STATEMENT OF ADJUSTMENTS

- THE REAL ESTATE TRANSACTION -

REAL ESTATE LAWYERS ASSOCIATION OF NOVA SCOTIA
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STATEMENT OF ADJUSTMENTS

(A) ADJUSTMENTS BETWEEN SELLER AND BUYER- The top portion of page 1.

Preparing the statement of adjustments can be a scary task when you are first learning. There is really no mystery to preparing adjustments if you keep in mind what you are trying to achieve. The Agreement of Purchase and Sale provides that the purchase price shall be adjusted (up or down) in favour of the Seller or Buyer. The standard clause provides:

> "Interest, rentals, taxes, rates, fuels on the premises and assessments are to be adjusted to the date of closing".

This means, for example, the Seller is entitled to be paid for the fuel in his/her tank as an addition to the purchase price or to be reimbursed by the Buyer for taxes which he/she has paid to the Municipality for a period beyond the closing date.

The first page of the calculations are called the Statement of Adjustments. The second page is the disbursement of Trust funds. However, both pages are usually referred to within the law firm as the Statement of Adjustments.

I will review many of the various adjustments which may be encountered in real estate transactions. Always remember - whether you are representing the Seller or the Buyer, the first step is to determine how much money the Seller is entitled to on the date of closing. This is determined by the first page of the Statement of Adjustments. (Refer to attached Schedules A, B and C while reading so that you will be able to follow my explanation.)

Any items on the top part of the adjustments ("Cost of Property to the Buyer") are additions to the purchase price. Any items on the bottom ("How Paid") part are deductions from the purchase price for the benefit of the Buyer, also known as credits to the purchase price.

(i) COSTS OF THE PROPERTY TO THE BUYER (ADDITIONS TO PURCHASE PRICE)

The following list contains certain types of adjustments which may be added to the purchase price before any deductions are taken into account:

1. Purchase Price

The first entry is the price which the Buyer has agreed to pay in the Agreement of Purchase and Sale or any counter offers or amendments. If your client is buying a newly constructed home, the contract may provide that the HST is included in the purchase price and the rebate(s) which may be available to the Buyer is/are to be assigned to the Seller on closing. The Seller receives the purchase price on closing from the Buyer and applies for the rebate after closing. Note that the HST which is included in the purchase price may be deducted before calculating the Deed Transfer Tax. The calculation for subtracting the HST will vary depending on the purchase price. Refer to the guides provided by the Canadian Customs and Revenue Agency for the relevant calculations. Note that if the net purchase price is in excess of $350,000.00 there are different calculations to apply for the purpose of calculating the rebate.

The matter of HST on newly constructed homes is for a more advanced discussion on adjustments. There are materials available from the Canadian Customs and Revenue Agency as well as from the Nova Scotia Association of Realtors which you can obtain to assist you with the calculation.

2. Tax Adjustment

There are two ways of determining how the taxes are to be adjusted. I will explain only the one which I use and which is the one (I believe) to be the most fail safe and most commonly used. It is a two part adjustment.

First, enter the amount of tax that has been paid, if any, in the particular tax year on the top of the adjustments. For the purpose of the calculation you are simply crediting to the Seller the actual amount paid. The tax year commences April 1st and ends March 31st. This entry is called "taxes in advance". In the event the Seller has not paid any amount towards taxes in the tax year, leave it blank. What you have done is added to the price, the taxes which have been paid by the Seller for the current tax year. The second step in the calculation is performed in the credit portion which shows the actual amount of the Seller's share of taxes up to closing. The credit portion is the second part of the adjustments which show "deductions" or "credits" to the price. The Seller's share of the taxes are prorated and commence with the beginning of the tax year and end on the date of closing. The Seller pays taxes to the end of the day on closing and the Buyer starts paying the day after closing. The net effect of crediting the Seller with the amount he has paid in a tax year and then deducting from that amount the actual taxes for which he is responsible, is either a balance owing by the Seller which becomes a credit to the Buyer for payment by the Buyer of those outstanding taxes, or a credit to the Seller for having paid more than he/she is responsible.

