New for 2023

Construction Loan Inside Secrets

Knowing How To Obtain The Best Loan To Build Your Dream Home.

"If the everyday consumer really wants to have a great experience in building thier dream home then this is a must read.- Rick Gomez

After reading the following 15 construction loan "Inside Secrets" you will know more about construction loans than most loan officers, bankers, and home builders.

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INTRODUCTION

I started out working in the construction loan business way back in 1984. It was my first real job, and I was a mere 25 years old. The interest rates in 1984 were 14%, yes, you read that correctly. The crazy thing is that interest rates the year before were 17%. With interest rates that high you would think that no one would want to build but they did. Interest rates will always go up and down because everything in life is cyclical especially the real estate market. With the many different loan products that exist in today's marketplace homeowners are always looking for the best loan to fit their specific needs.

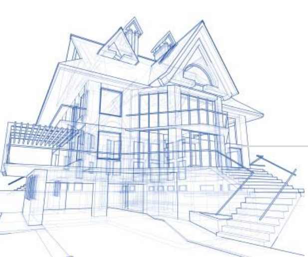
Over the years I have seen a lot of changes in the construction loan industry over the last 30 years. Firstly, the only type of construction loan that existed way back when was a construction only loan. The banks would provide you or your builder up to 12 months to build a home and then you would have to refinance upon completion. If you couldn't refinance your new home the banks "could" foreclose on your home. Today's popular construction to permanent loan solved the refinance or conversion part of the construction loan by combining the construction part of the loan with the end loan. aka; one time close.

With today's technology in the home lending world, you can pretty much get any type of construction to perm loan anyway you want whether it's an adjustable or a fixed product. The problem is most banks simply do not offer construction loans. Some of the best advertised construction loan lenders have below average programs and/or higher interest rates.

You literally must search to find the best construction loans available in today's marketplace and the best way to do that is through a **construction loan specialist**. Someone that is not only experienced with construction loans but someone that is objective and can tell you the pros and cons each lender. Why because the devil is always in the details. It used to be all about the rate now the hidden problems are in the loan to value and how much cash you're going to need to close once the appraisal is completed, etc.

So, I wrote this e-book to help you strip away a lot of the construction loan mysteries out there and help you find the best loans and rates. I have personally built 2 homes over the past twenty years and have funded multi-millions of dollars of construction loans for customers just like you.

Just remember no matter who you decide to work with if you want the best service or product of any kind you need to always work with a specialist versus a jack of all trade. That small bit of advice is worth its weight in gold, for some reason including myself at times people are drawn to good sounding loan officers not "real" specialists. The best way to find a good specialist is to find someone that has been providing construction loans their whole career longer than 15 or 20 years.



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1. Why You're Going to Need <u>Luck</u> and <u>inside knowledge</u> to Get the Best Construction Loan.

The reason most people don't have a chance in obtaining the best construction loan is because they don't know the inside industry secrets.

As a matter of fact, most industries never let the truth out because their products are just not perfect. If banks had to tell you the truth about their construction loans and their flaws you would hit the road and continue shopping.

Imagine a bank telling you that "the bank down the street has the best construction loans in town". It will never happen assuming they want to stay in business. It's not that those banks and their loan officers don't tell the truth, it's just that they don't tell you everything. They need your business and want to keep their jobs, so they sell you or mislead you into buying their products.

Also, customers feel obligated to their banks and loan officers because they have relationships. They will settle for an average construction loan because they feel obligated or embarrassed if they went to another bank.

Now don't get me wrong most people simply just can't find a good construction loan. That's because they are hard to find, decipher and when they find one, they just take whatever they can find. So, are brokers the answer?

Most brokers are not construction loan specialists in fact most brokers are a jack of all trade. Brokers try to do everything, and most are just not the answer. The answer is to always find the specialist. Think about it if you needed heart surgery would you want someone new or a jack of all trade? No, you want the best you can find or afford so you can live a long and healthy life.

2. What comes first the land purchase (chicken) or the construction loan (egg)?

This Chapter is only for those that do not own land Yet.

