

MORTGAGE LENDING UPDATE

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Construction Lending

Last week, we spoke of the joys to be encountered in building your own home. (If your marriage survives, that's a plus.) This week we'll discuss the nuts and bolts of obtaining financing for the construction of your new home.

The first question we ask is whether you presently own the land upon which you wish to build, or does it belong to someone else. The reason for the question is that the construction loan has to be in the name of the owner of the dirt. If the dirt belongs to the builder, then the builder will need to get the construction loan in their name, unless you buy the building lot from them. Of course, depending upon the developer's wishes, you may not be able to build your own home in certain subdivisions. The developer may have an exclusive list of builders and if you want to live in that subdivision, you'll have to either buy an existing home or contract with one of the approved builders to build your home.

It boils down to a discussion with the construction lender and/or your builder or general contractor, if you have one. Sometimes the builder or general contractor may prefer the construction loan to be in the name of the future owner-occupant of the home (you). The reason is that the bank(s) providing the construction funding to the builder may limit the number of loans or dollar amount of loans outstanding to the builder at any one time. That limit is known as the builder's construction line.

If you don't have a builder, then the construction loan, as well as the dirt, would be in your name. This is the situation we'll discuss today. Construction loans are normally made by any of the local commercial banks (whichever ones are still making loans). The reason for using a local bank is that regular on-site inspections of the progress of construction will need to be made before funds are released to the borrower. But, I'm getting ahead of myself.

Before obtaining a construction loan from a local bank (which is not presently as simple as it once might have been), you will need to be pre-approved for a permanent mortgage loan to pay off the final balance of the construction loan owed to that bank. The reason is that it would do neither you nor the local bank any good to have your new home completed only to find out that you don't qualify for a permanent mortgage. Thus, if the local bank doesn't have a mortgage loan department of their own, they will require a "take out" letter from a reputable mortgage lender. The "take out" letter takes the construction lender out of the picture when the home is complete.

Once you have been pre-approved by a permanent mortgage lender for the total amount of construction funds needed, the next step would be to obtain an appraisal of the plans and specifications (specs). The appraiser would inspect the building lot, the house plans of the proposed home, and a separate list of specifications for how the home will be finished. The specs would tell the appraiser such things as whether the home will be brick veneer or vinyl siding. Whether there will be a basement, a slab or a crawl space. Whether the bonus room over the garage will be finished or simply roughed in for finishing at a later time.

Thus, we arrive at the final and most important topic for today, staying on budget. This is the primary difficulty encountered by most owner-builders. They see a little better grade of carpet, available for just a little more money than the amount allowed in their budget. They go a little over on their cabinets because, hey, this is going to be their home for years to come. Soon, they are robbing from one line item to pay for a shortfall in another line item. They finally run out of Peters to pay Pauls. It happens so routinely in owner-builder situations that many construction lenders factor in 10 to 15 percent of the total estimated cost as probable cost overruns in owner-build jobs. I've been there and done that. It happens, so it's best to plan for it.

Many mortgage lenders have one-time-close construction-permanent loan programs available that combine the construction portion of the financing with the permanent portion of the financing. I have often found those programs too restrictive for the deviations from the plan which regularly occur. Speak with a local professional member of the Mortgage Bankers Association of Middle Georgia (mbag.org) or the Georgia Association of Mortgage Professionals (gamb.org) for assistance in discovering the best solution to your particular home building needs.

David Griffin has been financing homes in Macon, Warner Robins and all of Middle Georgia since 1983 and is a member of the Mortgage Bankers Association of Georgia, mbag.org. For an archive of past articles visit mbag.org/ML_Update.html.(6/23/10)