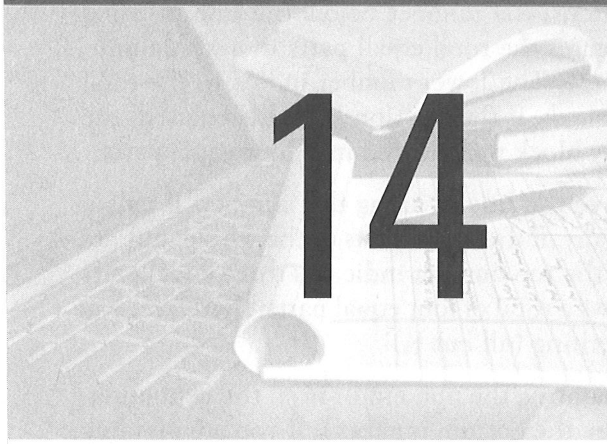
UNIT



14 REAL ESTATE–RELATED COMPUTATIONS AND CLOSING OF TRANSACTIONS

LEARNING OBJECTIVES

When you have completed this unit, you will be able to accomplish the following.

- Compute the sale commission.
- Calculate the percent of profit or loss, given the original cost of the investment, the sale price, and the dollar amount of profit or loss.
- Define settlement and title closing and list the preliminary steps to a closing.
- Prorate the buyer's and seller's expenses.
- Calculate the dollar amount of transfer taxes on deeds, mortgages, and notes and compute individual costs, allocating the transfer taxes and costs to the proper parties.
- Explain the rules of thumb for closing disclosure entries.

KEY TERMS

arrears	debit	profit
credit	preclosing inspection	proration

INTRODUCTION

Real estate brokers and sales associates must understand closing disclosures and should be capable of computing the various simple arithmetic problems to be solved in arriving at the figures entered on the closing disclosures provided to the contracting parties. Many adults have had little or no occasion to work with fractions, decimals, percentages, and the like for years.

14.1 WORKING WITH NUMBERS REVIEW

Fractions, Decimals, and Percentages

When a whole unit or number is divided into equal parts, each of the parts is a fraction (and a percentage) of the whole unit. For example, if a city block is divided into two equal parts, each of the parts is ½ (or 50%) of the city block.

Parts of a Fraction. When dealing with fractions, the number below the line is called the *denominator*. The denominator always indicates the total equal parts in a whole unit. In the example of the city block, each part was ½. The lower number indicates the total number of equal parts (two) in the entire city block. If the fraction ¼ had been used, the denominator would have indicated that the city block was divided into four equal parts.

The number in a fraction that appears above the line dividing the numbers is called the *numerator*. The numerator indicates how many of the equal parts of the whole unit are being counted. For example, in the fraction ¾, the top number indicates three equal parts are being counted, and the bottom number shows a total of four equal parts: therefore, you are talking about all but one equal part of something (all but ¼).

Changing Fractions to Decimals. The line separating the numerator from the denominator means division (the top number is divided by the bottom number). If you are dividing a fraction using a calculator, enter the numerator first, then press the division key, followed by the denominator. For example, in the fraction ½: press 1, followed by the division key, then press 2. Press the equal sign key (=) and the answer displayed is 0.5. You have now converted (changed) a fraction (½) into a decimal number (.5).

Changing Decimals to Percentages. To change a decimal number to a percentage, move the decimal point two places to the right and add the percent sign (%) (this is the same as multiplying the decimal number by 100). If only one decimal number is involved, add a zero to the right of the number.

EXAMPLES: .5 = .50 = 50%

1.5 = 1.50 = 150%

Changing Percentages to Decimals. To change any percentage to an equivalent decimal, simply place a decimal point two places to the left of the number and drop the percent sign (this is the same as dividing the percentage figure by 100).

EXAMPLES: 34% = .34

150% = 1.50

If only one number is involved, add a zero to the left to permit moving the decimal point two places to the left.

EXAMPLE: You want to calculate in dollars the 7.5% commission on a house sale price.

Convert the fractional part of the decimal number:

½% = 1 ÷ 2 = .5

Next, convert the entire commission percentage to a decimal number.

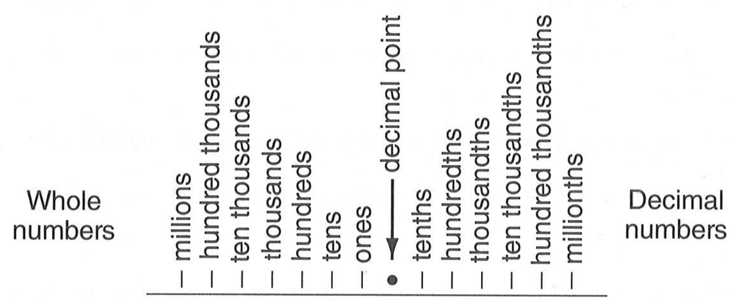
7½% = 7.5% = .075

Thus, the decimal number .075 is used to calculate the sale commission. Assume the sale price is $130,000. Calculate the commission.

$130,000 × .075 = $9,750

Decimal Place Values. A great deal of the basic arithmetic required to compute routine real estate problems involves decimal numbers. This review of decimals will be more meaningful if you refresh your memory of the decimal system of place values and the importance of the decimal point in separating whole numbers from fractional parts of whole numbers. The chart of decimal place values in Figure 14.1 should be memorized if you do not already know the place values. Notice that the *whole numbers* are to the left of the decimal point. The *decimal fractions* of a whole number are to the right of the decimal point.

FIGURE 14.1 ■ Decimal Place Values



Working With Decimals. To divide a whole number by a decimal—for example, 41,500 divided by 1.85, first enter 41500 into your calculator, press the division key, then enter 1.85. When you press the equal sign key, the answer will appear in the display, as demonstrated in the illustration.

Calculator Method:

41,500 ÷ 1.85 =

Press	*Display*
4 then 1 then 5 then 0 then 0	41500
÷ (the division key)	41500
1 then . then 8 then 5	1.85
= (equals sign)	22432.432

EQUIVALENT UNITS

Percentage	Fraction	Decimal
100%	100/100	1.00
50%	50/100	.50
6%	6/100	.06
½%	.5/100	.005
¼%	.25/100	.0025

SALE COMMISSIONS (PROFESSIONAL SERVICE FEES)

Real estate professionals usually receive payment once a property has successfully sold. The terms of payment are agreed upon by both parties in a contract. The listing agreement is negotiated between the seller and the listing broker, while the buyer's representation agreement is between the buyer and the selling broker. These agreements determine the commission or professional service fees paid to the listing and selling brokers. The parties involved can renegotiate to reach a mutual agreement to complete the property sale successfully.