I get calls every single day from people wanting to build a new home but have yet to purchase land, obtain house plans, determine construction costs and most importantly have yet to submit house plans for approval. All lenders require the above to obtain a construction to perm loan.

The phone calls I get are from individuals wanting to "combine" the land purchase and construction loan into one loan but 99.9% of the time it doesn't work… here why!

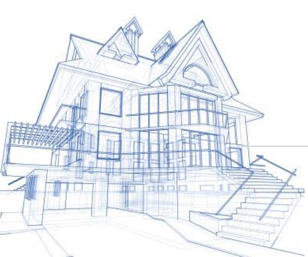
Obtaining an all-in-one construction loan with the purchase of the land is "possible" and "does happen" but here are the reasons it usually doesn't work.

1. Rarely will a land seller and realtor wait around a few months for you to obtain house plans, find a builder, obtain costs, and submit plans to the county planning department for approval.
2. All the above items are requirements by the bank if you want to combine the land purchase and construction into one loan.
3. The most common exception to the rule is if the land is being sold along with approved house plans or if the seller of the land is willing to provide owner financing while you obtain house plans and plan approval from the city or county.

The solution is to buy the land first with temporary seller financing or obtain a land loan which we do offer.

Once the land is in your name you can then focus on obtaining the items required by the bank to qualify for a construction loan.

Remember, for you to obtain a construction loan, the bank requires that you already have the land (the land does not have to be paid in full), house plans, contractor, and cost breakdown. **If you would like information on obtaining a land loan, give us a call and we can help you with that.**



3. Which lenders/banks have the best construction loans?

There are plenty of banks willing to lend money for buying an existing home, refinancing, home equity loans and every other type of loan. But if you're planning on building a new home, where can you obtain the best construction loan with the most competitive rates and pricing?

More importantly what are the characteristics of a good construction loan?

The next time you have some spare time, call some local banks, and ask for the construction loan department or a construction loan officer.

99.9% of the time the person on the other end of the phone (assuming you get a human being) will rarely be able to direct you. If you do find a bank that provides construction loans, they usually only offer one product that may or may not be competitive in today's marketplace.

Below are the 3 ways lenders/banks offer construction loans. It is very important to note that construction loans are very different than conventional home loans in that there is a construction period at the start of the loan, usually ranging from (6 to 24 months).

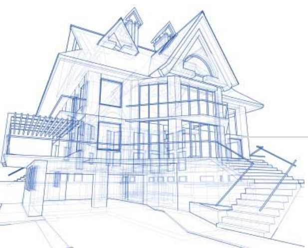
Below are two of the most common types of construction loans.

1. **Construction loans that allow you to lock the construction loan rate and the permanent mortgage interest rate upfront;** most lenders/banks can offer you today's construction loan rates upfront. The rate during the construction period is going to be the same interest rate (or close to it) into the permanent part of the loan. An example would work like this.

   The first 12 or 24 months would be the construction loan period and once the home is completed this loan would automatically convert into the permanent part of the loan <u>at the same rate you locked into upfront.</u> The loan is usually for a 30-year amortized period.

   If rates rise you will not have to worry because you would have locked in your interest rate in advance. This type of construction loan is the most common product out there today which is called a "One Time Close" or "Construction to Perm" one set of fees loan.

2. **Construction Only Loans (no permanent);** the construction only loans are usually for investors or builder projects in which take out financing is not needed.



The most important thing when searching for a good construction loan is to find an experienced construction loan specialist that knows which banks offer the best loans to fit your exact needs.

Today's construction loan choices include the 30-year fixed, 15-year fixed, 10/1 ARM, 7/1 ARM, 5/1 ARM. These products are fixed for the first number of years so the 10/1 is fixed for the first 10 years. Once the 10-year fixed period is up the loan switches over to an adjustable rate.

The most popular construction loan today is the "One Time Close" but not all are created equal. Just like any product there are the best loans, good loans, and downright bad loans.

With today's technology you now could obtain a construction loan from any bank in the country and sign your loan documents at your local title company or escrow office. This benefit allows you to have the most competitive construction loan available nationwide.

The graph below shows the type of loan you should apply for depending on your needs.

Which loan is right for me?

