Johnson Bank

CONSTRUCTION LOANS

What You Should Know

Building the home of your dreams is an exciting prospect.

The thought of everything being brand new and designed to your exact specifications – from the size of the rooms to the color of the walls – is thrilling. It's yours in more than name; it's a complete reflection of your preferences and personality. Yet just as a solid foundation is important to any well-constructed house, financing is critical to the construction process as a whole. Here's the background information you need to get started.

CONSTRUCTION FINANCING: IS IT REALLY THAT DIFFERENT?

While a construction loan isn't necessarily more difficult to obtain than a conventional purchase or refinance loan, it is more complicated to process. It's a process rather than a one-time transaction. It involves a variety of factors and a number of specific parameters. There's more paperwork, more discussions and more decisions. But when done correctly, it can pave the way to a happy home building experience.

This is why pre-approval is the most important first step. It's how you find out for sure whether you can afford to make your dream come true based on your current assets and existing debt. (The last thing you want is to sell your existing house or be in the middle of drawing up plans before learning that you don't qualify for the loan.) If you're working with a quality lender, it's also the point where you can get answers to all your questions about the construction process: what's involved, what you are responsible for and what to expect of the builder.

FINDING A GOOD LENDER

Of course, you can't get pre-approved for construction financing until you select a lender. Ideally you'll want to work with one who:

- has a lot of local experience in construction financing with a good reputation among area builders and customers alike.

- is willing to answer all your questions, explains the process in a way that is understandable, and asks questions that help you make fully informed decisions about the building process.
- you feel comfortable with. Again, construction financing is a process, not a transaction. Is the lender one who you will feel good about meeting with and talking to over the next six to twelve months?

Not all lenders handle construction financing; others handle it, but maybe not well. The best construction lenders fit the above considerations and offer more than one or two construction loan programs. They are the ones who can provide you with the right options to best meet your unique needs.

FINANCING OPTIONS TO ASK ABOUT

Construction lending is so intricate both because you're buying something that doesn't yet exist and because you most likely have current expenses that need to be maintained. If you're currently living in a home, you need to cover that mortgage while paying toward the construction of your new house. While construction is ongoing, you will need to have money in an escrow account to pay the builder at designated points throughout the process. After the building is complete, you may need additional funds to finance certain aspects like landscaping. These are only three of the possibilities that play into the type of loan you will need.

With so many variables, it's easy to see why lenders with more options are often the better choice.

Typically most new construction loans are adjustable-rate mortgages, or ARMs. This gives the borrower a lower interest rate during the building process. The ARM is usually converted or modified to a longer-term fixed-rate loan once construction is complete.

Some lenders offer a variety of flexible options tailored to the customers' varied needs. This can include the ability to convert or modify the loan rather than refinance it, saving you associated refinancing costs. Down payment requirements may range from 5 to 20%.

Of course, there are particular benefits built in to every construction financing product, so in addition to working with a lender who provides a variety of options, it's important to work with one who knows the new construction market and the best product for the market based on your time frame and loan amount.

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OTHER POINTS TO CONSIDER

Experienced construction loan providers can provide a wealth of information on the entire construction process, not just the financing portion. Here are a few of the tips they often share:

SELECTING A BUILDER

- Look for ways to educate yourself on the builders and contractors in your area by attending home builder shows, talking to vendors, reading online reviews and participating in seminars, etc.

PURCHASING A LOT

- If you haven't already purchased a lot, anticipate needing 60 to 70 days for closing. This gives you time to review the contract and develop plans, and ensures that you have enough time to complete an appraisal.
- Make sure the lot you plan to purchase can accommodate the home you want built. The dimensions, pitch and location can all factor in to the size and type of house that can be built on it.

CONSTRUCTION CONTRACT

- Your construction contract should be as detailed as possible for your protection and include a spreadsheet itemizing all the costs associated with the construction of your new home.
- The contract should support the appraisal value. The appraiser will assign values based on the level of detail and quality specified: for example, you want the contract to specify "Anderson Wood Windows" versus "Windows" so that you, your builder and the appraiser understand the specific type of windows that will be installed.
- Your contract, blueprints and specification sheet all need to be completed before an appraisal is ordered.

USING A TITLE COMPANY FOR CONSTRUCTION DRAWS

- Typically a construction loan has four to five draws during the building process. (A draw is a portion of the total cost of the construction paid to the builder at certain points during the process.) An inspection of the project will be done before each draw is distributed to the builder to ensure that part of the building project has been completed to your satisfaction.
- A title company should be used to administer the draw account because it is neutral to the builder and the lender. They're in an objective position to make sure draws are only done when certain project milestones are met.

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