



UNIVERSITY DISTRICT

ECUMENICAL CAMPUS Coalition

Draft Ownership & Governance Plan

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UDECC - Draft Ownership & Governance Plan

Introduction

For the past year, the UDECC Board has grappled with how several churches might enter into a joint initiative to form and thrive in a new, shared facility. This document represents the Board's work in determining what principles should govern that group of churches. In developing and revising these principles, the Board has sought to balance the interests of each prospective member congregation with the interests of the collective group.

During the process, the Board has been advised by UDECC's counsel, Perkins Coie, on the legal and tax implications of this imagined joint initiative. As the Board releases this set of principles to the member congregations for review, study, and further refinement, Perkins Coie will develop these principles into a draft "Term Sheet," a more formal expression of the rules that would govern the joint initiative, intended for the legal counsel or professional advisors of each prospective member congregation. The Board hopes to release the draft Term Sheet in mid-November.

The Board has set a deadline of December 12 for receiving feedback on this draft of the Plan. Please review it carefully, begin preparing any feedback you might have for the Board, and, in the mean time, feel free to raise any questions to the Board.

Defining Terms

For the sake of clarity, we have adopted the following usage of terms in describing the UDECC Ownership and Governance Plan (the "Plan"). While UDECC refers to the currently existing body created to study the feasibility of multiple church congregations selling current church properties and building a new, shared facility, we also use the term UDECC to refer to the future organization of congregations that would actually execute the Plan. We refer to the member congregations and campus ministries that ultimately commit to the Plan as "member organizations." This term refers to the church and campus ministry entities themselves.

The Plan contemplates the construction of a development project that will be divided as a commercial condominium into several condominium units. One of those condominium units will be retained and managed by UDECC as the shared worship and ministry space for the member congregations and possibly for non-member (or "non-equity") congregations. We refer to this condominium unit as the "religious unit." It includes all church administrative, worship, fellowship, education and campus ministry facilities, and associated common areas. We refer to the other units, whether sold or leased to other nonprofit, commercial, retail, or government owners or tenants, as "commercial units."



Proposed Principles

1. Formation and Initial Investments in UDECC

- a. UDECC will be an entity wholly owned by the member organizations.
- b. UDECC, as an entity, will own the religious unit and any commercial units retained for lease, and the member organizations will own the religious unit and any retained commercial units indirectly through their ownership of UDECC.
- c. Member organizations will own UDECC in proportion to their equity investment as a share of all contributions by all member organizations.
- d. Initial member organizations must make their equity investments in cash. UDECC will not be responsible for liquidating the real properties of member organizations. In the case of a member organization's existing church property that is to be integrated into the UDECC development, the property will be valued equitably with at least two official appraisals, one paid for by UDECC and one paid for by the member organization.

2. Core Ownership and Governance of UDECC

- a. UDECC will be managed by a Board consisting exclusively of member organization-appointed representatives.
- b. Seats on the Board will be allocated to member organization-appointed representatives roughly in proportion to the member organization's investment. The Board shall be limited to a manageable size. The Board will provide for governance by delegation to Committees, as it deems appropriate.
- c. Actual decisions ("votes") will be weighted directly in proportion to interests held by each member organization. Each member organization must vote its interest as a block and must determine how its board representatives will cast its interests for each vote. Votes may at times need to be tabled so that board members can receive direction from their organizations' leadership.
- d. Provisions will be made to ensure that no member organization's equity investment, either initially or through subsequent increases in the member congregation's investment, will permit that member organization to control UDECC.
- e. Member organizations will be prohibited from borrowing against their ownership interest in UDECC or using their ownership interest to secure any debts incurred by the individual member organizations.
- f. The Board will have direct oversight over paid staff responsible for facility management and operations (see Section 9, below).



3. Admission of Additional Member Organizations

- a. Membership in UDECC will be limited to Christian, worshiping communities with 501(c)(3) tax-exempt status.
- b. New member organizations must contribute equity in cash. This contribution will result in a percentage of ownership proportional to the value of shares held by the existing member organizations as equitably determined by an appraisal of the value of UDECC at the time of the new contribution. New equity contributions will be allocated to the existing member organizations in proportion to their ownership interests.
- c. Admission of a new member organization will require unanimous approval of the existing member organizations. An existing member organization may abstain from a vote to admit a new member organization for any reason or for no reason without blocking the new member's admission. Only a negative vote by a member organization will block the new member's admission.