Years you plan on staying in the house	Recommended Program
1-3	3/1 ARM, 1 year ARM or 6 month ARM
3-5	5/1 ARM
5-7	7/1 ARM
7-10	10/1 ARM, 30 year fixed or 15 year fixed

3. Is it Better to Obtain a Construction Loan from a Bank or a Broker?

1. Banks provide financing through **<u>retail pricing channels</u>** or storefronts (banks).

2. Brokers provide financing through **<u>wholesale pricing channels</u>** (from banks).

When I worked for a large nationwide retail bank as a construction loan officer there were a few things that the customer never knew.

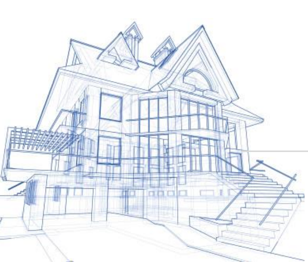
First, I was told by management that I had to charge every customer a 1-point origination fee (this fee is no different than the 1-point broker fee). The other thing I was allowed to do was raise the rate and hide the point in the yield spread premium. Banks and unfortunately customers seem to like the rate hidden probably because of the idea that since its out of site so its out of mind. Just remember that all lenders will get their profit/points one way or another. The old saying that there is “No Such a Thing as A Free Lunch” is true. It just feels better…

The customer was never told that banks could charge a higher rate without having to show the customer their profit (Yield Spread Premium). This fact might not sound like a big deal but charging just a “little” higher rate over the life of the loan can add up to tens of thousands of dollars of profit to a bank.

What some banks do is raise the rate and tell you that they are not going to charge you any points. But the reality is you will never know how many points are built into the loan. This is tough because the uninformed consumers think they did not pay any points but, they’re paying for the points on the back end over the life of the loan (YSP).

<u>Unlike the bank the broker must disclose their points</u> being charged which doesn’t always look good on paper but at least it’s not hidden, and you know what you are really paying. By the way some people prefer not knowing, like I said it just feels better that way but trust me everyone pays an average one point fee plus closing costs.

A broker is a representative for many banks. Although the broker appears to serve as the middleman, his or her services will not cost you anything extra. That's because brokers obtain loans <u>through</u>



***wholesale channels*. If you walk directly into a bank that provides construction loan financing the loan is adjusted for retail pricing.**

The broker also can provide financing from banks throughout the entire USA. As a matter of fact, many brokers can offer their clients better rates and pricing depending on the level of difficulty of the loan request.

With an experienced construction loan broker, you will get the most competitive banks nationwide, obtain wholesale pricing and can negotiate on rates and pricing.

To prove it to you please send me a copy of any quote/good faith estimate from any lender and I will pick it apart for you. I will show you how the loan officer and bank are getting paid. I will also show you how I can beat their pricing and offer a better interest rate and program.

The number one problem that has occurred over the last 10 years is that consumers are only finding one or two banks to work with. These banks spend 90 days processing a loan only to notify the customer that the loan is turned down. We hear the stories all the time and I think it's because most people do not believe it will happen to them. Wouldn't it be nice to know in advance whether the loan fits the lenders guidelines. We determine that upfront, so we don't waist our time and more importantly your time.

The only way to prevent this from happening is by going through an expert that already has many choices to work with that offers options, not stories. Every now and then I get asked, why should I go with you versus directly to a bank. My answer is always the same, we are construction loan specialist, and we make sure to submit your file to the right lender.

4. The Most Important Question to Ask When Looking for a Construction Loan?

In all my experience over the last 38 years the consumer simply just wants the best construction loan with the best features such as interest rates, terms, and benefits. That all sounds good but since I want to offer the best programs my biggest hurdle has always and been how can I explain how not to go down the wrong road and insure them the best construction loan available.

Loan officers working at banks know what their construction loan weaknesses are, but do you think they would ever tell you. No Way…. They want to keep their jobs and they know when push comes to shove the customer will take the loan no matter what. Sad but true.

At our construction lending company, we know every lender's strength and then offer the best available product for their needs Why? Because if we do not, the loan may not work.