Formula: Sale Commission

sale price × commission rate = total commission

total commission × percentage to listing brokerage = listing commission

listing commission × listing sales associate percentage = listing sales associate commission

total commission × percentage to selling brokerage = selling commission

selling commission × buyer's sales associate percentage = buyer's sales associate commission

Let's begin with an example of a commission calculation. In this example, the property is listed and sold by the same sales associate.

EXAMPLE: Suppose a broker's listing agreement specifies that a 6.5% commission is to be paid on the sale price. A sales associate for the firm lists and sells the property and is to receive 55% of the 6.5% sale commission. How much will the sales associate earn after selling the property for $62,000?

Step 1: Find the total sale commission.
$62,000 sale price × .065 rate = $4,030 total commission
Step 2: Find the sales associate's commission.
$4,030 total commission × .55 split = $2,216.50 sales associate's commission

It is common for a property to be listed with one brokerage company but sold by another. The commission for each brokerage may be specified in different ways in the listing agreement or buyer's representation agreement. In the example below, the parties in the transaction agreed the seller would offer a portion of the commission to the selling broker.

EXAMPLE: A broker's listing agreement specifies that a 7% commission is to be paid on the sale price. The agreement specifies a 50-50 split between the listing and the selling offices. If the property sells for $100,000, how much commission is earned by the listing and the selling offices?

Step 1: Find the total sale commission.
$100,000 sale price × .07 rate = $7,000 total commission
Step 2: Find the selling and listing office's split.
$7,000 total commission × .50 split = $3,500 selling/listing office commission

The selling commission is typically shared between the broker of the selling office and the sales associate who works for the selling office that found a buyer for the property. The same is true for the listing office and the sales associate who listed the property for the brokerage company. The percentage that sales associates earn is negotiated between individual sales associates and their employing broker, taking into consideration each sales associate's experience and production.

EXAMPLE: Let's assume that the sales associate receives 60% of the total selling office commission. How much commission did the sales associate earn on the previous example? How much did the broker receive for the same transaction?

Step 1: Calculate the sales associate's split of the selling office commission.
$3,500 selling office commission × .60 split = $2,100 sales associate's commission
Step 2: Calculate the broker's split of the selling office commission.
$3,500 selling office commission × .40 split = $1,400 broker's commission

Today, 100% commission arrangements are popular. A sales associate in a 100% commission office receives the entire commission due the respective brokerage office. Instead of splitting the commission with the broker, the sales associate pays a specified share of office expenses plus a fixed monthly fee.

A broker who lists a property with higher-than-normal value may agree to a graduated (sliding scale) sale commission. This provides an incentive for the broker to get the seller the very best price possible.

EXAMPLE: The broker has a listing with a seller, and the parties agree to a graduated commission structure. The commission is 5% on the first $200,000 of sale price, 6.5% on the next $100,000 of sale price, and 8% on the amount over $300,000. What is the total commission if the property sells for $325,000?

Step 1: Calculate the first increment of commission.

$200,000 × .05 rate = $10,000 first increment commission

Step 2: Calculate the second increment of commission.

$100,000 × .065 rate = $6,500 second increment commission

Step 3: Calculate the third increment of commission.

$25,000 remaining portion of sale price × .08 rate = $2,000 third increment commission

Step 4: Add the commission increments to determine the total commission.

$10,000 + $6,500 + $2,000 = $18,500 total commission

Calculating Problems That Include Percent

Percent problems involve three elements. The three elements common to all percent calculations are

- part (of the total amount),
- rate (percent), and
- total (total amount).

We can use three simple formulas to assist with solving percent problems (see the following textbox).

Formula: Solving Percent Problems

part ÷ total = rate

part ÷ rate = total

total × rate = part

EXAMPLE 1: A property sold for $100,000. The commission was 7% of the sale price. What was the commission?

Rate = 7%

Total = $100,000

The formula indicates that to solve for the commission (part), we must multiply the total sale price by the rate:

total × rate = part

$100,000 × 7% = $7,000

EXAMPLE 2: A competing real estate company sold your neighbor's home for $200,000. The seller indicated that the commission on the sale was $13,000. What percentage of commission did the real estate company charge?

The formula indicates that to solve for the rate of commission (rate), we must divide the commission paid by the sale price:

part ÷ total = rate

$13,000 ÷ $200,000 = .065 or 6½%

EXAMPLE 3: Property taxes are $1,600 and are taxed at a rate of $2.50 for $100 of assessed value. What is the assessed value?

In this example, you must find the total assessed value. The part is the $1,600 property taxes. The rate is the $2.50 per $100. According to our memory device, we need to take the $1,600 (part) and divide by the rate ($2.50):

part ÷ rate = total

$1,600 ÷ $2.50 = 640

Because the rate was $2.50 per $100 of assessed value, if we multiply 640 by $100, the result is the amount of assessed value:

640 × $100 = $64,000

Practice Questions

1. A sales associate, while working for the broker, acquired a listing for $289,000 at a 6% commission rate. A second sales associate, who works for another brokerage office, found the buyer for the property. The listing and the selling brokers agree to a 50-50 split between the two offices. The property sold for the listed price. The selling broker kept 45% of the commission received by the selling office.
   - What was the total commission earned on the sale?
   - What was the selling office's split?
   - What was the sales associate's commission at the selling office?
2. What is the principal balance of a mortgage loan if the interest is $400 for one month at an annual rate of 4%?
3. A property sold for $115,900. The commission was 7% of the sale price. What was the commission?
4. A competing real estate company sold a residence for $350,000. The seller indicated that the commission on the sale was $25,375. What percentage of commission did the real estate company charge?

14.2 PERCENTAGE APPLIED TO SELLING PRICE, COST, AND PROFIT

Profit is how much you make over and above your cost. It may be expressed as the dollar amount of profit or as a percentage of profit.

EXAMPLE: Assume a buyer paid $100,000 for a lot and later sold the lot for $150,000. How much profit did the property owner make on the sale?

$150,000 sale price – $100,000 amount paid = $50,000 profit

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Formula: Profit

amount made on sale ÷ amount paid = percentage profit

Hint: made ÷ paid

Refer to the previous example. We can take the amount the property owner made on the sale ($50,000 profit) and divide by the amount the property owner originally paid for the property ($100,000) to determine the percentage of profit made on the sale.