4. Increase in Existing Member Organization's Investment

- a. An existing member organization may increase its equity investment in UDECC with a cash investment. Additional equity purchased by a member organization will result in a proportional adjustment in shares held by all member organizations. New equity contributions will be allocated to the existing member organizations in proportion to their ownership interests.
- b. The consent of two-thirds of all membership interests is required to permit an existing member organization to increase its equity interest.

5. Reductions or Withdrawal of a Member Organization

- a. While member organizations will generally be permitted to reduce their investments or withdraw from UDECC, they will not be permitted to do so during the construction phase of the project, as such reduction or withdrawal could irreparably harm the other member organizations. Provision will be made for when reductions in equity or complete withdrawal by a member organization will be permitted.
- b. A reduction in the equity held by an individual member organization would necessitate the sale of some or all of that member organization's interests. Such a sale would proceed as follows:
 - First Option: The existing member organizations would be given the opportunity to purchase the available shares collectively, in proportion to their existing shareholdings, thereby maintaining the proportional distribution, but increasing the value of each member organization's holdings.
 - Second Option: If the existing member organizations do not agree unanimously to purchase the available shares collectively, according to the First Option, one or more



individual member organizations may elect to purchase the available interest. In this option, member organizations who withheld their agreement to the First Option would be excluded from participation in the Second Option, except as agreed to unanimously by the other member organizations.

- Third Option: If no existing member organizations agree to purchase the available shares under the First or Second Options, above, the member organization wishing to reduce or eliminate its position may offer its shares to an outside organization (or organizations) meeting the criteria outlined in Section 3, above. In this option, the remaining member organizations must vote unanimously to approve the new member organization, which approval may not be unreasonably withheld. In the event that a member organization believes that approval of a potential sale is being unreasonably withheld by other member organization(s), it may then seek recourse through dispute resolution mechanisms to be developed (per Section 11, below).

6. Resident Non-Member Worshiping Communities

- a. Provision shall be made for the long-term use of space by non-member organization worshiping communities on a case-by-case basis as well as for short-term rental to other parties. Rental fees shall be allocated per Section 10, below. The Board may provide for participation of the non-member worshiping community in the operation of UDECC in a non-voting capacity.
- b. Non-member worshiping communities will be accommodated in the religious unit's administrative center on a space-available basis.
- c. If an existing member organization withdraws its investment, it may negotiate to continue to operate its ministry at the religious unit as a rent-paying tenant.

7. Disbanding of a Member Organization

- a. In the event of the dissolution of a member organization, that member organization's shares will become the property of the appropriate regional body associated with that organization, if one exists and controls the assets. The regional body may:
 - Elect to retain ownership in the shares, with full rights to participate as a member organization;
 - Elect to assign its interest in the shares to another worshiping community qualified under the terms of Item 3a, above, and subject to the unanimous approval of the existing member organizations, as provided in Item 3c above; or
 - Elect to reduce or withdraw its ownership of the shares according to the terms outlined in Item 5b, above.
- b. If no such regional body controls the assets, the disbanding member organization's shares shall be sold under the terms of Item 5b, above.



8. Removal of a Member Organization

Provision shall be made for the circumstances under which a member organization may be expelled. Expulsion will be permissible only in extraordinary circumstances in which one member organization's continued participation in UDECC threatens the integrity and viability of ministry of the other member organization(s). Expulsion will require unanimous consent of the other member organizations.

9. Management and Operation of the UDECC Facility

- a. The Board will establish policies to guide decisions on items such as appropriate tenants and outside renters, and rules of conduct for tenants and renters.
- b. The Board will establish policies to define appropriate usage of worship spaces by outside users, and will work to resolve other issues that may be at variance between member organizations. All member organizations share the goal of maximizing the use of the facility (and maximizing revenues accordingly) by seeking suitable nonprofit organizations who will pay to use facilities throughout the religious unit, including worship spaces, classrooms, dining facilities, meeting rooms and other facilities.
- c. The member organizations will always have primary use of UDECC-owned religious facilities for their ministries, and scheduling will always favor the member organizations over other users.
- d. Member organizations will be assessed a usage fee allocated fairly among the member organizations in proportion to their use of the facility to cover expenses of operating the facility. Generally, usage fees will differ based on size of worship space and amount of other space (private office space, for example) dedicated to the exclusive use of a particular member organization.
- e. The facility will be managed and staffed by persons with professional expertise in property management, facilities operation, maintenance and security. Staff will also have expertise in marketing and managing the use of the facility by compatible outside users.
- f. Staff will also have expertise in special event production, particularly with regard to memorial service and wedding coordination, and the facilitation of programming by member congregations, tenants and renters.
- g. The Board will approve covenants with purchasers of commercial condominiums within the project, to govern their operations to the satisfaction of the member organizations. (Such negotiations will have to balance the value of such limitations against the potentially reduced value of the commercial condominiums due to the imposing of such covenants.)