Experienced loans officers do not shop around for banks they are already approved with many banks. A construction loan specialist does not "hope" that your loan will work they know upfront who has the best terms. The number one priority should always be to package your loan file and make sure it goes to the right bank.

The reason most people do not obtain the "best construction loan" available is because they usually do not know what the most important variables of a construction loan are. They are usually only focused on the interest rate.

People search for a construction loans the same way they search for a typical mortgage or refinance and the number one question is always about the interest rates. The other questions that are typically asked are usually the following.

1. How do construction loans work?
2. What loan programs do you offer?
3. Can I lock the rate in upfront?
4. Is the loan a construction to perm one time close?
5. What are the loan fees?

These are all great questions, but rarely will anyone ask the most important questions that will affect them the most.

The most important questions to ask are…

How much cash will I have to bring in to close the loan?

Notice it has nothing to do with interest rates especially since almost everyone has decent interest rates. So why doesn't anyone talk about cash to close?

Why doesn't your loan officer at your highly recommended bank talk about the cash needed to close? Why is everyone focused on everything but what usually matters the most, the cash that you have to part with and hand over to the bank to close the loan.

Your bank and loan officer must keep you focused on the rates in order to keep your business here's why.

If you knew the banks that offered the exact same rates with much better cash to close terms you would jump ship faster than lightening.

The other reason the bank or loan officer does not bring up the loan to value and cash to close is because they want you "off the street" and since you've invested all your time providing all the loan documents and the appraisal has been ordered they've officially got you of the street.

The odds of you starting all over again at another bank resubmitting all the loan papers again and ordering another appraisal is far and in between (and they know that). So, in the end most families just assume that what they were offered is the best anyone could have done and they pay dearly at loan closing.

The questions of how much money to you need to bring to close has everything to do with the loan to value, loan to cost, appraisals and the separation of your cash to the lender. So, this is the ultimate loan trick in the construction loan business and most customers never see it coming until it's too late…

So, while you're most likely shopping interest rates and fees the very well informed are shopping loan to value and loan to cost requirements. The other important questions to ask are 1. How does the fund control work? Is there a float down rate option if rates improve? Do you have other loan programs that might be better? How does the income to debt ratio work?

Let me give you a basic example of an actual customer scenario going through 2 different banks and let's see if you can pick the best construction loan.

1. Actual Customer Scenario; purchased land about 2 years ago for 200k with a 100k balance. The construction costs are 950k. The customer found a great construction loan with a rate of for a 5/1 fixed loan amortized for 30 years. The lender had a 70%, loan to value requirement and the bank is very well known and was a referral from a friend. The loan amount request was 1,050,000.

A. Bank Result A, 70% loan to value of 1,150,000k is a loan amount of 805k so now the customer will have to come in with the difference to close the loan of $245,000 plus closing costs.

B. Bank Result B, 90% loan to value at the same interest rate. Once the appraisal came in at about the same value of 1,150,000k we were able to provide a loan amount of $1,035,000k and the customer only had to bring in $15,000. That is a savings of $230,000 thousand dollars that the customer does not have to come in with….

So, when shopping it's not always about the rate, or the name of the bank, or who referred you ***it's about your options and the lenders guidelines. The most important term is the loan to value vs loan to cost***…. Remember everyone usually has good rates; Ask about the guidelines of the construction loan instead.

By the way if you are already planning on coming in with a boat load of down payment money, have land free and clear you can pretty much go to any lender with any terms and you should do just fine. Your only concern at that point should be rate and term and how does the fund control work? No one focuses on the fund control and believe me there are good ones and bad ones. The good ones allow you to control the funds online.

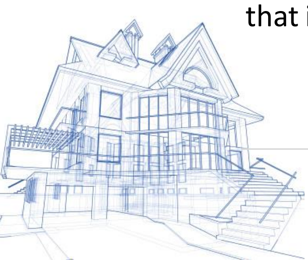
5. What experience does your construction loan officer have and does it matter?

When it comes to money it's amazing how fast mortgage loan officers becomes instant experts at construction loans.

I recently got a call from a shopper that had a bad experience with a loan officer at a well-known bank that said he was an expert in construction loans. So of course, I had to ask who he worked with and since I know a lot of people in our industry. As soon as I heard who it was, I instantly knew this loan officer had only been providing construction loans for a year.