$50,000 amount made ÷ $100,000 amount paid = .50 or 50% profit

EXAMPLE: An investor purchased 4 acres of land for $150,000. The investor subdivided the land into two 2-acre lots and sold the lots for $90,000 each.

a. How much profit did the investor make on this investment?
$90,000 × 2 lots = $180,000
$180,000 sale price for the two lots – $150,000 paid = $30,000 profit

b. What was the investor's percentage of profit on the sale?
$30,000 made ÷ $150,000 paid = .20 or 20% profit

What if the investor purchases a property and, because of a prolonged economic recession, the investor must sell the property at a loss?

Formula: Loss

amount lost on sale ÷ total cost = percentage loss

Hint: lost ÷ cost

EXAMPLE 1: An investor purchased a lot for $100,000 and had to later sell the lot for $80,000, resulting in a $20,000 loss. What was the investor's percentage of loss?

$20,000 amount lost ÷ $100,000 amount cost = .20 or 20% loss

EXAMPLE 2: A lot sold for $6,000, making a 25% profit. What was the cost of the lot?

100% cost + 25% profit = $6,000
125% = $6,000 selling price
$6,000 selling price ÷ 1.25 = $4,800 cost

EXAMPLE 3: A lot sold for $10,000, representing a 20% loss. What was the cost of the lot?

100% – 20% = $10,000
80% = $10,000
$10,000 selling price ÷ .80 = $12,500 cost

Practice Questions

5. A lot that cost $45,000 sold for $54,000, yielding a profit of $9,000. What is the percentage of profit?

6. A lot that cost $50,000 sold for $47,000, resulting in a $3,000 loss. What is the percentage of loss?

7. A lot sold for $32,200, making a 15% profit. What was the cost of the lot?

8. A lot sold for $75,000, representing a 20% loss. What was the cost of the lot?

14.3 PRELIMINARY STEPS TO CLOSING

All real property sales or exchanges eventually conclude with a transfer of title. This occurs at the title closing (or settlement), when the seller delivers title to the buyer in exchange for the purchase price. The date and place of title closing should be specified in the sale contract. There are usually several things to accomplish between the time of signing the sale contract and the title closing. For example, some of the preliminary steps include the following.

Earnest Money Is Deposited. Sales associates must deliver the earnest money deposit (also called good-faith deposit, or escrow) to the broker by the end of the next business day. The broker must deposit the buyer's good-faith deposit into the escrow account no later than the end of the third business day after the brokerage company receives the funds. Some brokers do not maintain their own escrow accounts. If the earnest money deposit is placed with a title company or with an attorney, the sale contract must indicate the title company's or attorney's name, address, and telephone number. The broker must deliver the earnest money to the attorney or title company by the end of the third business day (see "Escrow or Trust Accounts," Unit 5).

Additional Deposit, if Required. If the sale contract requires the buyer to give additional funds as a good-faith deposit, the sales associate must keep track of when additional funds are due and document that the deposit was received, delivered to the escrow agent in a timely manner, and deposited into the escrow account.

Loan Application. If the buyers intend to finance the purchase, they will complete a mortgage application. The contract for sale specifies the number of days within which the buyer must submit a loan application. The listing and the selling licensees should monitor progress.

Contingencies. The licensee must keep track of any contingencies in the contract and follow up to ensure that the contingencies are cleared in writing in a timely manner.

Appraisal. Because the property is pledged as collateral for the mortgage loan, the lender will order an appraisal to determine whether the property's value is sufficient to ensure recovery of the loan amount should a default occur. The buyer also may want the property appraised to verify the property's value. The buyer is entitled to a copy of the appraisal no less than three business days prior to the closing.

Loan Approval. The lender's loan approval removes an important contingency. The seller should be notified once the buyer's financing has been approved.

Survey Is Ordered. A survey is required by the title company and the lender. The buyer will want to have the property surveyed to determine the exact location and size of the property and to make sure there are no encroachments, such as a neighbor's fence across the property line. See Unit 10 for or additional information regarding surveys.

Title Insurance. A search is made of the public records for condition of the title and existing liens, judgments, or other encumbrances. The seller is responsible for removing any encumbrances on the title. Typically, there is a simultaneous issue of the owner's policy and the lender's policy. See Unit 9 for complete details regarding title insurance.

Termite Inspection. A copy of the wood-destroying organisms (WDO) inspection report is given to the buyer, lender, and the title company. The WDO inspection is for termites and other WDOs (such as wood-boring beetles and fungi). The sale contract should specify the details should a termite treatment or repairs be required.

Required Repairs Are Ordered. Once the loan is approved, any required repairs should be ordered to remove these contingencies as soon as possible. The appropriate party should inspect the work to be sure the work has been done properly. The buyer and the seller should be notified once the work is complete.

Home Inspection. A home inspection is for the structural condition of the home (including electrical, HVAC, plumbing, etc.). Home inspectors cannot legally perform WDO inspections unless they work for a licensed pest control company.

Buyer Hazard Insurance. Buyers who are obtaining a mortgage must provide proof of homeowners insurance coverage at closing. The buyer should make a decision regarding the insurance company early in the transaction. If a tropical storm is named, the insurance company will suspend issuing homeowners insurance policies until the storm passes. Most insurance companies allow the buyer to purchase insurance up to 30 days in advance. As soon as the buyer's financing is approved, the buyer should have the insurance company "bind" the hazard insurance. Proof of hazard insurance coverage is forwarded to the closing agent.

Closing Documents Are Reviewed. The closing agent (title company or attorney) prepares the closing disclosure, warranty deed, and property tax proration agreement and the lender prepares the closing documents. The buyer and the seller are given the opportunity to review the closing documents before closing. It is important for sales associates to have an understanding of the closing documents. Sales associates should be able to explain and verify the entries on the closing documents. The day before the closing, licensees should examine and review the closing disclosure with the buyer or the seller to correct any errors and explain each entry. Sales associates usually attend the title closing with the buyer and the seller in case their knowledge of the transaction is needed to assist with answering any questions or concerns that may arise.

Preclosing Inspection Is Conducted. Before the title closing, the buyer makes a final **preclosing inspection** (*walk-through*) of the property with the sales associate. The purpose of the preclosing inspection is to verify that repairs have been completed and that the property has been left in good condition.