10. Allocation of Revenues

- a. Gross revenue includes the following:
 - Revenue received in usage fees paid by member organizations (see Item 9d, above)
 - Revenue from parking garage operations
 - Revenue received from rental of UDECC facilities to outside users
 - Revenue from tenant leases
 - Revenue received from investments of reserve funds
 - Other revenue generated from facility ownership and operations
- b. UDECC facility operating costs will first be deducted from gross revenue. Facility operating costs include routine maintenance, insurance, taxes, utilities, condominium association fees, marketing, general office expenses and associated staff.
- c. A “Capital Reserve Fund” will be maintained to hold and invest capital for future building repairs and improvements.
- d. In addition to the Capital Reserve Fund, the Board may borrow to fund building repairs or improvements.
- e. The UDECC Board will maintain an operating reserve fund as a contingency for operating expenses.
- f. A percentage of net revenue will be deducted for the purpose of establishing and funding the “Ecumenical Campus Mission Fund,” to fund grants to the community. Distributions from the Mission Fund will be made at the discretion of the Board.
- g. All remaining net income will be divided among the member organizations in direct proportion to their shares in the corporation.
- h. Net income shall be allocated to each member organization’s account or distributed annually, at the close of the fiscal year.

11. Resolving Disputes Among Member Organizations

Provision will be made for a series of processes to resolve disputes among member organizations in a manner consistent with the Christian and ecumenical spirit of the UDECC endeavor, designed to avoid litigation in the judicial system.

12. Dissolution

UDECC will dissolve if member organizations representing a majority of the interests in UDECC determine that they will withdraw from UDECC and there is no agreement among the member organizations for transfer of the withdrawing member organizations' interests under Item 5b. UDECC will then liquidate its assets, and the member organizations will receive distributions from UDECC in proportion to their ownership interests.



TO: UDECC Board

FROM: Perkins Coie UDECC Team

RE: **Legal and Tax Implications of UDECC Governance and Ownership Plan**

Overview

As joint ventures become increasingly common in the nonprofit sector, UDECC's collaborative vision, in the context of religious organizations, is relatively unique. While prospective member organizations will face a variety of unknowns and uncertainties as they contemplate whether to become a participant in the UDECC vision, they can and should fully understand how their participation will affect their own legal identity, tax-exempt status, capacity to receive deductible tithes and contributions, and mode of operation. Our guidance here is not intended to be conclusive but should instead serve as a framework that each prospective member organization might carefully review with its legal and tax advisors.

Nonprofit Joint Ventures and Independence of Members

Nonprofit joint ventures appear in all forms. Many joint ventures are simply contractual relationships among the participating organizations. Some take the shape of a new corporate entity in which each participating organization is a part owner. In either case, the participating organizations can maintain their status independent of the joint venture.

The UDECC vision generally contemplates a joint venture among 501(c)(3) religious organizations. Each organization will continue to maintain its separate legal identity and its system of committees, councils, boards, and interaction with regional church bodies. The primary difference is that each member congregation will no longer own and be separately responsible for its own church building and real property. Instead, each will own and be jointly responsible in the management of the joint venture.

Organization Through a Limited Liability Company

Limited liability companies ("LLCs") are the most flexible of corporate entities available under Washington law, and they are well suited to the kind of joint venture that takes shape in the UDECC Ownership and Governance Plan. The member organizations can form a single LLC with their equity contributions, and the LLC can own and govern the religious space in the new development. Each member congregation would own an interest in the LLC proportionate to its contribution, and the LLC agreement would codify the Ownership and Governance Plan.