You must keep in mind that all loan officers are salespeople. Yes, I know they have fancy titles like loan officer or vice president, but the title is nothing but a fancy name for salesperson. It doesn't matter if they work for a bank and have a nice office or a broker with their own office, they are still salespeople.

Salespeople usually have one main goal in mind when helping you with your loan request and that is their commission. By the way, the fancy name for commission in the loan business is called



a loan fee, origination fee, broker fee, points or yield spread premium (YSP). But no matter what you call it it's still a commission.

Whether you go directly to a bank or utilize the services of a broker the name of the commission is usually called one of the above. By the way the average loan fee all loan officers whether you go directly to a bank, or a broker is 1 percentage point of the loan amount.

Now don't get me wrong, there are a lot of good honest salespeople (loan officers) that work very hard at providing you the best service and rates. What's important is distinguishing the experienced from the inexperienced.

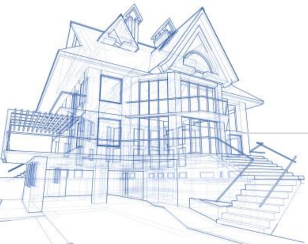
The following questions allow you to quickly find out if your loan officer is experienced at construction loans.

1. How long have you been doing construction loans? 15 years or more is best, why because their experience causes fewer mistakes in getting your loan approved.
2. What is better? The voucher or draw disbursement system and why? Draw is now the most popular because the customer has the control of the money, and the builder can take as many draws as possible assuming the line item on the cost breakdown is completed. Most importantly though is the fund control online or at a lumber yard.
3. Does the bank require a contingency and an interest reserve account?
4. How many constructions loans have they done? An easy way to determine if they are specialists or a jack of all trades is by looking at their web site. If you see that their focus is everything, then they are not a construction loan specialist.
5. What is your loan to value, loan to cost guidelines and how much cash will you have to come in with?

If the loan officer (salesperson) can answer these questions with no problem, then they have passed a pretty good basic litmus test.

But the best and most important indicator is how helpful is the loan officer? Is the loan officer more interested in helping you obtain the best construction loan? Or is the loan officer more interested in helping you obtain the most profitable loan for their sake.

If you really want to throw a curve at them, ask the loan officer if they have ever built a home themselves and what type of construction loan that they got.



6. Qualifying for your construction loan, exactly how is it done?

The first thing your loan officer wants to see is your completed loan application. The loan application called the (1003) will tell a story of your financial picture. The completed loan application will tell the loan officer many things including,

1. What type of loan you want.
2. How much money you need.
3. Where you currently live.
4. If you rent or own.
5. Your social security numbers.
6. Your current employers.
7. A list of all your assets (money) and liabilities (bills).
8. How much money you make.
9. How much real estate you own.
10. Some declarations along with some government questions.

Once the loan officer has your loan application in hand, they can determine whether you financially qualify for a loan.

One of the first items pulled in this determination is your credit report. The credit report is going to tell 3 main important things.

1. Show your current credit score. The credit score should range from 680 to 800.
2. Show a complete list of all your monthly liabilities (bills).
3. Show all past credit problems including bankruptcies, foreclosures, and late payments.

With this information the loan officer will do an analysis to determine if you can qualify for the loan amount that you're looking for based on the lender's guidelines.

This analysis determines a ratio called the (income to debt ratio) and depending on the banks underwriting guidelines this ratio will usually range from 38% to 50%.

The income to debt ratio is the percentage of monthly debt payments (including your new mortgage payment, taxes, and insurance). This ratio should not exceed 36% to 50% of your monthly income.

If you would like to find out how much you qualify you can download an application on our website.

7. How not to be taken by the oldest trick in the book "Bait and Switch"?

The mortgage lending business is notorious for baiting and switching. Baiting and Switching is when a loan officer or banking advertisement offers you one thing and then tries to sell you something else.

It is very important to note that banks and lenders have changed their lending guidelines over the last few years at least a dozen times. So, if you were quoted one thing one week and it seemed like the world changed the next week it just might have. It’s important to know the difference between a bait and switch and a qualifying, market or lending change.