Buyer Is Informed of the Amount of Funds Needed to Close. The buyer is responsible for ensuring that the funds needed to close are delivered to the closing agent. The current industry practice for transmitting these funds is in the form of a certified check or wire transfer.

475.25(1)(d), F.S.

Earnest Money Is Transferred to the Closing Agent. When the earnest money has been held in the broker's escrow account, the sales associate is responsible for notifying the broker of the date that the earnest money is to be transferred to the closing agent. The sales associate should verify with the broker and the closing agent that the transfer has occurred. Florida real estate license law places the responsibility on the broker for an accurate accounting and delivery of all monies, deposits, drafts, mortgages, conveyances, leases, or other documents entrusted to the broker by the parties to the transaction.

Practice Questions

9. The purpose of a final ______________ ______________ is to verify that repairs have been completed and that the property has been left in good condition.

10. The buyer should arrange for hazard insurance early in the process because in the event of a named ______________ __________ insurance companies will suspend issuing homeowner policies.

14.4 CLOSING DISCLOSURES

The Closing Disclosure is a detailed accounting of funds in a real estate transaction. Some entries on the Closing Disclosure are shared between the buyer and the seller.

Prorated Expenses

The Closing Disclosure involves the division of financial responsibility between the buyer and the seller. Items that are to become a **credit** (reimbursed) or **debit** (charged) to either buyer or seller are *prorated* because the item applies to both the buyer and the seller. The various credits and debits are allocated between the buyer and the seller in the proportions or **prorations** specified in the contract.

Every sale contract should specify a date for prorating items. All prorations are calculated as of midnight: when one day ends and the new day begins. The closing day is allocated (belongs to) either the buyer or the seller as determined in the sale contract. It is customary when transferring title to have all prorated items determined as of midnight of the day before the closing date. This means that the seller's responsibility ends at midnight the day before the closing occurs and that the buyer is responsible for costs incurred from the closing date going forward. If the seller is being charged for the day of closing, simply add one extra day to the seller days.

Prorations are entered on the Closing Disclosure as double entries (one party is debited and the other party is credited). A single dollar amount is entered as a debit to one party and a credit to the other party.

365-Day and 360-Day Methods. There are two methods of calculating prorations:

1. The 365-day method is the most common and most accurate method. This method calculates the proration using the actual number of days in the proration period. The annual charge is divided by 365 (the number of days in a calendar year) to determine the daily rate. The actual number of days in the proration period is multiplied by the daily rate.

2. The 360-day method allocates 30 days to every month. In this method, the annual cost is divided by 360 to determine the daily rate. This method is not normally used for calculating prorations for closing disclosures.

County and/or City Property Taxes. Property taxes are paid once a year (on an annual basis). Property taxes become due on November 1 of each year, and the homeowner has through the end of March of the next year to pay the tax bill before the taxes becomes delinquent. Because the taxes are not due until late in the year, the buyer is credited at closing for the time the seller owned the property. The buyer will pay the tax bill at the end of the year when the entire tax bill becomes due (see "Property Tax Schedule," Figure 18.1).

Formula: Unpaid Property Taxes

property taxes for year ÷ 365 days = daily tax rate

daily tax rate × number of days seller owns property in year = proration amount (credit buyer, debit seller)

EXAMPLE 1: Closing date is July 23. The annual property taxes are $3,467.50 and have not yet been paid. How much is the seller to pay the buyer for the days the seller owned the property? The day of closing is charged to the buyer. (When doing calculations, use the 365-day method unless the 360-day method is specifically stated in the question.)

Step 1. Begin by dividing the annual property taxes by 365 to find the daily rate:

$3,467.50 ÷ 365 = $9.50 daily rate

Step 2. The seller will credit the buyer for January through June and through midnight the day before closing (midnight of July 22). Calculate the exact number of days in the months January 1 (when the tax year begins) through June and add 22 days for July.

January 31 + February 28 + March 31 + April 30 + May 31 + June 30 + 22 of July = 203 days

Step 3. Multiply the daily rate by the number of days the seller owes the buyer:

$9.50 daily rate × 203 days = $1,928.50

Step 4. Prorations are entered on the Closing Disclosure as double entries; a debit to one party and a credit to the other party. The dollar figure is identical for the debit and the credit.

The seller has not paid the property tax bill for the year because it won't become due until November 1. The seller owned the property for the tax year up until midnight of the day before closing. So the seller is charged (debited) $1,928.50 on the closing disclosure. The buyer is credited $1,928.50 on the Closing Disclosure. The buyer is credited $1,928.50 on the Closing Disclosure. When the tax bill becomes due later in the year, the buyer will pay the entire property tax bill of $3,467.50.

Closing Disclosure entry: $1,928.50 debit seller, $1,928.50 credit buyer

EXAMPLE 2: The closing date is April 15. The annual property taxes are $2,283.44. The day of closing is charged to the buyer. The proration is calculated as follows:

The daily rate of property tax is:

$2,283.44 ÷ 365 days = $6.256 daily rate

Taxes are paid in **arrears**, so the seller will owe the buyer for three months (January through March) and 14 days in April:

January 31 + February 28 + March 31 + April 14 = 104 days

$6.256 daily rate × 104 days = $650.624, rounded to $650.62 (debit seller, credit buyer)

If the closing occurs late in the year (November or December) and the seller has already paid the taxes for the year, the buyer will reimburse the seller for the remainder of the year. Thus the buyer will be charged a debit for taxes for the days remaining in the year, and the seller will receive a credit for the same amount.

PRORATING PROPERTY TAXES

- Property taxes (items paid in arrears) "seller days" are used to calculate the proration.
- Unpaid property taxes appear as a *credit* to the buyer and as a *debit* to the seller.
- Prorations always have the same dollar amount entered for the debit and the credit.

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Prepaid Rent. Normally, any rental income collected in advance belongs to the new owner (buyer) as of the date of closing. In other words, the unused portion of advance rent belongs to the buyer. The total rent amount should be divided by the number of days involved in the rental period and allocated on a daily basis.

Formula: Prepaid Rent

rent paid for the closing month ÷ number of days in closing month = daily rental rate

daily rental rate × number of days buyer owns property in closing month = proration amount (credit buyer, debit seller)

EXAMPLE: Assume that a property rents for $1,245 per month. The closing date is on the 21st day of June. The seller (landlord) received the tenant's rent on the first of the month. Therefore, the buyer is entitled to the rent beginning with the day of closing through the remainder of June.

Step 1. Calculate the number of days owed the buyer.

