
HOW DO CONSTRUCTION LOANS WORK



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THE CONSTRUCTION LOAN:

A construction loan is a mortgage agreement designed specifically for those who are building a new home. This is how it works:

- 1. You buy the vacant land first and then arrange to build on this land in an agreed timeframe (or you can make a deposit to the lender - usually 20% of the total cost although some will lend up to 95%) This provides the lender with security and a commitment from you.**
- 2. The lender releases funds as progress is made. This is the more traditional method.**

Point one speaks for itself, but let's take a closer look at point two.

With a construction loan, the lender considers the total amount required to pay the builder to complete construction. This amount is then broken down into 'progress payments'; separate payments that come out of your mortgage fund and are made at each phase of the building process to the builder. The lender will only require you to pay interest due on the amounts drawn. Let's use this construction loan example to demonstrate.

If your loan is for \$300,000 and your first invoice is for \$55,000, the interest will be calculated on your account balance of \$55,000 as well as fees. Full principal and interest payments begin once the house is built and you are in your home.

COMMON MISCONCEPTIONS AND MISTAKES:

There are a few things that a lot of people don't quite understand when it comes to construction loans:

1. You don't need to already have land!

Great news: some folks think they already need to own their lot in order to get a loan to build their home, but that's not the case! It is normal to have construction loans for people that include both the house and the land: it's all part of the cost of building a house. If you have your land already, that's great, but you certainly don't need to.

2. Don't think "I've been approved, so the bank will take care of me no matter what"

Sometimes people will get approved for a construction loan, which they get excited about, and in their excitement while designing their home, they forget they've been approved up to a certain limit. Don't think this will automatically be extended if your costs go up.



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3. Don't go on a spending spree after getting qualified

This is especially important if you have a two-step loan: sometimes people think "I'm qualified for a huge loan!" and they go out and buy a new car... which can be a big problem, because it changes the ratio of their income and debt, which means if their qualifying ratios were close when obtaining their construction loan, they might not get approved for the mortgage that is needed when the construction loan matures. Don't make this mistake!

4. Don't forget to pay your other bills!

This one may seem extremely obvious, but things happen sometimes that make a bigger impact than you might expect. The truth is that mortgage companies really don't care what "the story" is on why you're late on a payment - if you go on a vacation and forget to pay your mortgage, your credit score is toast.



5. Make sure you have a contingency for unexpected or unplanned expenses

There will be extra expenses when building a home, and you need to have a way to pay for them. Sometimes these expenses are for issues and problems that come up, like finding rock when excavating.

Other times, even if you don't find surprises when excavating, you may have good reasons for adding to the project's cost; you may change your mind on some allowance items and would want to get an upgraded flooring material. Perhaps you come up with good ideas or find some appliances or finishes that are more than you budgeted: not having the money to purchase these items can suck the fun out of building your home. You wouldn't want to have to say "no" to things just because you didn't budget for them.

So changes can either be positive or negative things, but they still need to be paid for, so you want to make sure you have some extra money set aside.

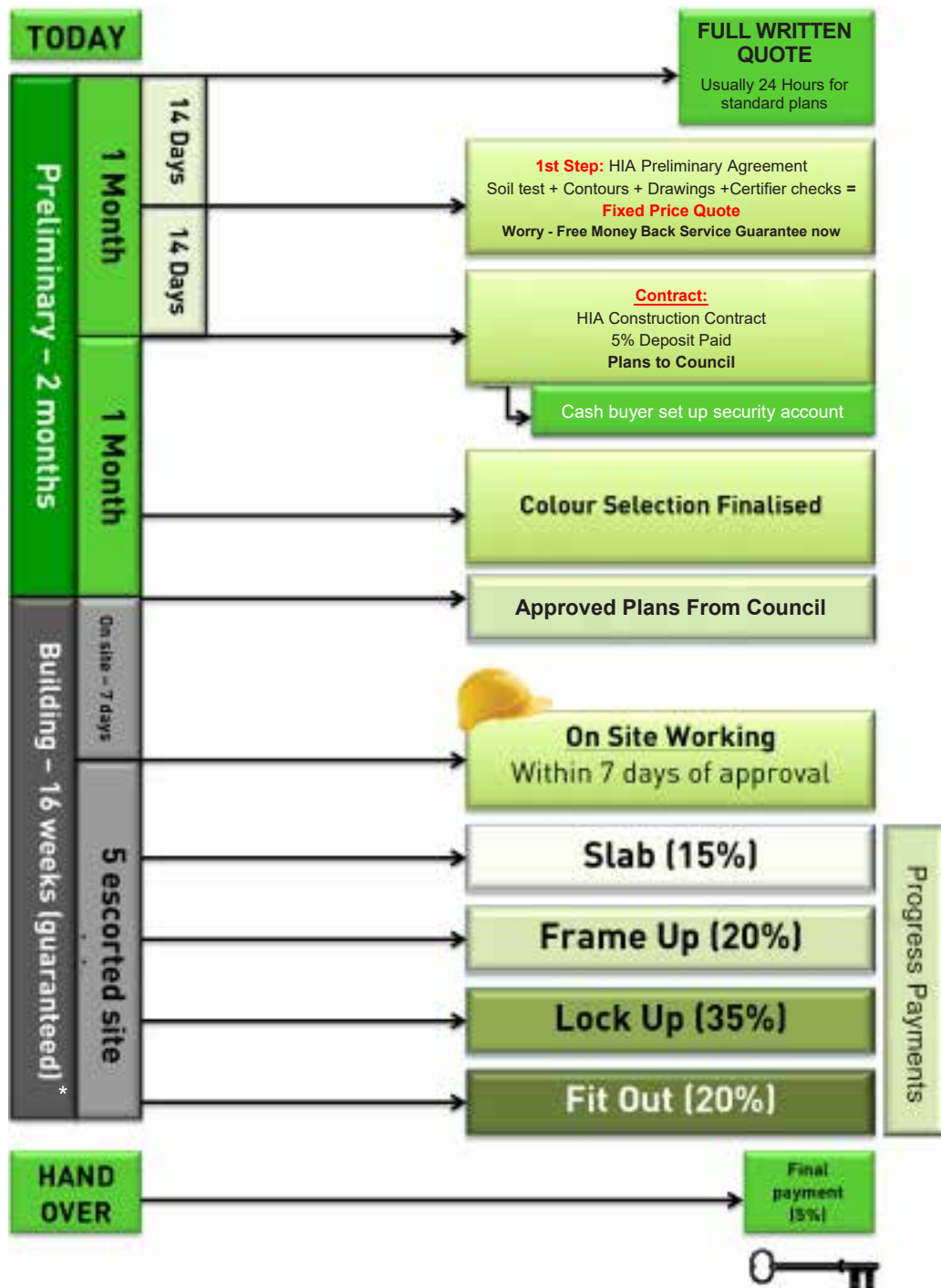


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FROM CONCEPT TO CONSTRUCTION



*16 week build time applies to single level homes under 300m2. Does not apply to split-level homes.



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