Typical signs of baiting and switching are obvious; some basic examples are:

1. Over the phone, you are offered a much lower rate than any other quote and once you've sent in your application the rate you were quoted has suddenly vanished.

2. You are offered a construction loan with no points and zero loan fees. What you are not told is that you are paying for it with a higher interest rate and the costs are built into a higher interest rate.

3. You are told that you will not have to bring in any funds to close, what you are not told is that it all depends on the lender’s equity requirements, appraisal, loan to value and or loan to cost.

On the flipside of bait and switching, it is very important to realize that most loan products typically go hand in hand with banking guidelines. These guidelines are provided to loan officers to coincide with the customer's qualifications.

8. Has your loan officer structured your construction loan properly and why it's so important to obtaining an approval?

I receive loan requests all the time from customers that went to a bank or another broker and were either turned down or were offered a below average construction loan.

Recently I received a construction loan request from a customer that was turned down by literally every bank in the current marketplace.

The customer owned his own business and had a lot of tax deductions on his tax returns. The way banks qualify customers as full documentation is very conservative and the customer was turned down. We took the loan, found the problems upfront and submitted the loan for approval on an asset-based construction loan. The customer was approved and completed a new and beautiful home in Malibu California. The loan size was 5.5 million dollars, and the owner was the ex-screenwriter for the television show “Happy Days” and “Laverne and Shirley”.

Structuring construction loans for approval is vitally important and is the last thing on most customers’ minds. **Every time I receive a loan from a customer with a bad loan experience it is always because the loan officer did not specialize in construction loans and did not structure the loan accordingly.**

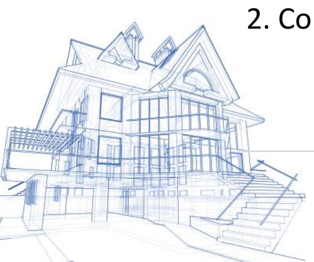
The old saying “you get what you pay for” is especially true when obtaining financing in building your new home.

9. Now for the biggest secret of all, ready? All banks have access to the same rates and the only reason everyone ends up with a different rate is directly related to how much your loan officer and bank is going to profit from you.

You should probably read that one a couple of times.

Your loan officer gets paid like all salespeople, either by;

1. Salary plus commission
2. Commission only



If you walk directly into a bank the loan officer most likely receives a basic draw or salary and a percentage of the loan origination fee (points and yield spread premiums). If you work with a broker, the broker usually works on a straight commission (points).

The least experienced loan officers usually start off working for a local bank and if they are successful and survive in the business climb up the corporate ladder or eventually move on their own by becoming a broker. Becoming a broker allows the loan officer the ability to offer their customers with the most options.

It always amazes me when I see TV commercials or hear radio commercials advertising zero closing costs. I always wonder if people understand how they can do that.

Ok, here is how it is done.

The inside secret is that in exchange for these low or zero closing costs the lenders will make their profits and cover the costs of the loan by charging you a higher interest rate over the life of the loan.

By charging you a higher interest rate over the life of the loan the bank can make a small fortune.

Think about it, what kind of loan fees do you end up paying over the life of the loan in exchange for no upfront loan fees? Would you believe 1 to 4 points on average…

The most important thing to remember is that you want the best loan available at a fair price/fee with an experienced construction loan officer that will look out for you and provide you with excellent service for their fee.

By the way all banks and brokers on average earn anywhere from a half of a point to a point and a half (.500% to 1.500%) on a construction loan. One point is one percentage point of the loan amount, so 1 percentage point on a $417,000 loan amount is $4,170.

Remember you can have a no fee loan all day long if you really want that, but you will pay dearly over the life of the loan with a higher interest rate. Let's pretend your loan officer offers you a zero-loan fee construction loan. For the bank or loan officer to offer that “benefit” the interest rate will need to be increased.

If you increase the interest rate just a .250% on a $417,000 loan amount the profit to the bank paid by you is a whopping $24,480, over the life of the loan.