30 days in June – 20 days seller owned property = 10 days rent due buyer

Step 2. Calculate the daily rate of rental income.

$1,245 ÷ 30 days in month = $41.50 daily rent

Step 3. Calculate the rent due the buyer.

$41.50 daily rent × 10 days due buyer = $415.00

Step 4. Prorations are entered on the closing disclosure as a double entry; the seller is debited (owes) $415.00 and the buyer is credited $415.00 for rental income beginning with the closing date through the remainder of the month.

Closing disclosure entry: $415.00 debit seller, $415.00 credit buyer

PRORATING ITEMS PAID IN ADVANCE

- When a prorated item is paid *in advance*, as is the case with rent, the "buyer days" are used to calculate the proration.
- Prepaid rent is entered as a *credit* to the buyer and a *debit* to the seller.
- If the rental property is a duplex, it has two units; a triplex has three units; and a fourplex has four units. For example, if the rent proration states the income property is a duplex, multiply the monthly rent per unit by 2.

Mortgage Interest on Assumed Mortgages. When a loan is assumed, the accrued interest for the month of closing must be prorated. Interest is paid in arrears, therefore, the monthly payment made on the first day of the month pays interest for the entire previous month. Interest is figured from the last date for which interest was paid. The exact number of days in each month is used, and interest is figured on a daily basis.

Formula: Interest on Assumed Mortgage

loan balance × interest rate = annual interest ÷ 365 days = daily interest rate

daily interest rate × number of days seller owns property in closing month = proration amount (credit buyer, debit seller)

EXAMPLE: A home is scheduled to close on May 8. The buyer is assuming the seller's loan. The loan has an interest rate of 4.5% and a monthly payment of $612.62 due on the first of each month. The loan balance on May 1 is $93,600. What is the proration?

Step 1. Find the daily rate of interest.

$93,600 loan balance × 4.5% interest = $4,212 annual interest

$4,212 ÷ 365 days = $11.539726 daily rate of interest

Step 2. Find the number of days of accrued interest the seller owes.

The seller owes the buyer interest for the period May 1 up until midnight of the day before closing, or seven days.

Step 3. Multiply the daily rate of interest by the days owed.

$11.539726 daily rate × 7 days owed = $80.778082 or $80.78

Closing Disclosure entry: $80.78 debit seller; $80.78 credit buyer

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PRORATING MORTGAGE INTEREST ON ASSUMED MORTGAGES

- Interest on mortgage loans is paid *in arrears*.
- When prorating an item paid in arrears, use "seller days" to calculate the proration.
- Enter interest on an assumed mortgage as a *debit* to the seller and as a *credit* to the buyer.

FIGURE 14.2 ■ Proration Summary

Proration	Formula							Disclosure Entry*
Unpaid Property Tax	property taxes	÷	365 days	×	days seller owns property (1st part of year)	=	prorated amount	☹ seller ☺ buyer
Prepaid Rent	monthly rent	÷	days in closing month	×	days buyer owns property (2nd part of month)	=	prorated amount	☹ seller ☺ buyer
Interest on Assumed Mortgage	annual interest (loan × interest rate)	÷	365 days	×	days seller owns property in closing month (1st part of month)	=	prorated amount	☹ seller ☺ buyer

* In the column Disclosure Entry, if an individual receives money at the closing table, it is called a *credit*, which we can represent as a ☺ because credits make us happy. If the buyer or the seller must pay out money at the closing, it is called a *debit*, which we can represent as a ☹ because debits make us sad.

Practice Questions

11. The closing date is May 10, the annual property taxes are $3,011.25, and the tax bill has not yet been paid. The day of closing is charged to the buyer. How much is the seller to pay the buyer for the days the seller owned the property?

12. The closing date is April 14. The buyer is assuming the seller's mortgage loan that has a principal balance on April 1 of $200,500 at 4% interest. The day of closing is charged to the buyer. What is the proration and how is it entered on the Closing Disclosure?

13. The closing date is April 10, and the duplex rents for $1,200 per unit. The seller (landlord) received the rent from both tenants on the first of the month. What is the proration and how is it entered on the Closing Disclosure?

14.5 STATE TRANSFER TAXES

201.02, F.S.

Florida has three types of state taxes that apply to deeds, notes, or mortgages associated with the transfer of ownership of real property and financing.

State Documentary Stamp Tax on Deeds. Florida requires the payment of a tax on deeds and other conveyances. This state *documentary stamp tax on deeds* is assessed at the rate of $.70 ($.60 in Miami-Dade County) for each $100 of the full purchase price (or any fraction of $100). It makes no difference whether the purchase is all cash, all financed, or some combination of cash and financing because this tax is based on purchase price. This is a one-time tax and is not paid annually (see Figure 14.3).

3

Formula: Documentary Stamp Taxes on Deeds

purchase price ÷ $100 = taxable units; (if result is a decimal number, round to the next whole number)

number of taxable units × $.70* = cost of documentary stamp tax on deeds

* Rate is $.60 in Miami-Dade County

EXAMPLE 1: If a home sells for $171,200, the documentary stamp tax on the deed will be as follows:

$171,200 ÷ $100 = 1,712 taxable units
1,712 × $.70 = $1,198.40 documentary stamp tax on deed

EXAMPLE 2: Assume the purchase price in the previous example is $171,225. $171,225 divided by $100 is 1,712.25. The result is a decimal number, so round the taxable units to the next whole number of 1,713 before calculating the stamp tax due as follows:

$171,225 ÷ $100 = 1,712.25, round up to the next whole number = 1,713 taxable units
1,713 × $.70 = $1,199.10 documentary stamp tax on deed

EXAMPLE 3: A home sells for $295,995. How much will the state charge for the documentary stamp tax on the deed?

$295,995 ÷ $100 = 2,959.95, round up to the next whole number = 2,960 taxable units
2,960 × $.70 = $2,072.00 documentary stamp tax on deed

The law requires that the seller deliver a recordable deed. Because a deed may not be recorded until the stamp tax has been paid, the seller is obligated to either deliver a deed having paid the stamp tax or negotiate with the buyer to assume the obligation. If the buyer does not agree to pay the stamp tax on the deed, the tax remains the seller's responsibility.

