

Construction Loans Fact Sheet



This fact sheet aims to guide you through some of the matters that borrowers need to consider when contemplating a construction loan.

A construction loan is for people who are building a house from scratch or making substantial renovations to an existing property. In order to borrow against the value of the property once it has been completed, the property needs to be valued on an "On-Completion" basis. This is where a registered valuer looks at the plans of the new dwelling as well as the builder's specifications and compares this against recent sales in the area. This is completed to ensure that the cost of your new home is in keeping with the sale prices of established houses in the area.

In order to prepare this valuation the lender will require full plans and specifications provided by the builder along with a fixed-price building contract. To get to this stage with your builder you will often need to pay for the initial deposit upfront.

Things to consider:

1. The bank will expect you to put your equity (either cash or property equity) in at the start of the construction project. This protects the bank and you by ensuring that based on the fixed-price building contract, there is always enough money left in the loan to complete the future construction progress claims in full.
2. The builder will often require the deposit before they can provide council approved plans, which are often required by the lender before a formal approval can be obtained. It is wise to have this money available to cover this cost directly rather than from the construction loan.
3. During the construction period, your loan will be on an interest only basis until fully drawn. You will need to be aware that while you only pay interest on the loan amount you have drawn to date, you will no doubt still be paying rent during this period as well, which can be a real drain on your cash flow. It is wise to keep additional funds aside to assist you during this period if your cash flow is tight.
4. The lender will want to ensure that the expected valuation is in line with the total amount you are spending for the house and land. This may cause problems with the lender as the Loan to Value Ratio could become too high in some cases, especially where your equity is low.
5. For each stage being claimed by the builder, the lender will usually inspect the work completed (often via a valuer) to ensure that it is at the stage being claimed. The lender will also require the owner to sign off on the work completed. Keep in mind that many lenders will also charge a fee for every inspection on the property.

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6. In some cases it may be tempting to remove certain items from the building contract and have them completed yourself, assuming you have contacts in the applicable trade, to save money on the construction. In many cases, however, the lender will only include the actual building contract for the valuation and draw downs, so you may have to finance these trades directly from your own cash reserves. This is predominantly due to the lender only wanting to deal with the one principal contractor, being the builder.

Progress Claims

The lender will drawdown your new construction loan in a number of stages as per the building contract, in line with the progress on the construction of the house, called progress draws. Typically there are five to seven progress claims required which are in your building contract with the following being relatively standard:

- Deposit – This covers some of the builders out of pocket expenses for the Architect and council approval fees plus some of the initial site works and connection of electricity and water to the site.
- Base / Slab Stage – Concrete slab or stumps for a wooden floor are included in this stage, which often include underfloor plumbing.
- Frame Stage – The floor, wall and roof frames and windows are usually completed, and you can finally see your house beginning to take shape.
- Lock up / Enclosed stage – This is where it starts to get exciting! The house is starting to look like the Architect drawings with the roof on and the external walls and doors on.
- Fix-out / Practical Completion – While this stage seems to take forever for a new homeowner, it is where all of the necessary personal items such as baths and kitchens and door furniture are completed.
- Final / Completion Stage – Carpets, tiles, paint and the other final niceties are completed ready for final hand over and occupation.

If you would like more information on construction loans please call us on 02 9220 0396 to discuss your situation and objectives.