In the long term it is far better to pay the loan officers origination or broker fee at par pricing then it is to be sold on the low or no fee program unless you do not plan on living in the home for very long.

10. What are interest reserves and contingency funds doing in my closing costs?

The two items most customers do not factor into the cost of the building their new home are interest reserves and contingency funds.

Interest reserves are added to your loan amount to make the monthly payment on your loan. Yes, you read that correctly, you will not have to make a monthly construction loan payment while your home is being built. The payments are made from this interest reserve account and no, it’s not free. This reserve is added to your construction loan amount if you choose to have reserves.

Interest reserves were designed for the benefit of the customer. Most people building a new home are either paying rent or have an existing mortgage payment while their home is being built.

The last thing a customer needs is another monthly payment while building. So, banks created the interest reserve account by adding up the estimated interest payments over a 12-month period and add this to the loan amount.

If you do not want interest reserves added to your construction loan amount you can ask to make your own monthly construction loan payment. Over the last decade this seems to be more popular.

Contingency funds are added to the loan amount just in case you need more money to finish building your new home. With all good intentions construction loans tend to have cost over runs. The bank adds 5% to 10% of the cost breakdown and adds this amount to the loan amount just in case you have cost over runs or need better appliances.

If you don't need or use this extra contingency fund, then it will not be added to your mortgage upon completion of your new home.

So, when you apply for a construction loan ask your loan officer to provide you a copy of the estimated construction loan budget. This budget is not usually meant for the customer, but an experience construction loan should not have a problem providing this to you. By the way this budget will also show the loan to value, loan to cost and how much money you are estimated to bring to closing.

The budget is created from your costs and includes every cost within the loan including land balances, closing costs, interest reserves, contingency and bank fees.

We provide a copy for every pre-qualification that we do.

11. What is loan to value (LTV) and loan to cost (LTC)? Why it's probably the most important factor in getting approved for a construction loan besides your income and credit.

Banks are concerned with two important variables, loan to appraised value (LTV) and loan to cost (LTC).

If you were buying a home instead of building, you would normally have to put up to 20% of the purchase price as a down payment. Since you're building a home your cash equity usually comes in the form of how much cash you've put down on your land or any pre-pays such as architect costs.

Market/Cash equity is king when applying for a construction loan. For example, if you bought a $200,000 piece of land and you paid for the land free and clear you have a lot of equity.

With this much cash equity you will most likely not have to bring in any additional cash. Or if you purchased a piece of land for $100,000 and its now worth $200,000, most banks will use the current value. In both cases you have brought $200,000 cash equity to the table.

Cash equity or down payment whatever you want to call is how the loan to cost is calculated. This variable can be more important than the appraised value as a matter of fact it directly affects if you need to bring in more cash to close and the finished appraised value of your new home.   The important thing to remember is that most banks require 15% to 20% cash/market equity into most projects or more depending on the loan amount.

12. Should you hire a builder or be an owner builder?

The goal of being an owner builder is mainly to save money. Some people can save quite a bit of money if done correctly.

Possible problems when acting as owner builder are:

1. Construction cost over runs.
2. The best banks with the best rates require a builder or management contract.
3. Managing contractors to finish on time or to show up for work.
4. Depleting your personal savings.
5. The need to borrow more money.
6. Loan extension penalties.
7. Being taken by unscrupulous contractors.
8. The need to refinance your construction loan.
9. Foreclosure.

I could go on and on about the horror stories I hear from owner builders

If you've never built a home before and absolutely need to act as owner builder, please take my advice and hire a reputable builder to manage your project. By hiring a builder on a management basis, you can build your home and still save money.

The builder/manager will help you with the cost breakdown and manage the project to make sure your new home is completed and to ensure the project comes in under budget.

If you are a builder and want to build your home as owner builder that is not a problem, but you need to understand that most banks will require you to provide 2 years tax returns for qualifying.

13. How does your builder determine how much your home will cost to build?

The Estimated Cost Breakdown of your home is probably one of the most important forms in the construction loan package. This is the breakdown of each line-item cost of construction of the home. The cost breakdown consists of numbers for your foundation, lumber, framing, plumbing, heating, electrical, painting, and builder's profit, etc.