Federal Income Tax Status

Under section 501(c)(3) of the federal tax code, churches are exempt from income tax because they engage solely in religious, charitable, and educational purposes. As a result, contributions to churches are deductible charitable contributions. There are a few things that churches can do to lose their tax-exempt status. Participation in a political campaign, for example, disqualifies a church



from exempt status. Devoting substantial activity toward a non-religious, non-charitable, and non-educational purpose can also jeopardize a church's exempt status. While a church can engage in trade or business activity that is unrelated to its exempt purposes, the activity cannot be a substantial activity of the church. In addition, income derived from such trade or business activities, when not subject to limited exceptions, is taxable under what is called the unrelated business income tax.

Participation in a joint venture alone does not jeopardize a church's tax-exempt status. The IRS scrutinizes joint ventures when there is opportunity for a non-exempt business or individual to benefit at the expense of a nonprofit participant. When joint ventures involve exclusively nonprofit organizations, as with UDECC, IRS scrutiny and the risk of loss of exempt status is not more significant than if the organization conducted the joint venture activity (in UDECC's case, ownership and operation of a church building) on its own.

On the other hand, developing commercial condominium units for sale or lease is not an exempt purpose. If a church developed a commercial condominium project and sold the condominium units, income from the sales would likely constitute unrelated business income subject to tax. If the development and sale activity was substantial, the church's tax-exempt status could be in jeopardy. A common strategy for nonprofit organizations to protect their tax-exempt status in such circumstances is to create a separate non-exempt corporate subsidiary to conduct the trade or business activity. Because of the contemplated scale of the project, UDECC should probably create a separate non-exempt subsidiary to develop the project.

The UDECC Plan also contemplates that the member congregations may retain an ownership interest in one or more condominium units not reserved for religious activity but intended instead for lease at market rates to unrelated commercial or nonprofit tenants. Commercial rent from a church's real property is generally excluded from unrelated business taxable income as long as the church does not provide services other than those usually or customarily rendered to commercial tenants and as long as the property is owned outright and not debt-financed. Here, UDECC may own real property free of debt that it leases to unrelated tenants for commercial activities without incurring unrelated business income tax or jeopardizing its 501(c)(3) status.

Local Property Tax Implications

In Washington, churches are exempt from property taxes. Specifically, the law exempts "all churches, personal property, and the ground, not exceeding five acres in area, upon which a church of any nonprofit recognized religious denomination is or shall be built." Churches must use their property "wholly for church purposes" to qualify for the exemption, but there is an exception for churches that rent property to nonprofit organizations for charitable activities. So long as the rental income is devoted to the operation and maintenance of the property, the property is still considered "wholly used for church purposes." "Church purposes" is broadly defined to include worship, administrative, educational, eleemosynary, and social activities.

Here, the religious unit itself would probably constitute a "church" for property tax exemption purposes. The Washington Board of Tax Appeals has recently interpreted the church exemption in two decisions involving church property owned through LLCs. These decisions suggest that the religious condominium unit owned by UDECC as the Plan envisions would be exempt from property taxes, but the position is not yet well established. We would encourage UDECC to seek an advance



ruling from the state to provide sufficient assurance that the UDECC religious space would qualify for the exemption. Exemption does rest, however, on the use of the space "wholly for church purposes." If UDECC rents its religious unit to a for-profit organization, UDECC may not qualify for the property tax exemption. Also, if UDECC retains commercial units to lease to commercial tenants, such property will not qualify for the church property tax exemption and will likely be subject to property tax.

Summary of Entity Recommendations and UDECC Operation

Having analyzed the Ownership and Governance Plan UDECC has developed in light of the legal framework described above, we have proposed a series of new entities through which UDECC might best carry out this vision. First, member organizations would create a UDECC LLC; this would be the core entity through which the member organizations govern themselves and conduct ongoing activities. Second, this UDECC LLC would create a wholly owned corporate subsidiary, the primary purpose of which would be to develop the new commercial condominium project. In the course of developing the project, this development subsidiary would create a third entity, a condominium association, through which the condominium owners would manage the entire new facility. The development subsidiary would finally sell commercial condominium units to third-party buyers and distribute the religious condominium unit to its corporate parent, the core UDECC LLC.

When the UDECC LLC takes ownership of the religious unit, it would then manage the unit according to the Ownership and Governance Plan as codified in the LLC agreement. It would also be a co-owner of the condominium association. As a co-owner, the UDECC LLC would be responsible for its allocation of dues for the common expenses of the development. Member organizations of the UDECC LLC would be responsible for their share of these dues and the UDECC LLC's other expenses as provided in the LLC agreement.

Attached are diagrams of the entity relationships.

