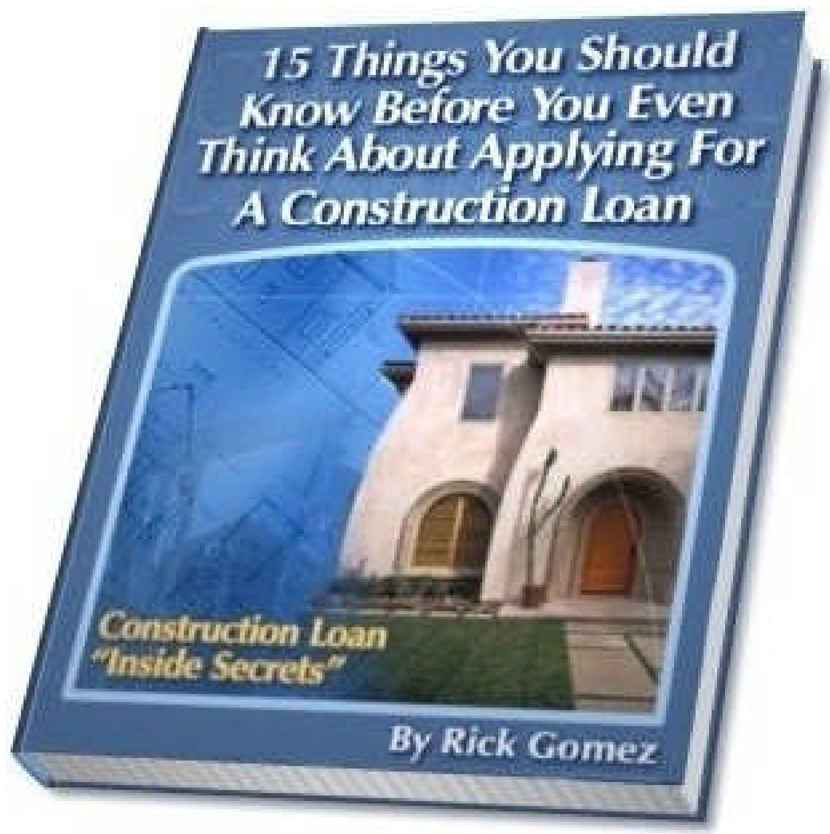

After reading the following 15 construction loan "Inside Secrets" you will know more about construction loans than most loan officers or bankers.
R. Gomez

(866) 211-3344

CaliforniaConstructionLoans.com
NationwideConstructionLoans.com

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 still built. 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 like never before are searching for the best loans that fit their particular needs.

Over the years I have seen a lot of changes in the construction loan industry. First of all, the only type of construction loan that existed back then was a 12 month construction 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 loan. 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.

With today's technology in the home lending world, you can pretty much get any type of construction to perm loan almost any way you want whether it’s an arm product or a fixed product. The problem is there are hundreds of banks that simply do not offer or care to offer construction loans. Some of the best advertised construction loan lenders have below average programs and/or high interest rates.

You literally have to do your homework to find the best construction loans available in today's marketplace and the only way to do that is through a construction loan specialist. Someone who is not only experienced with construction loans but someone that can be objective and can tell you the pro’s and con’s of all the lenders.

So I wrote this report to help you strip away a lot of the construction loan mysteries out there and help you find the best loans, best rates and best service. I have personally built 2 homes over the past twenty years and have funded 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 of 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 specialists.

Table of Contents

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

<u>This Chapter is only for those that do not own land yet.</u>

I get calls every single day from people wanting to build a new home but have yet to purchase land, obtain house plans, figure out the construction costs and most importantly have yet to submit house plans for approval and a building permit.

The phone calls I get are from individuals wanting to combine the land purchase and construction loan into one loan. Obtaining an all in one construction loan with the <u>purchase</u> of the land is possible and does happen but rarely works out, here's why.

1. Rarely will a land seller and realtor wait around a couple of months for you to obtain house plans, find a builder, obtain costs and submit plans to the county planning department for approval. All of the above items are required by the bank if you want to combine the land purchase and construction into one loan. The most common exception to the rule is if the land is being sold with approved house plans or if the seller of the land is willing to wait for you to get all your ducks in a row.

The most common way to handle this problem is to buy the land first or by obtaining temporary seller financing or a land loan. Once you own the land you can focus on obtaining the items required by the bank in order to qualify for a construction loan.

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

There are plenty of banks willing to lend money for mortgages, 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, pull out the yellow pages and start calling your 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 actually get a human being) will rarely be able to direct you. If you do find a bank that provides construction loans, they may only offer one product that may or may not be competitive in today's market place.

Below are the various 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 between (6 to 24 months).

The reason that understanding this important part of the construction loan (build time) is because there is always a cost to the lender/bank for providing this phase of the loan along with the rate lock. This cost assuming if you want to lock your long term rate upfront will be passed onto you, the consumer, in one way or another.

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

Lock into today's interest rate upfront construction loans; some 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. Let's say you wanted a thirty year construction to perm loan.

The first 12 or 18 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 at the same rate you locked into upfront. If rates go through the roof you will not have to worry because you would have locked in your interest rate in advance. The cost for locking the interest rate upfront can range in the form of higher lock in rates, fees or a combination of both. By the way if the rates go down by time you complete your new home some lenders have a float down option with the interest rate with no additional cost to you.

The Prime Rate adjustable construction loan, Some lenders/banks offer an adjustable Prime Rate based construction loan while building. This is actually a great way to go if the prime rate is low or heading downward. Another advantage is that most lenders will provide rates below the prime rate since the lender does not have to worry about the cost of locking in the rate a year in advance.