Most Municipalities start the tax year commencing April 1st of each year. There are normally two bills per year, one for the period commencing April 1st and ending at the end of September and the other commencing approximately October 1st and ending at the end of March in the next year. Taxes are therefore paid in advance.

For example, if taxes in a particular year were $1,000.00 and the Seller has paid $1,000.00 already, you would enter $1,000.00 on the top portion of the adjustments. On the credit side (bottom portion) the Seller's actual share for the number of days he owned the property from April 1st in that year until closing date would be entered. This amount is calculated by dividing the yearly taxes by 365 days (to give you a daily amount for taxes) and then multiplying the resulting figure by the number of days from the first of April to closing day.

Let us suppose the closing is February 23, the 310th day of the year. First you would divide the total taxes in the year ($1,000.00) by the number of days in the year (365) in order to get a daily rate for taxes:

$1000.00 / 365 days = $2.74 per day

Then you would multiply that amount by the number of days in the tax year from April 1st to closing day.

$2.74 X 310 days = $849.32

This resulting figure would be the tax credit to the Buyer and would be entered on the credit portion of the adjustments. The net effect of these two tax entries is to calculate the amount of taxes the Seller has over paid or to give the Buyer a credit for the amount of taxes which the Seller has under paid. In the example, the Seller paid $1,000.00 towards taxes because this is the bill which was rendered by the Municipality. The actual share of taxes of the Seller was $849.32. The Buyer pays the Seller, through the adjustments the amount that the Seller has paid in excess of his actual share. ($1,000.00 - $849.32 = $150.68).

In the event the Seller had not paid any taxes for the year, then the Buyer would receive a credit ($849.32) for the Seller's share of taxes. The Buyer would then use that credit to pay for the taxes which the Seller should have paid. Instead of reimbursing the Seller, the Buyer pays the outstanding taxes to the Municipality. This payment is shown on the disbursement of funds. The Buyer has paid less to the Seller due to the credit for taxes and so he will pay that amount plus his share for the remainder of the billing period, to the Municipality on the disbursement of trust funds on the second page

3. Fuel Oil Adjustment

If the Seller wishes to be reimbursed for the oil in his/her tank, his/her solicitor will instruct him/her to have the oil tank filled on closing. The Buyer will pay for a full tank of fuel as an addition to the price or credit to the Seller (top portion of the adjustments). RELANS developed a protocol to adjust based on 850L for a standard tank even though it can hold up to 910 litres. Due to risk of spillage, the oil companies try not to fill to the top and on average to approximately 850 litres when filling a tank. Always determine the size of the tank in any event prior to preparing the adjustments . Sometimes there is more than one oil tank on the property. The cost of a full fuel tank varies of course with the cost of fuel and has been increasing over the years.

If the property uses propane, the propane company may reimburse the Seller directly for the propane in the tank and will invoice the Buyer separately for a full tank or in the alternative, the adjustment may be done in the same manner as the oil top up where the Buyer pays the Seller on closing for a full tank. The latter is the more common. Ask your client to check how their propane company will deal with the adjustment. The propane tank will be rented as all are in Nova Scotia. Some owners wish to adjust for this rental as well on a prorated basis.

4. Extras

If the property being purchased is a new home, any extras requested by the Buyer or overruns on allowances will be added to the purchase price on the top portion of the adjustments or credits to the Seller. Similarly, any unused credits or allowances will be deducted or credited off the price.

5. HST

In the event the transaction calls for the payment of HST in addition to the price, such amount would be entered on the top portion of the adjustments. In the event the HST is included in the purchase price, you will want to show the breakdown of the price, HST and the applicable rebate, if any. Most firms now have the calculations set up on a spread sheet or use a program called Hot Docs which is most helpful to the solicitor.

