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Examine prorations carefully

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(This is the 21st in a series of articles about issues that sellers and buyers face when negotiating a purchase-offer contract.)

The standard, pre-printed real-estate purchase contract that brokers representing sellers use with buyers always includes language that refers to “Prorations” or “Proration and Costs.”

Proration refers to an agreement between buyer and seller to divide a cost or expense involved in the purchase of property. Generally speaking, proration is calculated from the closing date, according to the number of days each party owns the property figured on a 360-day year, 30-day month.

Proration incorporates the idea of a fair division, usually based on days owned. The parties can agree to other division formulas as part of their overall negotiation.

States differ on how prorations are handled. In some places, state law governs; in others, custom prevails. Both buyer and seller should ask their respective real-estate lawyers to provide information as to which expenses can be prorated and which cannot or should not.

A typical set of pre-printed prorations includes: taxes (which may or may not specify the taxes being referred to); homeowner association fees, maintenance and upkeep fees (may or may not be specific); insurance premiums (usually unspecified, but generally referring to a homeowner’s policy if it’s being assumed); interest on assessments and mortgage interest when interest is paid in arrears.

Buyers should be wary of items included in prorations that need not be prorated. The broad category of “taxes” may be too broad for a buyer.

Other items that can be subject to proration include whatever costs the seller and buyer might agree to divide, such as taxes other than property taxes, which could include trash pick-up charges and special levies; fuel bills or fuel in a tank prepaid by the seller; utility charges that cover both pre- and post-closing time; and rent.

Accrued items are those that the seller owes, but will later be paid by the buyer. The seller gives the buyer credit for these items at closing. Prepaid items are those that the seller has already paid for, which benefit the buyer. They are credits to the seller.

Transfer tax stamps, or deed stamps, are a state tax levied on real-estate transactions. This tax is not usually prorated. A one-percent tax figured on the gross sales price is typical.

I have seen buyers get sticky with sellers on pre-paid items. I once saw a buyer refuse to pay for fuel oil in the tank, which forced the seller to give the oil to the buyer because the supplier would not drain it. The buyer's argument was that he was shifting to a different heating system and had no use for the oil. I think the buyer should have paid the $100 in return for goodwill that he could tap on other issues.

And then there was the lead seller who signed a purchase contract agreeing to prorate property taxes with me. The conventional number-of-days formula was used.

At closing, the seller's lawyer, who was a relative and also a beneficiary of this estate sale, announced that the seller would not pay his share of the property tax, amounting to about $150. I helpfully pointed out the sections in the contract where the sellers, including him, had signed, where he had initialed the proration of tax, where I could declare a breach of contract over this issue. The lawyer shrugged.

I was furious. It was so petty and transparent. I considered walking out of the room. I considered filing a complaint against the lawyer who, I should add, was also the broker representing the 18 sellers. I considered filing a complaint against him as a broker.

And then I thought: Maybe, they have a back-up contract at a higher price. Don't be a sucker. So I paid the $100 and did nothing else, except thank my stars that I was buying 450 acres for about half what they were worth.