So for example the lender will offer a half of a point below the prime rate during construction. So if the prime rate is 5.00%, a half a point below prime would be the construction loan rate of 4.50%.

There are three reasons you would want this type of construction loan.

1. If rates are expected to improve over the next year.

2. If the prime rate is expected to go lower.

3. If the upfront lock in costs are too high.

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, 1 year ARM, 3/1 ARM, 5/1 ARM, 7/1 ARM, 10/1 ARM and don't forget the popular interest only loans.

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 have the ability to obtain a construction loan from the best banks 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.

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. Should you go directly to your local bank or to a loan broker for your loan?

1. Banks provide financing through retail pricing channels.

2. Brokers provide financing through wholesale pricing channels.

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

First I was told by the bank that I had to charge every customer a 1 point origination fee (this fee is the same as the 1 point broker fee). The reason I had to charge every customer the same fee was because the bank couldn't discriminate from charging one customer one fee and another customer another fee.

The second thing was that banks could charge a higher rate without having to show the customer their profit (yield spread premium).

Unlike the bank the broker has the ability to negotiate their fees and can disclose their profit (yield spread premium) spread. The broker also has the ability to provide financing from many different banks (one stop shopping).

A broker is a representative for hundreds of banks. Although the broker appears to serve as the middle-man, his or her services will not cost you anything extra. That's because brokers obtain loans <u>through wholesale channels</u>. If you walk directly into a bank that provides construction loan financing the loan is adjusted at retail pricing.

In fact many brokers are able to offer their clients better rates and pricing depending on the level of difficulty of your loan request.

A broker can charge whatever you negotiate. I once traded a set of Callaway golf clubs with an executive of Callaway Inc. and if you went directly to the bank they would have told you that it cannot be done. By the way my client also provided 4 dozen golf balls and a Callaway golf bag. The new golf clubs didn't help my game much but it was fun to make that deal.

With an experienced construction loan broker you can shop dozens of 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 is getting paid. I will also show you how I can beat their pricing and offer a better interest rate and program.

4. Should you lock in your construction loan before you start building or let the interest rate float?

If the rates are heading upward, lock. If the rates are expected to be stay the same, relax and if the rates are headed downward, float.

Prior to 2008 locking or not locking upfront used to be an easy decision but with the changes in the real estate and mortgage industry it has become more of what you can get versus what you really want. Banks have tightened up their underwriting guidelines over the past year and I'm sure there are more changes to come.

Conforming loan amounts for construction loans (below $417,000) you can still get a great upfront lock in rate. So I would say lock in upfront for conforming loan amounts.

Jumbo loan amounts are a completely different story. Larger construction projects take anywhere from 12 months to 2 years to complete so the banks are currently charging larger lock in fees and well as the jumbo rates are currently (on average) a whole point higher than conforming rates.

The better way to go if you are building a larger project is to take advantage of the Prime Rate construction loans since the rates are at an all time low of 5%. Call me and I will tell you about an available construction loan that is below the Prime Rate.

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

When it comes to money it's amazing how fast any loan officer becomes an instant expert at construction loans. 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 earn 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 sales people (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? 5 years or more is best.
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 particular line item on the cost breakdown is completed.

3. Does the bank require a contingency and an interest reserve account? This is a choice but most banks automatically add both to the loan amount.
4. How many constructions loan have they done? An easy way to determine if they are specialists or a jack of all trades is by taking a look at their web site. If you see that there main focus is everything then they are not a construction loan specialist.

If the loan officer (sales person) 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 did they get.

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 number.
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 can 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 can range from 500 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 lenders 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 of a home you qualify for please call my office and I will provide you with a pre-approval and good faith estimate.

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 sells you something else.

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 all of a sudden 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 any payments while you're building. What you're not told is that all construction loans have this option and it's called "interest reserves" and the payments are added to the loan amount.

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 a large national bank. The loan officer had calculated the income incorrectly and submitted the loan as full documentation.

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, stated income construction loan. The customer was approved and completed a new and beautiful home

Structuring construction loans for approval is vitally important and is the last thing on most customers' minds. Each and 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 again.

Your loan officer gets paid like all sales people, either by;

1. Salary plus commission
2. Commission only

If you walk directly into a bank the loan officer most likely receives a basic 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 and yield spread premiums).

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?

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. In order 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. You should probably read that one over and over until it really sinks in.

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. Why are interest reserves and contingency funds being added to my requested loan amount into the budget?

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.

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.

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.

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.

Call me and I will provide one to you via email.

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.

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 cash 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 over 12 months ago for $100,000 and its now worth $200,000, the bank will use the current seasoned value (12 months). 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 5 to 20% cash equity into most projects.

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. <u>The best banks with the best rates require a builder</u> or <u>management contract.</u>
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 <u>manage</u> 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 insure 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 particular 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, 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 really 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 as long as 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:

1. It requires less work.
2. Provides more control for both the customer and the builder.
3. The funds are wired directly into your bank account or the builders.

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.

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 WCI.</u>

About the Author

The above information is from 24 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 (866) 211-3344.

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 please call me.

http://www.CaliforniaConstructionLoans.com
http://www.NationwideConstructionLoans.com

Thank you,

Sincerely,

Rick Gomez
President/Owner
Nationwide Construction Loans, Inc.
Construction Loan Specialists
3940 Hancock Street, Suite 219
San Diego CA 92110