6. Condominium Common Fee Adjustment

If the property is a condominium and the Seller has paid the common fees for the month of closing, he/she will want to be reimbursed for the remaining days in the month. (See example calculation in Schedule B - page 2). In that case, assume the condo fees are $95.00 per month and have been paid by the Seller for the month of February. Since there are 24 days remaining in the month, the Seller would want to be reimbursed for 24 out of 28 days or:

$95.00 / 28 X 24 = $81.43

If the Seller has not paid the common fees for the month of February, the Buyer will be required to pay those fees for the month of February and will therefore want a credit from the Seller for his/her share. The credit to the Buyer will be equal to the common fees prorated for four days of the month, being the period of the Seller's ownership. There is no need to do the condominium fee adjustment as you would do a tax adjustment with the amount actually paid as a credit to the Seller and the actual share of the Seller as a credit. This does not seem to be common practice, because the adjustment is for one month at a time rather than one year with several billing periods. Be careful if the management company tells you that the Seller`s fees for the month of closing are paid when the closing is within the first few days of the month. If the cheque does not clear, the Buyer will be responsible for that month and will have to seek reimbursement from the Seller themselves.

7. Contingency Fee/Reserve Account

The standard Agreement of Purchase and Sale provides that the credit in the Contingency or Reserve Fund is included in the price. In the event the Agreement of Purchase and Sale provides that the Seller is to be repaid the funds held in the Condominium Corporation to his credit, then the Buyer must pay that amount to the Seller as an addition to the purchase price. Be careful as there are a few condominiums that require a contribution to the contingency fund on a resale (which may be contrary to the Condominium Act) and often the agreement is silent on the issue. It may only be discovered upon a review of the Declaration or By-Laws or when the estoppel certificate is provided.

8. Tax Account Balance at Mortgage Company (Debit and Credit)

Although it is fairly unusual when interests rates are low for a prolonged period of time, sometimes the Buyer assumes the Seller`s mortgage. In this case, the Buyer receives a credit from the cash due on closing since he or she is taking over this debt. If the Seller has a credit in his/her tax account with the mortgage company, he/she will want the Buyer to reimburse him/her back for it. Therefore, you must refer to the assumption statement produced by the Mortgage Company to determine if there is a credit or a debit in the tax account. If there is a credit, the Buyer will reimburse the Seller. This will be done as an entry on the credit portion to the Seller.

If there is a debit or deficit in the tax account, the Buyer will take a credit off the price for the amount to compensate for the deficit in the tax account. The deficit in the tax account increases the amount of liability the Buyer is assuming. (See Schedule C - page 1 for example of credit situation.)

(ii) CREDITS TO THE PURCHASE PRICE- The bottom portion of page 1.

9. Deposit

The Buyer will receive a credit on date of closing for the amount of the deposit placed with the Seller's Realtor or Seller's solicitor. This amount is placed on the credits portion of the adjustments to reduce the balance of funds due to the Seller on closing. Sometimes the Agreement of Purchase and Sale provides that interest is to accrue on the deposit and to be credited to the Buyer on date of closing.

The common practice appears to be that the Realtor will invest the deposit and pay the interest on the deposit as a separate cheque back to the Buyer on closing. This allows the Realtor to invest the funds until the last minute and allows solicitors to confirm their adjustments in advance of closing.

10. Interest on any Outstanding Taxes

As we discussed previously, if the Seller has not paid tax bills rendered to him/her up to closing, there may be interest outstanding. The Buyer takes a credit off the purchase price for outstanding taxes for previous years <u>and</u> for outstanding interest. The Buyer takes this money by way of a credit so that the Buyer can use these funds to pay the outstanding amount. The payment of these amounts will show up on page two of the adjustments and will be discussed later.

11. Betterment Charges

When you call the tax office for the tax status relating to the property, you should always ask if there are any betterment or capital charges against the property. Under the standard Agreement of Purchase and Sale, any such charges are payable by the Seller if the improvements were completed on the date the contract was made. Therefore, the Seller is usually responsible for the payment of the betterment charges. Sometimes the Buyer's solicitor would rather take a credit for the betterment charges and pay them on closing date. If this is the case, the credit will be shown on the credits portion of the adjustments.

