but they do not have the financial ability to acquire a church building," observes Dr. Linda M. Hooks, professor of economics at Washington and Lee University in Lexington, Va.

"There are a limited number of prospects," adds Todd Whittaker, president of Service Realty Inc. in Denver. "Most churches are set in a particular area. They do not normally move from the east end of town to the west end of town."

However, Whittaker offers another alternative to foreclosure: seeking refinancing from other lenders.

"I've seen it happen from time to time," he says. "There is a possibility to move the loan to another bank."

But Morehouse College's Price states that this option is becoming increasingly unlikely.

"As banks are currently not aggressively lending or refinancing because of high inventories, foreclosure becomes more attractive than carrying these loans on the book," he says.

Yet Brian C. Coester, CEO of Rockville, Md.-based Coester Valuation Management Services, suggests that private entities outside of the financial services industry could possibly provide some degree of salvation.

"You could find a private buyer or a private donor that would be willing to buy the property for the church, which happens very frequently," he says.

"I have seen a private company that will either buy the note or pay off the note and come to an arrangement with the defaulting church," says Liberty University's Sandez. "This company is in the construction business and chooses to help out churches that are financially struggling and can prove they are a legitimate Christian ministry. At times, the company obtains title to the property and leases it back to the church. At other times, the company and the church enter into a payment plan that is manageable for the church until it is able to become financially stable, at which point the payments are increased."

Stop the press!

But as the past few years have shown, many churches are not able to secure a viable escape from their dilemma. As a result, foreclosure proceedings begin, albeit with reluctance.

"I don't think any lender wants to take property," says Mark Berry, senior commercial real estate strategist for the CoStar Group's property and portfolio research division. "But at some point, they have obligations to their shareholders."

On the flip side, some churches are not willing to give up their property without a loud fight. For example, in March, the 194-year-old Charles Street African Methodist Episcopal Church in Boston declared bankruptcy after it was threatened with foreclosure by its lender, Boston-headquartered OneUnited Bank. The church's pastor, Rev. Gregory G. Groover, proactively took his case to the media.

"This is our loan, and we own it," Rev. Groover said in an interview with the Boston Globe. "We want to pay it back, and we think there is a reasonable way to do that. This will be wonderful news for the city, that these institutions can work it out."

The church's decision to take its case to the court of public opinion via the mainstream media is not unusual - news about churches facing foreclosure or being foreclosed upon tends to percolate very quickly. And for the servicing industry, which is barely recovering from negative press coverage during the past few years, a new headache is created when the news spreads that a servicer is trying to shut down a house of worship.

"This is the worst possible scenario for a financial institution," says Hooks. "And it will draw news coverage because it is still pretty unusual for this to happen."

Brian Rieger, principal with the Broadview Heights, Ohio-based public relations firm True Impact Communications LLC, warns servicers that the presence of the press needs to be handled with the utmost sensitivity.

"Any good reporter will be looking for the ugly angle," he warns. "Once a story breaks, don't hide or send out lawyers. Have a competent, articulate spokesperson expressing sympathy for the church, but have the spokesperson clearly state the lender's point of view. People will sympathize less with servicers who hide."

"It is a PR nightmare," says Price. "You don't want to be seen as being insensitive to those who are doing God's work on Earth."

Indeed, OneUnited Bank learned that the hard way. The bank was already in the midst of press scrutiny as the financial institution in the congressional ethics probe of Rep. Maxine Waters, D-Calif., and for controversy surrounding news reports that it used bank funds to finance an \$880,000 Miami Beach condominium and lease a \$26,500-a-month mansion for its chairman and CEO, Kevin L. Cohee. Boston political leaders including Mayor Thomas M. Menino and U.S. Sen. Scott Brown publicly came out in favor of the church, further isolating the bank. When the church's case reached bankruptcy court last month, it received extensive local news coverage.

Taking over a church

In the event that a church is foreclosed upon and the servicer is spared rancorous publicity, a new challenge arises: what should be done with the property? Coester notes that appraising this type of commercial structure could require an extra degree of effort.

"A church is not terribly difficult to appraise," he says. "Most zoning in the U.S., regardless of classification, allows for a church to be built on the land - so you are almost able to put one anywhere. The main problem with churches is that they are typically continually growing and expanding, so having excess land that can be built upon and large parking lots that are adjacent to property can add significant value to a property.

"Another problem with churches is that they turn over very infrequently," Coester adds. "As an appraiser, you have to go back three to 10 years to find comparable sales which sometimes, at best, are below average. A good appraiser will look at the use of the church in its current state, so considerations such as how many people can sit in the church, classrooms and recreation facilities - as well as the future potential use for expanding the property on the land tract - is almost as important as the church building itself."

Posavec points out that churches that do not have the traditional architecture associated with the property have, traditionally, been easier to resell.

"From 2000 to 2008, a lot of banks made the decision not to lend on church properties with a steeple," he says. "They preferred a building that did not look like a church because they knew it

would be difficult to sell the property if it was foreclosed on. A lot of the churches seeing foreclosure today are the non-steeple type. If the average lender sees a bell tower, he could be reticent to take it back."

Bailey adds that unless the property is in an advanced state of disrepair, the servicer will most likely be in possession of an excellent structure.

"These are extremely valuable buildings, beautifully built with high ceilings," he says. "People build best when they are doing it for God."

For the near-term future, this problem might be abating: CoStar Group's Berry reports that the first half of this year saw only 36 churches foreclosed upon. To prevent a reprise of this situation, Bailey warns lenders and servicers to be more proactive in dealing with this type of borrower.

"The key is prevention," he says. "Before you make a loan, read the church's finances and check the litigation databases for disputes. Many times, as churches get older, they have internal fights, and they stop paying their bills."

And, ultimately, Rieger advises servicers to handle this niche market with the level of professionalism expected from the industry.

"Treat the church like any other customer - with dignity," he says.