

Let's Talk About a Construction Loan

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One of the areas that economists view when evaluating the strength of the economy is new home construction. An obvious reason for this query is that money is turning when new homes are being built, so one would think the economy is strengthening. But a lesser known portion of this statistic is that banks are lending money for that construction, which truly is an indicator of economic growth. Banks wouldn't lend the money for construction if there's not a good chance the home will be completed on time, at a good price, and readily marketable should the need arise.

Until I became a banker, I really didn't know how much work went into the process of building a home. Of course, there is the obvious work – the actual labor involved and the purchase of materials. But I'm talking about the budgeting process, the appraisal estimation and final evaluation when completed, the inspection process and all of the documentation at every step to be sure that folks are being paid for work performed and that the work is actually completed according to specs and plans.

Most people who have a home built use a reputable contractor whom they have thoroughly vetted, usually after looking at other projects completed by that contractor. They also use architectural plans and specifications which have been drawn up by a knowledgeable professional in their field. And sub-contractors, if not employed through the general contractor, are usually also checked out for job performance, reputation and of course, cost. This time of year, there are lots of "Parade of Homes" events that provide ample opportunities to personally view recently completed construction projects.

Where the banker comes in on this project is to make sure that all of the parties involved are in fact fiscally reputable, that they don't have a habit of filing Mechanic's and Materialmen's (M & M) liens on properties which might be an indicator they weren't paid for work completed. In some cases, they have legitimate M & M liens, but it could also be a sign of inferior work or work that was not completed resulting in non-payment. Your lender also holds the purse-strings on the project. In short, that means if the builders and subs want to be paid, they go through the banker, not the homeowner. It provides another level of more objective look at a project by someone who has usually been involved in construction or construction lending and it's not their first rodeo.

During the construction process, the lender makes periodic inspections to check progress against an industry standard completion checklist. Payments are made on a "draw" basis, where the initial draw is usually to cover the start-up materials and the first work by the contractors. At a third of the way through the project, there are certain tasks which should be completed in order to receive the next draw. Then at two-thirds of the way through the project, another draw is issued bringing the total paid out to about $\frac{3}{4}$ of the loan versus $\frac{2}{3}$ of the construction. But the final draw isn't issued until the project is complete and a punch list addressed with the homeowner, bank, and builders all in agreement that everything is finished.

A good lender will also ensure that the title remains clear and free of any of those M & M liens, and will assist with permanent financing for the project once the home is completed. Preliminary discussions of

the long-term financing have probably taken place when the initial construction loan was arranged so that the final appraisal evaluation to ensure the project came in as projected is just one more item on a checklist to be completed before the end-mortgage loan is processed.

Throughout the entire process, there are a great many decisions to be made, and I have yet to work on a construction project that came in under budget. It's just a nature of the beast that costs will increase, or changes will be required based upon some unforeseen obstacle in the middle of the project. There are often times when emotions play into decisions that should be free of emotion but realistically aren't. And I've seen a marriage or two tested by the tediousness of the process or even the sheer overwhelming number of factors that have to be considered. It's another one of those processes that are regulated to death, but mostly for good reason. It's definitely not a project for the faint of heart.

So if you're totally sure about building a home, make certain you work with a good experienced lender every step of the way. Remember, it's your family home, and you'll build it the way you want to build it. Just be prepared to devote some time and energy into making it the best home ever. While the economy appears to be recovering, why not call or come in, and let's talk about a construction loan.