12. Mortgage Assumption

If the Buyer is assuming the Seller's mortgage, the amount to be assumed will reduce the funds due to the Seller on closing. The statement produced by the mortgage company as the amount to be assumed is not necessarily the amount to be placed on the adjustments.

You must look at the breakdown in the statement to determine what credits go the Seller and what credits go to the Buyer. For example, I have already discussed that the Seller will want a credit for the tax account balance. Also, most statements are prepared to be effective as of the first day of the month. If the closing is, for example, February 4th, the Buyer will want to take credit for four days of interest from the Seller, so that when the Buyer makes mortgage payment on the first of March, he/she will have received the Seller's share of the mortgage payment which is due on the let of March. Remember that the mortgage payment due on the first of March is for the period running February 1st to February 28th and this is the reason why the Buyer will ask for four days interest from the Seller. (Refer to Schedule C - page 1). You must be particularly careful when the closing is on the 1st day of the month. In that case, the Seller must still make the mortgage payment on that date, provided the mortgage assumption statement produced by the mortgage company indicates that the assumption figure is based on that payment having been made. Otherwise, if the assumption figure is calculated as if the payment is not made, you must take a credit for a full months' interest on the mortgage plus four days. Always check the effective date on the statement.

13. Vendor Take Back Mortgage

If the agreement provides for the Seller to hold a mortgage on the property, this amount is entered as a credit to the Buyer. In other words, the Seller is postponing his/her right to receive, for example, $10,000.00 of the purchase price and his security for that is a mortgage on the property. (Refer to Schedule A - page 1)

14. Release of Mortgage, Statutory Declaration

If the Seller has a mortgage to pay out from the proceeds of the sale or if there is a mortgage on record at the Registry of Deeds or Land Registration Office which has not been marked released, the Seller's lawyer will be required to undertake to payout that mortgage and record a release for recording to the Buyer's lawyer. See also Mortgage Payout Protocol - http://www.lians.ca/documents/MortgagePayoutProtocol.pdf

Note: a Statutory Declaration dealing with judgments is registered in the Judgment Roll at no cost.

15. Holdback

If there are deficiencies in the property on the date of closing, sometimes a holdback is agreed upon the by lawyers for the parties. Usually the Seller`s lawyer will hold the funds until the work is completed by the Seller. If the holdback funds are held by the Buyer's lawyer, credit is taken by the Buyer on the bottom portion of the adjustments and then transferred on the 2nd page to the Buyer's Solicitor's trust account which will be discussed more fully later on in the paper. If the Seller's lawyer holds the funds, there will be no credit shown on the first page of the adjustments because it does not affect the cash to close. However there will be an entry on the second page of the Seller's statement of adjustments showing that the Seller's lawyer is holding that amount in trust until deficiencies are completed. There will of course be an undertaking given by the Seller's lawyer to the Buyer's lawyer confirming that the funds will be held and upon what conditions.

16. Allowances

In the case of new construction, the purchase price often includes allowances for such items as flooring, fixtures and cabinets. In this way the Buyer can select his own flooring etc. If the Buyer is to arrange installation <u>and payment</u> of the flooring, a credit is given to the Buyer off the purchase price. The Buyer can then spend whatever amount he/she likes on flooring. This method you will see on Schedule C - page 1 as a credit to the Buyer. If, however, the price is to include the allowance and the Seller pays for the flooring then the allowance is not be reflected in the statement of adjustments because it is part of the purchase price. If the Buyer exceeds the amount of the allowance, the "overage" will be shown as a credit to the <u>Seller</u> as an addition to the purchase price. (Refer to Schedule C - page 1). The HST rebates may be affected by extras, overages and credits.

