

TIPS TO FINANCE

# HOME CONSTRUCTION

Claremont Savings Bank 

WWW.CLAREMONTSAVINGS.BANK



NMLS# 418469

# HOW A HOME CONSTRUCTION LOAN WORKS

1

## UNDERSTANDING A CONSTRUCTION LOAN

When you apply for a loan to build a home, the lender doesn't have a complete home as collateral, so qualifying for a loan can be challenging. The lender will want details about the home's size, the materials to be used and the contractors and subcontractors who will do the work. The general contractor can pull all this information together with their estimates. All contracts must be signed by borrower and contractor.

The bank will not only look at the information above to qualify you, but will also review your credit history and your debt-to-income ratio (this includes all your monthly debt payments plus your mortgage payment, estimated property taxes, Homeowners Insurance and any Association fees) to ensure affordability.

2

## SELECTING THE RIGHT LOAN

### Construction-to-permanent loan

- Borrow to pay for the construction
- Only pay interest on outstanding loan balance during construction phase
- Loan balance converts into a permanent mortgage upon completion of construction
- Lock mortgage rate at beginning of construction
- Typically a 20% down payment is required to begin construction (lower down payment options may be available)
- May be able to use land value toward down payment
- One set of closing costs and fees

### Construction only loan

- Borrow to pay for construction, then get a mortgage to pay off construction debt
- Can't lock maximum mortgage rate at beginning of construction
- May allow smaller down payment based on construction loan value
- If your financial health changes during construction, may limit options and rates for mortgage
- Two sets of closing costs and fees: one for construction loan, one for complete home mortgage

3

## CHOOSING THE RIGHT BUILDER

Find a builder that has built the kind of house you want in terms of price, style and size. Look into the builder's credentials with the local homebuilders association and ask for references from previous clients. Ask your builder for proof of insurance and check with the Better Business Bureau to see whether there are any complaints against the builder.

4

## APPLYING FOR BUILDING PERMITS

It's essential that you get the right building permission and the necessary permits required to build your various structures. By getting the right permits, you will avoid fines and work delays. If you proceed to build without the proper permits, you expose yourself to penalties, including having to take the structure down after you've built it. The right permits for construction projects will also ensure that safety standards are met. It's important to adhere to building regulations because these codes are in place for a reason and public safety is one of them.

The method of applying for building and construction permits will vary depending on the state that you live in. You can get all the information necessary at your state government's website. Leave ample time for the permit process, because it can take weeks or months for your permits to come through. Most lenders will require a copy of your building permits before the loan can close.

5

## BUILDING PROGRESS INSPECTIONS

Lenders will conduct routine inspections as the home is built. During this period, the lender pays the builder in stages, called "draws," and usually sends an appraiser or inspector to make sure that construction proceeds as planned. This process keeps the construction draw amount and completion percentage in line.

6

## PLANNING FOR UNEXPECTED COSTS

Cost overruns can occur when borrowers change their minds during the construction process or if the price of materials increase. It is recommended to have a 10% overrun budget available.

# FREQUENTLY ASKED QUESTIONS

## HOW DO I SELECT WHAT BUILDER TO USE WITH SO MANY TO CHOOSE FROM?

When hiring a builder it is important to remember you are buying a service – not just a product. The quality of service the builder provides will determine the quality of the finished product and your satisfaction with it.

Here are some questions to consider when choosing a builder:

- | YES                      | NO                       |   |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | 1. Am I comfortable with them and do I feel they are a good fit?  |
| <input type="checkbox"/> | <input type="checkbox"/> | 2. Are they quality oriented and do they offer a warranty?  |
| <input type="checkbox"/> | <input type="checkbox"/> | 3. Are they a good listener and will they accept changes?   |
| <input type="checkbox"/> | <input type="checkbox"/> | 4. Do they primarily build custom homes or “spec” homes?  |
| <input type="checkbox"/> | <input type="checkbox"/> | 5. Can they supply me with multiple references from other people they have built for?                             |
| <input type="checkbox"/> | <input type="checkbox"/> | 6. How long have they been in business and can I see other homes they have built?                                 |
| <input type="checkbox"/> | <input type="checkbox"/> | 7. What is their reputation in the building industry? Do they have subcontractors who would speak highly of them? |
| <input type="checkbox"/> | <input type="checkbox"/> | 8. Are they a member of the HBA (Home Builders Association) and do they abide by their standards?                 |
| <input type="checkbox"/> | <input type="checkbox"/> | 9. Have they built different home styles and have they ever managed a project like mine?                          |
| <input type="checkbox"/> | <input type="checkbox"/> | 10. Can they offer ideas and guidance throughout the entire building process?                                     |
| <input type="checkbox"/> | <input type="checkbox"/> | 11. Can I review all of their contracts and required documentation in advance?                                    |
| <input type="checkbox"/> | <input type="checkbox"/> | 12. Am I comfortable with the terms of the proposed project?  |

## WHEN DO I HAVE TO MAKE OUR DOWN PAYMENT?

At the time the bank closes on your construction loan, you will have to furnish your down payment. The down payment is held by the bank and is used to fund your builder’s draws. Once they have exhausted your funds, the bank will begin to fund the builder’s draw requests from your construction loan. There is no interest paid on your down payment.

## WHAT IF I WANT TO MAKE CHANGES DURING THE CONSTRUCTION PROJECT?

Changes are never a problem and are a common occurrence with custom home construction. If your changes result in a decrease in square footage, change in the home type (two story to a ranch, etc.) or some type of change that results in the value of your new home decreasing, you will need to notify the bank immediately. These may affect your loan and changes like this should not be made prior to talking to the bank.