The builder usually completes this form to show you exactly what it will cost to build your new home. The most important thing to remember here is that you do not want to underbid any line item and you do not want to overbid any line item.

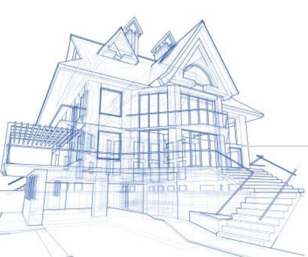
You want accurate numbers from real bids (not guesses) and a 5% contingency for cost overruns. Most banks add a 5% contingency over and above the builder's contingency for added protection.

Good builders will send out the house plans to their contractors for specific bidding on each main item or can estimate the home themselves. The builder will send one set of plans to the foundation contractor, one set of plans to the framer, one set of plans to the plumber, etc. When all the numbers come in, the builder will fill out the cost breakdown and come up with a total cost to build your new home.

Most builders will provide the contract but make sure you read it carefully and that you add your requirements as well. There are two types of contracts

1. Fixed Contract: This contract is simple and straightforward. Take the total of the cost breakdown and put that fixed number into the contract. The builder will provide a list of responsibilities.

2. Cost plus Contract. This type of contract is usually meant for large construction loan projects. This type of contract is utilized when the customer wants to make a lot of changes to their home as its being built. With large homes the construction loan period to build the home is



usually 18 months so construction costs can change drastically. Builders prefer this contract to protect the costs and profits over long periods of time.

14. How do you draw your construction loan funds to build your new home?

There are two methods that banks use to make sure your builder gets paid while building your home.

The Voucher Reimbursement system has been around for quite a while. As usual you'll have some builders that are very familiar with this method of payment and do not like change. Most builders are only concerned with how fast they can be paid and how often they can be paid.

The Draw Reimbursement system is becoming the standard for construction loan funding for most banks. The main difference is that the bank puts the accounting responsibility on you or your contractor. The bank uses your cost breakdown as the guide for the draws. The modern day draw system is set up for builders to request as many draws as needed if the work is completed.

The draw systems also allow the choice of taking draws on a bi-weekly or monthly basis, collecting partial payment for work and material items that have been completed.

Most customers usually prefer the draw reimbursement system because:

It requires less work, provides more control for both the customer and the builder and lastly the funds are wired directly into your bank or the builders.

The new system for fund control is the online setup and draw request system. The days of contractors having to drive to the bank or a lumber yard fund control to get paid are slowly disappearing. Nowadays you can log into the website and request an inspection and payment for all disbursements.

15. What type of construction loan insurance is required and who is required to get it?

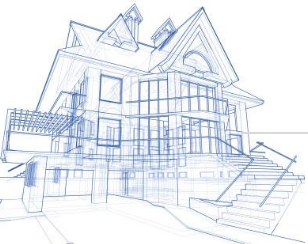
There are three types of insurance needed to build. All banks require the first two insurances, course of construction and general liability. Workman's compensation is only required if your builder has employees.

1. Course of Construction Insurance. This policy is an all-risk policy to include, fire, extended coverage, builder's risk, replacement cost, vandalism, and malicious mischief insurance coverage. A similar product is builder risk insurance.

2. General Liability Insurance. Your builder usually provides this insurance policy. This policy is a comprehensive general policy or a broad form liability endorsement. The minimum amount of $300,000 for each occurrence is required. If the builder provides the insurance a general policy of $1,000,000 or a broad form liability endorsement is required.

3. Workers Compensation Insurance. If your builder owns his own company and has employees that are helping to build your home, workman's compensation is required.

<u>If the builder simply subcontracts out the work and does not have employees per se, they will need to write a letter acknowledging that they do not have employees and are not required to have workers comp.</u>



About the Author

The above information is from 38 years' experience in the construction lending business. If you have additional questions and or would like to apply for a construction loan to build your new home, call me on my direct line (619) 855-6091.

Or visit our website and either download a complete construction loan application package or request one to be sent to you by regular mail or email.

I hope this information has helped you.

Any questions don't hesitate to contact me.

http://www.CaliforniaConstructionLoans.com

Thank you,

Sincerely,

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