17. Rental Adjustment, Security Deposits and Interest on Security Deposits

If the property is a rental property and is sold with tenants remaining in the property, the Buyer will want his/her share of the rent for the month of closing. If the rent was $600.00 per month and the closing was on the 4th day of February, then the credit to the Buyer for the remaining twenty-four days would be calculated as follows:

$600.00 / 28 X 24 days = 514.08

In addition, the Buyer will want to obtain from the Seller by way of a credit, the security deposits and interest on that security deposit held by the Seller. Since January 1996 interest on security deposits are calculated at the rate of 1% annual compound interest. The interest is calculated until the date of closing. For example, interest to February 4th in any year from January first is:

security deposit / 365 X 35 days

Every year is calculated as security deposit x 1%, the resulting figure is then added on the security deposit. In other words, interest accumulated on security deposits plus interest in each succeeding year. Therefore, you will need to know how long the security deposit has been held in order to calculate the interest on it. (Refer to Schedule A - page 1). Previous to January 1, 1995, the interest was 3% so be careful to check the commencement date of the lease.

You can find the interest rate calculator on the web at:
http://gov.ns.ca/snsmr/access/land/residential-tenancies/security-deposit-interest-calculator.asp

(B) SELLER- CALCULATION OF NET PROCEEDS OF SALE

Once the balance due to the Seller has been calculated, the second page of adjustments is usually called the distribution of trust funds because in both cases, the lawyer is disbursing funds from the law office trust account. This page is used to determine either:

1. On the Seller's side, the net funds the Seller will receive after all deductions are made from the funds to pay encumbrances, legal fees, disbursements, HST, real estate commission etc. (see Schedules A-page 2; B-page 2; C-page 2); or

2. On the Buyer's side, the balance of funds required by the Buyer to close.

Which type of statement you use depends, of course, on whether you are acting for the Seller or the Buyer. In the Buyer's case, the additional costs are added to the net balance due to Seller. In the Seller's case, the funds received are disbursed to pay such items as Mortgage balance, real estate commission, legal fees, disbursements etc.

When acting for a Seller, the following amounts may be deducted to determine the net funds due to the Seller (Refer to Schedules A-page 3; B-page 3; C-page 3):

(1) Real Estate Commission

The deposit given by the Buyer is held in trust by the real estate broker who credits that amount to the real estate commission due. The broker will provide the lawyer's office with a commission statement showing the balance due for closing. Always double check the arrangement regarding commission with your client and check the calculations to make sure you're the statement is accurate. (Refer to Schedules A-page 2; B-page 2; C-page 2).

(2) Mortgage Payout

The mortgage payout statement will show the balance due on closing. I always check with my clients before closing to make sure the balance is correct. Sometimes penalties are added to the payout which may not have been expected by the Seller and it is better to communicate these figures to the clients before closing rather than have a delay on the closing date. The Seller's lawyer undertakes to payout the mortgage of the Seller and will want to be sure there are no obstacles in his/her way (Refer to Schedules A - page 3 and B - page 3).

(3) Holdbacks

Often the parties agree that the Seller's lawyer will hold any holdback funds in his/her trust account. If this is the case, there will be no adjustment shown on the first page, however, the Seller's lawyer will show that the funds are being held in trust on second page of adjustments, as a holdback from the proceeds of sale, not to be paid out to the Seller on closing until the conditions of holdback are met (Refer to Schedule C - page 3).

(4) Disbursements

Some disbursements to be paid out are:

1. regular office disbursements - postage, photocopying, deliveries, faxes, long distance charges;
2. recording costs - if the Seller has agreed to record any documents such as old releases;
3. estoppel certificate;
4. tax certificate etc.

(5) Judgments

If the Seller has a Judgment against him/her and the Seller's lawyer has agreed to pay them out of the proceeds of sale, any such amount is shown on the second page of the adjustments.

(6) Legal Fees

Most lawyers will deduct their fees, disbursements, and HST from the proceeds of sale at the time of closing.