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DOCUMENTARY STAMP TAX ON DEEDS

- Documentary stamp tax on deeds is charged at a rate of $.70 ($.60 in Miami-Dade County) for each $100 of the full purchase price.
- Documentary tax is an expense. It is entered as a debit to the person paying the expense. Unlike a proration, there is no credit to the other party (expenses are single entries).
- On normal sales or exchanges, the documentary tax is shown as a debit to the seller on the Closing Disclosure.

201.08, F.S.

State Documentary Stamp Tax on Promissory Notes. Florida requires the payment of a documentary stamp tax on all new and assumed promissory notes. The tax rate is $.35 per $100, or fraction thereof, on the face value of the *promissory note*. This is an expense usually charged to the buyer. The tax is entered as a *debit* to the buyer on the Closing Disclosure (see Figure 14.3).

3

Formula: Documentary Stamp Taxes on Promissory Notes

promissory note ÷ $100 = taxable units (if result is a decimal number, round up to the next whole number)

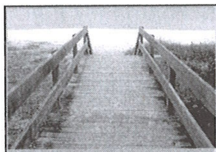
number of taxable units × $.35 = cost of documentary stamp tax on promissory notes

EXAMPLE 1: A home sells for $375,000. The buyer financed the purchase with a new 80% conventional loan and 20% cash. How much was the buyer charged for the documentary stamp tax on the promissory note?

$375,000 purchase price × .80 = $300,000 mortgage loan amount
$300,000 ÷ $100 = 3,000 taxable units
3,000 × $.35 = $1,050 documentary stamp tax on the promissory note

EXAMPLE 2: A home sold for $90,000. The buyer paid $10,000 cash, assumed a recorded mortgage of $55,000, and created a new second mortgage in the amount of $25,000. The documentary stamp tax on the promissory notes resulting from this transaction is as follows:

$55,000 ÷ $100 = 550 taxable units × $.35 = $192.50 (assumed)
$25,000 ÷ $100 = 250 taxable units × $.35 = $87.50 (new note)
$192.50 + $87.50 = $280 (tax on notes)



CALCULATING DOCUMENTARY STAMP TAX ON PROMISSORY NOTES

- Documentary stamp tax on notes is charged at a rate of $.35 for each $100 of the promissory note.
- Documentary stamp tax is an *expense.* It is entered as a debit to the buyer (a buyer expense unless agreed to otherwise).

199.133, F.S.

State Intangible Tax on New Mortgages. Florida requires the payment of an *intangible tax* on *new* mortgages. (An assumed mortgage recorded previously is not to be taxed again; likewise, intangible tax is not charged on purchases subject to an existing mortgage.) The tax rate for the state intangible tax on new mortgages is two mills ($.002 or two-tenths of one cent) per dollar of debt (see Figure 14.3).

3

Formula: Intangible Tax on New Mortgages

new loan amount × $.002 = cost of intangible tax

EXAMPLE: Use the figures from the previous example. The intangible tax on the new second mortgage is as follows:

$25,000 new second mortgage × $.002 = $50 intangible tax on new second mortgage

This tax is usually shown as a debit to the buyer on the closing disclosure.

FIGURE 14.3 ■ **State Transfer Taxes**

Type of Tax	Rate	Charged On	Applies To
Doc Stamps on Deed	$.70 per $100 ($.60 per $100 Miami-Dade County)	Purchase Price	All Conveyances
Doc Stamps on Note	$.35 per $100	Promissory Note	New and Assumed Mortgage Loans
Intangible Tax	$.002	Mortgage Loan	New Financing

EXAMPLE: A property sold for $179,950. The buyer paid $25,000 cash down and arranged for a $154,950 mortgage loan. What are the state transfer taxes on this transaction?

Deed:
$179,950 ÷ $100 = 1,799.5, rounded up to 1,800 taxable units
1,800 taxable units × $.70 = $1,260 tax on deed
Intangible tax on new mortgage:
$154,950 × $.002 = $309.90 intangible tax on new mortgage
Note:
$154,950 ÷ $100 = 1,549.5, rounded up to 1,550 taxable units
1,550 taxable units × $.35 = $542.50 tax on promissory note
Total state transfer taxes:
$1,260 + $309.90 + $542.50 = $2,112.40

Other Charges

Preparation of Documents. The customary method of handling charges for preparation of documents is to require the person who must sign the document to pay the fee for its preparation. Therefore, the seller (grantor) pays for preparation of the deed, and the buyer (mortgagor) pays for preparation of the mortgage and note. The charges that result are shown as a *debit* on the Closing Disclosure of the person required to pay. Expenses are single entries (there is no corresponding credit).

Recording Fees. Several of the legal instruments signed at closing should be recorded to give constructive notice of new ownership and debt status. Charges associated with recording these documents are usually paid by the person who wants a particular document recorded. For example, the grantee (buyer) wants the deed recorded and pays for this service, even though the grantor (seller) pays for the deed to be prepared by an attorney. The various recording fees are shown as a debit to the appropriate party.

Broker's Commission. Normally, the person who employed the broker is required to pay the commission. The broker's commission is entered as a debit to the party charged with paying the commission.

Title Insurance. Legally, the seller of a property is not required to provide an abstract of title, title insurance, or an opinion of title without contractually agreeing to do so. However, title insurances are used to protect the lender and the buyer. Lenders usually will not accept abstracts of title but do demand up-to-date *lender's title insurance*. A buyer's representative should recommend that the buyer's interest be protected by obtaining *owner's title insurance*. Actually, these charges, like many, are negotiable regarding who pays what (see "Title Insurance," Unit 9).

Practice Questions

14. The documentary stamp tax on deeds is charged on the __________ __________.

15. The documentary stamp tax on deeds is charged at a rate of ______________ per ______________ unit.

16. The closing date is July 15. The purchase price is $250,575. The buyer obtained a new mortgage loan for 80% of the purchase price.

    - What is the charge for the documentary stamp tax on the deed, and how will the tax be entered on the Closing Disclosure?

    - What is the total charge for the state transfer taxes associated with the financing?

14.6 RULES OF THUMB

Recall that a Closing Disclosure is a detailed accounting of funds in a real estate transaction. The disclosure summarizes who is responsible for paying each item associated with the sale contract. You can think of the Closing Disclosure as a photograph of a special moment in time (the day of closing). Every entry on the Closing Disclosure concerns money on closing day (cash *today*). At the closing table, the buyer and the seller each have financial obligations to one another. If an individual receives money at the closing table, it is called a *credit*, which we can represent as a ☺ because credits make us happy. If the buyer or the seller must pay out money at the closing, it is called a *debit*, which we can represent as a ☹ because debits make us sad.

