



Construction Loans

Building your house is an exciting and empowering event in a homeowner's life, and there are a few different strategies to financing construction.

Turn-Key financing is the simplest way to finance a new-construction home. Turn-key financing involves the builder actually financing the house during construction and differs little from traditional financing of an existing house. Although the builder is responsible for all construction costs, the contract to purchase usually requires a more substantial down-payment from the buyer since the house is built to the buyer's tastes and needs. Builders who are able to finance construction of the house until closing are also more likely to investigate the buyer's financing qualifications thoroughly to ensure the buyer can complete the purchase once the home is complete.

Interim Construction loans are used to pay the builder during construction of the loan while interest-only payments are made *only* on the amounts disbursed to the builder during construction. It is common to make 4-6 "draws", or reimbursements, to the builder along the way during the construction as stages are completed: the lot is purchased, foundation is poured, house frame is built, finishes are completed, etc. Each draw requires inspection from a third party to confirm work has been completed before disbursements are given to the builder (usually performed by the lender or escrow company). The standard initial draw period to complete construction is 12 months. At the end of the draw period, the buyer will then either refinance or "modify" their current loan to a permanent loan that will begin repayment at whatever interest rate prevails at the time of completion. Often, if the eventual permanent loan is taken out with a different bank, there is a fee incurred called a "deferred origination fee" or the like. This makes it difficult to take out an Interim Construction loan with one bank, and then refinance for permanent financing with another bank.

Construction-Permanent or **One-Time Close** loans are essentially the same as Interim Construction loans with the major exception being that only one loan is closed at the beginning of construction, usually when the lot is purchased. Interest-only payments are still required as disbursements are made during construction. At completion though, the loan is "converted" to permanent financing at the same interest rate locked in at the beginning of construction. The advantage here is there is no risk of interest rates increasing during construction since the rate is locked in. Repayment still begins after the first 12 months the same as Interim Construction loans. Another advantage of Construction-Permanent loans is there is only one loan, so there is only one set of closing costs-- rather than two.