Property Taxes are Making My Head Hurt

Property taxes in Oregon are all kinds of funky. When you close your home purchase, you'll probably pay about a year of taxes at closing, spread out on a few line items with names like "pro-rates", "escrow" and "hold and pay". Let's unravel what's behind all the mysteriously things on your Closing Disclosure.

Dates to Note

To make sense property taxes, you'll need some background information. The fiscal year for taxes in Oregon is July 1 to June 30. Property taxes are due each year on November 15, not quite halfway through the fiscal year. Odd, right? By the time taxes are due, you're already 4 months into the year for which you're paying. My hypothesis: November 15 must have been the birthday of Oregon's first tax assessor. (But I could be wrong about that.)

So how does this mishmash of dates relate to what you pay at closing? Let's talk about each of those three line items on which property taxes might be listed at closing:

Pro-rates

Your purchase agreement has a section devoted to "prorations". You'll find this on line 347 and 348 of the 2018 Realtor forms. Look at that section and odds are there's an 'x' next to "the Closing Date". That means you have agreed to pay the taxes for the days that you own the home and the seller has agreed to pay taxes for the days that they owned the home. Totally fair; totally makes sense.

How much you and the seller have to pay to square up depends on the closing date. If you happen to close on July 1st (the first day of the fiscal year), there will be no prorates. You'll pay the tax bill in November for the fiscal year that started on July 1st, the very day you got your keys. Perfect!

But what if you close on any other day?

If you close on any day from July 2nd through November 14th, your seller owes you a credit. You will be paying a tax bill on November 15th for a tax year that started on July 1st, even though you didn't own the house yet. So the seller will pay you a credit for each day from your closing date until November 15th.

If, on the other hand, you close between November 15th and June 30th, you'll pay prorates to your seller. Why is this? Last November 15th, the seller paid the taxes through the upcoming June 30th. At closing, to even up, you need to pay your seller a credit for each day from your closing date until June 30th.

Escrow Deposits

At closing, most loans are set up with an "escrow" account. An escrow account is a little savings account that pays the taxes and insurance on your home for you. Each month, along with your loan payment, you will pay one twelfth of your annual property taxes and insurance premium. The tax and insurance part of your payment gets deposited into your escrow account. Each year, when the taxes and insurance come due, your mortgage company dips into the money you've saved up in this account to pay your taxes and insurance.

At closing, will kick off your escrow account with an initial deposit. The goal is to have 14 months of last year's tax bill set aside when this year's tax bill comes out. The County will mail out your tax bill in October, about a month ahead of the November due date.

Julee Felsman • VP of Mortgage Lending
juleef@rate.com • (503) 799-3711
NMLS#120831
CA - CA-DBO120831 • OR - Licensed • WA - MLO-120831

So at closing, your lender works backwards. We figure out how many months of payments you're scheduled to make into your escrow account between your closing date and October. At closing, we collect enough to make up the difference and plop that into your escrow account.

Hold and Pay

If you close in September or early October, things get a little weird. As the property tax due date approaches, the County will file a lien against your new home-to-be for the taxes coming due in November. When this lien is first filed, unhelpfully, it has no dollar amount attached to it and, equally unhelpfully, the County will not accept payment.

All liens on your new property must be paid before we can close a mortgage, so this poses a bit of a challenge: How do we pay a lien for an unknown amount to an entity that won't accept payment?

Lending would come to a standstill each year, but for a clever workaround—called a "hold and pay". If your loan closes during this funny window of time, the title company will act as a middleman -- collecting for this year's taxes, holding the funds and paying the bill as soon as it is available.

Because the title company doesn't know exactly how much your tax bill will be, they collect a little more than they expect to need (usually 110-120% of the prior year's taxes). When the County gets around to issuing a bill, the title company pays it. The excess money gets refunded to you. If you have a hold and pay at closing, keep an eye out for a check in the mail… sometime in October you can have a nice dinner out with your windfall! (One caveat: If the seller paid 100% of your closing costs, the refund may be due to your seller.)

Examples

So how does this play out? As you read the examples below, remember that we know a property tax bill is coming along in October and our goal is 14 months of last year's taxes in your escrow account at that point.

If you close July 1st, your first loan payment is due September 1st. You'll write two mortgage checks (September 1st and October 1st) depositing 2 months of taxes into your escrow account as you do… then along comes the tax bill. So at closing, you must deposit 12 months of taxes into your escrow account. (12 months at closing + 2 months of payments = 14 months by October.) Closing July 1st, there are no prorates due, that 12 months of escrow deposit is all that you owe.

If you close August 1st, you'll only pay one payment (October 1st) and then the tax bill shows up, so you need to put 13 months of taxes into your escrow account. (13 months + 1 month payment = 14 months by October.) With an August 1st closing date, the seller owes you a month of tax prorates. (13 escrow deposit - 1 month of prorates = 12 months due at closing.)

If you close June 1st, you'll pay three payments (August 1st, September 1st and October 1st) before your tax bill shows up, so you only need to put 11 months of taxes into your escrow account. (11 months at closing + 3 months of payments = 14 months by October.) But in addition, closing June 1st, you owe your seller a month of prorates. (11 months escrow deposit + 1 month prorates = 12 months due at closing.)

A Helpful Shortcut

Did you notice the pattern? There's an easy shortcut: your prorates and your escrow deposit will always add up to between 11 and 12 months of taxes due at closing. Although, if you happen to close during that funny "hold and pay" window (in September or early October), plan on paying 15 to 16 months of taxes at closing (some of which should be refunded to you later).

And of course, the helpful folks at the title company will work out the math for you and the seller.

Julee Felsman • VP of Mortgage Lending
juleef@rate.com • (503) 799-3711
NMLS#120831
CA - CA-DBO120831 • OR - Licensed • WA - MLO-120831

A Frequently Asked Question

"Since I pay a year of taxes at closing, does that mean my mortgage payment doesn't include taxes for the first year?" Intuitively, that makes sense, but the answer is 'no'.

Even though you paid a whole year of taxes at closing (and a year of insurance too), your mortgage payment will include taxes and insurance from payment one. Remember that your escrow account is a savings account. You pay into this account all year long and taxes and insurance are paid out, once a year when they come due.

If you stop paying in (or don't pay in after making your initial deposit at closing) the account won't have enough money in it to cover your taxes the next time the they come due.

It's a little bit of an oversimplification, but you can (kinda, sorta) think of the taxes you pay at closing as covering this year's taxes and the taxes you pay in your monthly payment as saving toward next year's taxes.

Annual Escrow Review

And while we're talking about your escrow account, I'd be remiss if I didn't mention your annual escrow review. Each year (usually in January or February), you'll receive a statement showing the activity in your escrow account during the past year. It shows what went in in estimated payments and what was paid out to the actual tax and insurance bills. Because taxes and insurance change over time, your lender needs to do a little quick math and adjust your monthly payment to cover any changes to these cost.

And of course, like most things in life, taxes and insurance usually increase over time. So most years this means your monthly payment will go up too. Under normal circumstances, budgeting for a 5% change to the tax and insurance portion of your payment should do the trick. However, if you've made any big changes to your house (which can change taxes) or insurance plan, you may see a larger-than-normal adjustment.

Julee Felsman • VP of Mortgage Lending
juleef@rate.com • (503) 799-3711
NMLS#120831
CA - CA-DBO120831 • OR - Licensed • WA - MLO-120831