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Purchase Price. The purchase price is *credited* ☺ to the seller because the seller is happy to be receiving money. The purchase price is entered on the disclosure as a *debit* ☹ to the buyer because the buyer is sad to be paying out money. Assuming a $200,000 purchase price, $200,000 will be *credited* to the seller (seller is receiving money), and the buyer is debited $200,000 (buyer is paying for the property).

Earnest Money Deposit. The initial earnest money deposit is typically paid at the time an offer is presented to the seller. Because the buyer has prepaid the deposit, the Closing Disclosure will indicate a *credit* ☺ on closing day. The buyer paid the deposit a month or so ago, so the buyer is happy on closing day that this has already been paid. If the buyer's earnest money deposit was $10,000, this is the amount of the *credit* ☺ to the buyer. No entry is made on the seller's side of the Closing Disclosure because the deposit was previously given to the broker or another escrow agent. On the day of closing, the escrow agent delivers the escrowed funds to the closing agent.

New Mortgage Loan. Very few buyers pay for a home with all cash. For example, this buyer received a 30-year, fixed-rate mortgage loan for 80% of the purchase price ($160,000 loan). Today, the lender is bringing $160,000 to the closing table on the buyer's behalf. That means that the buyer's lender, on closing day, is taking care of $160,000 of the purchase price. Therefore, the $160,000 is entered on the Closing Disclosure as a *credit* ☺ to the buyer. There is no entry on the seller's side of the disclosure because the $160,000 is transferred to the closing agent on the day of closing.

Purchase Money Mortgage. Sometimes, the buyer does not have sufficient cash to pay the entire down payment. If the same buyer mentioned previously secured a $160,000 loan, the buyer's equity is $40,000. The buyer has already paid an earnest money deposit of $10,000, leaving a $30,000 obligation for the down payment. If the buyer only has the ability to pay $20,000 cash toward the down payment, the seller may agree to financing a new purchase money mortgage in the amount of $10,000. The closing statement would indicate a *credit* ☺ to the buyer because the buyer does not have to produce the $10,000 cash at closing. The seller, however, is receiving $10,000 less cash at closing, so a *debit* ☹ of $10,000 is entered on the seller side of the Closing Disclosure.

Prorations. Recall that three types of prorations were discussed earlier in this unit: (1) property taxes, (2) rent, and (3) mortgage interest on an assumed mortgage. Prorations are *always* entered on the Closing Disclosure as double entries. This means that the proration is entered on both the buyer side and the seller side of the Closing Disclosure (a debit to one party and a credit to the other party) and the dollar amount of the debit and the credit is the same dollar figure.

1. *Property tax.* Property taxes are paid *in arrears*. This is because the homeowner does not receive the bill for the current year's taxes until November. Therefore, if the closing date is before November 30, the seller will give the buyer the seller's share of the property taxes at closing. The property taxes will be entered on the Closing Disclosure as a *debit* ☹ to the seller and the same amount will be *credited* ☺ to the buyer on the Closing Disclosure. When the buyer receives the property tax bill in November, the buyer will have already received the seller's portion of the tax obligation and the buyer (or the lender if the property taxes are escrowed) will pay the property tax bill for the year.
2. *Prepaid rent.* On the first of the month, assume the seller collected $1,000 in rent money from a tenant who occupies the property that is being sold. Midway through the month, on closing day, the seller will give the buyer a portion of the rent money. If the seller is giving money to the buyer on closing day, it is entered on the Closing Disclosure as a *debit* ☹ to the seller and as a *credit* ☺ to the buyer.
3. *Interest on an assumed mortgage.* Mortgage loan interest is paid *in arrears*. Therefore, when the borrower pays the February mortgage payment, the borrower is paying the principal for February and the interest charged for January. If the closing date is in January, this means that the buyer will make a mortgage payment on February 1 and the February payment will include interest due for the month of January. Because the seller only lived in the property for a portion of January, at closing, the seller will pay the buyer for the seller's portion of the January mortgage interest. The seller is giving money to the buyer, so the proration is entered as a *debit* ☹ to the seller and as a *credit* ☺ to the buyer. The buyer does not have to pay any interest on closing day.

Did you notice that in all three proration scenarios, the proration was entered on the Closing Disclosure as a *debit* ☹ to the seller and as a *credit* ☺ to the buyer? Typically, this will be the case. This rule will not hold in some cases, such as if the property taxes for the current year were paid before the closing day (perhaps a December closing), if the rent is not paid at the first of the month (closing date before the monthly rent was paid), and so forth. But for test purposes and for typical situations, the proration will be entered on the Closing Disclosure as a *debit* ☹ to the seller and as a *credit* ☺ to the buyer.

Expenses. Expenses are always entered on the Closing Disclosure as a *debit*. An expense means money is being paid at closing, so it is entered as a *debit* ☹ and is charged to the person paying the expense. The closing agent will look at the contract to determine who is responsible for paying the expense. An expense is normally a single-entry item because only one party is charged the expense, unless the contract states otherwise. There are some common practices regarding who is charged certain expenses:

- The documentary stamp tax on the deed is typically the responsibility of the seller and appears as a *debit* ☹ on the seller side of the Closing Disclosure. There is no entry on the buyer side of the Closing Disclosure because the buyer does not receive this money. The tax is paid to the state of Florida.
- Intangible tax on new mortgages is entered as a *debit* ☹ on the buyer side of the Closing Disclosure. Expenses associated with the buyer's financing are typically paid by the buyer.
- Documentary stamp taxes are paid on new and assumed notes. Because these expenses are associated with the buyer's financing, the expenses are typically entered as a *debit* ☹ to the buyer.

- Miscellaneous expenses that are entered on the Closing Disclosure include items such as the termite inspection, survey, broker's commission, and so forth. These expenses are entered as a *debit* ☹ to the party who agreed to pay the expenses.

Practice Questions

17. The earnest money deposit held in escrow by the broker is entered on the closing disclosure as a ______________ to the ______________.
18. Expenses are entered as ______________ on the closing disclosure.
19. Prorations are entered as ______________ entries on the closing disclosure.