(C) BUYER - CALCULATION OF TOTAL FUNDS REQUIRED BY BUYER/DISBURSEMENT OF TRUST FUNDS

If you are acting for the Buyer, the following are some amounts which may be added to the balance due to the Seller to determine the total funds required by the Buyer on closing:

(1) Deed Transfer Tax

This is a tax payable to the Municipality upon the transfer of title to the property. There are certain exemptions which the lawyer should be familiar with. The tax is a percentage of the purchase price. The tax varies from Municipality from a high of 1.5% in the Halifax Municipality to no tax in some Municipalities.

(2) Municipal Property Taxes

If there are taxes owing to the Municipality, the Buyer will remit to the Municipality the outstanding amount. However, he/she will have received a credit for the Seller's share of the taxes up to closing. This amount was held back from the Seller as a credit to the Buyer on the first page of the adjustments. The Buyer may be responsible for a certain of the total amount that is outstanding for taxes because the tax bill represented a period of time both before and after closing. Therefore, some of the Buyer's funds together with the amount received from the Seller as a credit towards to the purchase price will be used to pay these taxes. Any interest outstanding will, of course, be added on and paid out with the taxes owing.

(3) Tax Certificate

If the Buyer and Seller are to do a proper adjustment for taxes, a Tax Certificate is normally ordered by the Buyer from the appropriate municipality and paid for by the Buyer. If the Buyer is using title insurance, there may not be a tax certificate cost.

(4) Payout of Existing Mortgages

Sometimes the Buyer agrees to payout the Seller's mortgage. This may happen if the Seller is not represented by a solicitor and in certain other cases. If the Buyer takes a credit on the first page of the adjustments for payment of Seller's mortgage, the same amount must be entered on the second page so that the funds taken off the purchase price representing the mortgage payout are actually used to payout the mortgage.

(5) Payout of Existing Liens or Judgments

If the Buyer has a judgment against him/her, this amount must be paid out from the proceeds of sale. If the judgment is against the Seller and if the Buyer took credit on the first page, then the amount of the payout will be added on the second page (See Schedule A - page 3). If the Seller's solicitor undertook to payout the lien or judgement, it would be on the Seller's second page (See Schedule A - page 3).

(6) Preparation of Second Mortgage

Often the lawyer for the Seller charges a fee for preparation of the Vendor take-back mortgage. This fee is either paid by the Buyer as a separate cheque to the Seller's lawyer or is added on to the purchase price on the first page of adjustments and the Seller's lawyer recovers it from the Seller or is added to the second page of adjustments and is paid by the Buyer's lawyer as a trust cheque to the Seller's lawyer. The more common practice is to add to the price, the cost of the preparation of the mortgage. The Seller's lawyer then deducts it from the sale proceeds.

(7) Payout of Betterment Charges

If the Buyer has received credit for the Seller's betterment charges, the Buyer will have to take those funds to payout such charges. The amount that was taken as a credit on the adjustments between the Seller and Buyer is entered on the second page so that the Buyer's lawyer will payout those charges. (See Schedule A - page 2)

(8) Other Amounts Payable on Closing

All of the legal fees, disbursements, title search costs, title insurance (if applicable) recording, surveyors costs and, HST are also added on to determine the net balance to close (Refer to Schedule A, B, C - page 2 for complete list). Most firms have the adjustment sheets on a spread sheet or use the Hot Docs program, or have special programs which serve as a reminder of what items must be entered.

(9) Final Balance

The total sum required at closing is determined by adding all closing costs to the adjusted purchase price determined on the first page of the adjustments. The mortgage of funds are deducted from the total funds required. The net figure represents the amount of money the client must bring in to the lawyer's office to complete the closing.

<u>Always</u> remember to obtain a certified cheque or bank draft from your client, representing the balance of funds required to complete the purchase. The client's funds and mortgage funds are assembled in your trust account and are often paid out the same day for the purchase of the property.

One word of advice... Even the most seasoned practitioner can make mistakes when doing adjustments. I have found it most helpful to have my assistant double-check adjustments or in the alternative, I will check her adjustments. This prevents errors from happening and the embarrassing situation of telling your clients that they need more money to close the transaction.