It is not uncommon for things to change during construction. Even though your builder may do a detailed review of your floor plan prior to starting construction, once they are in the field they may even suggest minor changes and modifications that will improve the functionality of your new home. They will encourage and welcome your feedback and thoughts as to things you may want to change while your home is being built. Changes can result in additional costs or a decrease in costs depending on what the change is. Unless you have allowed funds in your construction loan for cost overruns, be prepared to pay for these changes in cash at the time you request the change.

## WHAT HAPPENS IF THERE ARE CONSTRUCTION DELAYS AND CONSTRUCTION IS NOT COMPLETE WHEN THE LOAN COMES DUE?

You typically have 9 months to 1 year to complete the construction. It will be important to keep in close contact with the bank on any delays, however the bank will typically be aware of delays through the inspection process. Your bank will work with you on these issues on a case-by-case basis.

## WHEN DO LOAN PAYMENTS START?

With a construction-to-permanent loan your interest only payments will typically begin 30 days after your loan closing and will be based on any drawn funds. You will pay interest only on the drawn balance during the construction phase and then your regular principle and interest payments will begin during the next billing cycle for the permanent mortgage.

# GLOSSARY

**CERTIFICATE OF OCCUPANCY** The local jurisdiction's certification that all construction requirements for occupancy have been met.

**CHANGE ORDER** Documentation of a variance from the original agreed upon scope of the construction work to be completed. Change orders are common on large construction projects and can result in amendments to price and timeline. The change order defines the new work to be completed and it becomes a part of the original construction contract.

**CONSTRUCTION BUDGET** The construction budget includes all budgeted costs necessary to build the project to completion. These costs include, but are not limited to, land cost, hard costs, and soft costs.

**CONSTRUCTION CONTRACT** A legal document between a borrower and a general contractor, which specifies the details and terms under which a construction project will be performed.

**CONSTRUCTION PERIOD** The estimated timeline to complete construction from commencement through receipt of the certificate of occupancy.

**CONTINGENCY COSTS** Estimates for unknown factors that can influence the cost to complete the construction project. Contingency costs are a standard component of a construction budget.

**DEBT TO INCOME RATIO** This is your monthly payments (including monthly debt plus projected mortgage payment, estimated property taxes and homeowners insurance) divided by your monthly gross income. This ratio is one way lenders measure your ability to manage your payments and to repay the money your loan.

**DRAW REQUEST** A submission made by a borrower to a lender in connection with a request for loan proceeds. The package provides detailed documentation regarding expenses to be paid with the requested loan proceeds and estimates of total work progress. The specific form of the submission is agreed upon by the borrower and the lender prior to loan closing.

**HARD COSTS** Costs related to the physical development of the project, including labor; materials; infrastructure; furniture, fixtures & equipment (FF&E), site work, landscaping and contingency costs. These costs are addressed in a construction contract with a general contractor.

**INDEMNITY CLAUSE** A commonly negotiated feature of contracts with contractors, (general contractor, architect, designer, etc.), which provides parties to the agreement with relief from any potential liability caused by certain acts. Indemnity clauses can benefit either party, but in the case of construction projects, owners commonly negotiate for contractors to indemnify them against losses or claims relating to defects in their work performance.

**LAND COST** The cost or value of the land to be developed, which can be the purchase price of the parcel or a current market valuation that must be agreed to by the lender.

**LOAN-TO-VALUE (LTV)** This expresses the ratio of a loan to the value of an asset purchased. The term is commonly used by banks and building societies to represent the ratio of the first mortgage line as a percentage of the total appraised value of real property.

**PLANS AND SPECIFICATIONS** Commonly referred to as "Plans and Specs." These include all construction drawings related to the project, which cover building, mechanical, and electrical plans, as well as materials selections and specific installation instructions for the subcontractors.

**SOFT COSTS** These are the costs of development, which do not relate to the physical construction of the building but are necessary to complete the project. These may include architectural and engineering costs, third party reports, permit/licensing/regulatory fees, developer fees, finance fees, construction interest reserves and operating deficit reserves.

**ZONING** A designation made by a local zoning authority that governs land use, which must align with the proposed development plans in order for the project to proceed.

# CONSTRUCTION WORKSHEET

Property Address \_\_\_\_\_

General Contractor \_\_\_\_\_

BREAKDOWN	CONTRACTOR	ESTIMATE	PRE-PAID AMOUNT
Site Work: Excavation, Driveway, Lawn Seeding			
Septic Design & Installation			
Foundation			
Well			
Cost of House if Modular or Material Package			
Carpentry & Labor			
Plumbing/Fixtures			
Electrical/Fixtures			
Heating & Cooling System			
Drywall			
Floorings			
Interior & Exterior Painting or Siding			
Appliances			
Miscellaneous			

**TOTAL ACQUISITION COSTS** \$ \_\_\_\_\_

(includes loan balance on the land and above construction costs less any pre-payments)

Purchase price or appraised value of land\* \$ \_\_\_\_\_

\*If land has been owned less than 12 months use the purchase price; if owned more than 12 months use the appraised value.

Lenders look for 80% LTV based on acquisition costs or appraised value, whichever is less.

Attach materials list and quotes/contracts signed by both Contractor and Borrower(s).

Please make notations if items listed above have already been completed/paid for – need paid receipts to document total acquisition costs or to be reimbursed for this cost from construction funds.

# NOTES



Claremont • Charlestown • West Lebanon • Springfield, VT



Member  
**FDIC**

800-992-0316

*Apply Online* [claremontsavings.bank](http://claremontsavings.bank)