14.7 SUMMARY OF IMPORTANT POINTS

- *Profit* is the amount you make over and above cost.
- A *preclosing inspection* is a final walk-through with the sales associate to verify that repairs have been completed and that the property is left in good condition.
- To *prorate* means to divide various debits (charges) and credits between buyer and seller. A *proration* is a shared expense between the buyer and the seller.
- Property taxes are paid in arrears and are prorated using a 365-day year (actual number of days in the proration period). Unpaid property taxes appear as a credit to the buyer and as a debit to the seller. Prorations have the same dollar amount in each entry. Seller days are used to prorate items paid in arrears.
- Rental income collected in advance belongs to the new owner as of the date of closing. Advance rental income appears as a credit to the buyer and a debit to the seller. Buyer days are used to prorate items paid in advance.
- Documentary stamp tax on deeds is paid on the full purchase price. The rate is $.70 ($.60 in Miami-Dade County) per $100, or fraction thereof.
- Documentary stamp tax on notes is paid on the amount of debt. This tax is paid on all new and assumed mortgage notes. The rate is $.35 per $100, or fraction thereof.
- Intangible tax is paid on new debt. The rate is $.002 per $1 of new debt.

UNIT 14 EXAM

This quiz is intended not only to help you review this unit but also to assist with the various computations in other units.

1. Change the decimals to percentages.
   a. .395 _____
   b. .02 _____
   c. .075 _____
   d. 1.45 _____

2. Identify the other party's percentage of the commission.
   a. 50% _____
   b. 15% _____
   c. 25% _____
   d. 45% _____

3. Calculate the commission split.
   a. $25,000 split 60/40 _____
   b. $15,000 split 70/30 _____
   c. $35,500 split 65/35 _____
   d. $22,750 split 45/55 _____

4. Divide these numbers.
   a. 44,032 ÷ 1.72 _____
   b. 493.8 ÷ .60 _____
   c. 18,768 ÷ 25.5 _____
   d. 7,735 ÷ .17 _____

5. A broker lists a motel for $1,450,000. The listing agreement specifies a 6.5% sale commission for the first $600,000 of selling price, 7% for the next $800,000, and 8% commission on all of the actual sale price exceeding $1.4 million. The broker has agreed to a 45-55 split if the property is sold by one of the broker's sales associates. The property is sold "in house." The broker pays the sales associate involved in the transaction 55% of the total commission. What is the sales associate's commission if the associate sells the motel for the listed price?
   a. $44,550
   b. $54,450
   c. $95,000
   d. $99,000

6. A builder purchases a residential lot for $42,000 and constructs a new house at a cost of $178,000. The builder later sells the property for $187,000. What is the builder's percentage of loss on the sale?
   a. 13%
   b. 15%
   c. 20%
   d. 22%

7. You bought a house in Citrus County, Florida, for $130,000. You gave a deposit of $19,480, assumed a recorded mortgage of $90,520, and signed a new second mortgage and note for $20,000. What are the total state taxes due as a result of this transfer of property?
   a. $1,297.50
   b. $1,336.75
   c. $1,336.80
   d. $1,337.10

8. A broker lists a property with an agreement to a 7% commission to be split as follows: 45% to the listing broker and 55% to the selling broker. A sales associate who works for the selling broker sells the property for $160,000. The sales associate's agreement with her employer calls for a 60% share to her of all commissions she brings to the company. How much is due the sales associate?
   a. $2,016
   b. $2,464
   c. $3,024
   d. $3,696

9. A woman owned 3/8 of a property. She was paid $45,000 as her share of the proceeds from the sale of the property. What was the total selling price of the property?
   a. $61,875
   b. $72,000
   c. $90,000
   d. $120,000

10. A buyer has agreed to pay the state taxes associated with a new second mortgage loan of $31,000. What is the total cost?
    a. $62.00
    b. $108.50
    c. $170.50
    d. $217.00

11. A buyer is purchasing a house with a closing scheduled for April 22 (non-leap year). The annual property taxes are $2,652. The sale contract states that the day of closing belongs to the buyer. Calculate the property tax proration using the 365-day method.
    a. Credit seller $806.50, debit buyer $806.50
    b. Credit seller $1,854.50, debit buyer $1,854.50
    c. Credit buyer $806.50, debit seller $806.50
    d. Credit buyer $1,854.50, debit seller $1,854.50

12. A woman bought three 200-foot lots on a lake for $500 per front foot each. She then subdivided these lots into six lakefront lots, which she then sold for $62,500 each. What was her percentage of profit on the sales?
    a. 20%
    b. 25%
    c. 75%
    d. 80%

13. A warehouse measures 720 feet by 500 feet and rents for $118,000 a month. What is the rent per square foot per month?
    a. $.25
    b. $.33
    c. $3.05
    d. $3.96

14. A man incurred a 20% loss when he sold a 10-acre parcel (tract A) for $100,000. He also owns a 25-acre parcel (tract B) for which he paid $200,000. How much must he sell B for if he wishes not only to recover his loss from A but also to realize a 20% profit on his investment in B?
    a. $260,000
    b. $265,000
    c. $270,000
    d. $275,000

15. A couple is purchasing an apartment building. Each of the five apartments rents for $815 per month. The closing is scheduled for September 16, and the rents were collected on September 1. What is the rent proration for this transaction and to whom will the amount be credited? The day of closing belongs to the buyer.
    a. $407.50, credit buyer
    b. $1,901.67, credit seller
    c. $2,037.50, credit buyer
    d. $2,173.33, credit seller

16. A 28.5-acre parcel of land in Orange County sells for $4,100 per acre. What is the documentary stamp tax on the deed?
    a. $409.15
    b. $642.85
    c. $817.95
    d. $818.30

17. How is the buyer's binder deposit entered on the Closing Disclosure?
    a. Debit to buyer only
    b. Credit to buyer only
    c. Debit to seller and credit to buyer
    d. Debit to buyer and credit to seller

18. How is the purchase price entered on the Closing Disclosure?
    a. Credit to seller only
    b. Credit to buyer only
    c. Credit to seller and debit to buyer
    d. Credit to buyer and debit to seller

19. How are unpaid property taxes entered on the Closing Disclosure?
    a. Debit to seller only
    b. Debit to buyer only
    c. Credit to seller and debit to buyer
    d. Credit to buyer and debit to seller

20. The closing date is August 27. The buyer is assuming the seller's mortgage loan that has a principal balance of $242,500 at 4% interest. The day of closing is charged to the buyer. What is the proration and how is it entered on the Closing Disclosure?
    a. $132.88 debit seller; $132.88 credit buyer
    b. $132.88 debit seller; $690.96 credit buyer
    c. $690.96 credit seller; $690.96 debit buyer
    d. $690.96 debit seller; $690.96 credit buyer