



Construction Loans

What you should know

HOW CONSTRUCTION LOANS WORK

Once you have qualified for and been approved for a construction loan, the lender begins paying out the money they agreed to loan to you. However, they are not just going to give the builder the cash all at once. Instead, a schedule of draws is set up.

DRAWS/ PROGRESS PAYMENTS

Draws are designated intervals at which the builder can receive the funds to continue with the project. There may be several draws throughout the duration of the build. For instance, the builder may get the first 10% when the loan closes, and the next 10% after the lot is cleared and the foundation is poured. The next influx of money may come after the house is framed, and then the subsequent payout after the house is under roof and sealed up.

The number of draws and the amount of each is negotiated between the builder, the buyer, and the bank. Typically, the first draw comes from the buyer's down payment (so it is the buyer's money most at risk). It is also common for the bank to require an inspection at each stage before releasing the money to the builder. This helps to ensure that everything is on track and that the money is being spent as it should.

Once all the draws have been paid out and the home is built, the buyer then needs to get the end loan in order to pay off the construction loan.

THE CONSTRUCTION LOAN RATE TYPE

With a construction loan, as with all other loans, you must pay interest on the money you borrow. Typically, construction loans are variable rate loans, in some cases they can be negotiated at start up for a fixed rate loan – depending on the lender chosen. In many cases, construction loans are also set up as interest-only loans. This means you only pay interest on the money you have borrowed instead of paying down any part of the principle loan balance. This makes payment of construction loans more feasible.

You also pay only on the amount that has been paid out already. For instance, if you are borrowing \$100,000, and only the first \$10,000 has been paid out, you pay interest only on the first \$10,000 and not on the full \$100,000. You need to make monthly payments for this loan – just as with a conventional loan – so your monthly payments should start low when only a small amount has been borrowed, and gradually increase as more of the money is paid out to your builder.

WHAT HAPPENS WHEN CONSTRUCTION IS COMPLETED

It is when your loan is fully drawn and your home has been completed that your loan will convert to principal and interest repayments

It is at this time that your finance manager will be reviewing the current rates and loan types available to assist you in personalising your home loan to suit your needs and circumstances.

For more information call 1300 broker, visit www.amortgage.com.au or contact:

