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*Financial advice you can act on!*

## ***Borrowers Guide to Construction Loans***



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## Introduction

The Borrowers Guide to Construction Loans has been designed to assist consumers gain a better understanding of how the construction lending process works. The process can be confusing and overwhelming at times, but when you understand the basic process, you'll be much more prepared. The purpose of this guide is to assist you through each step. We believe the collection of the enclosed information will make your journey into the construction world an enjoyable one!

So, let's get started...



# Preparation

## *Before you start looking for land*

Before you start looking for land and a property to build there are several key details to consider such as:

- ✿ How much can I borrow?
- ✿ Understanding the costs involved
- ✿ How much deposit do I require?
- ✿ Can I afford it?

### *How much can I borrow?*

How much you can borrow will depend on several factors including:

- ✿ Your income
- ✿ What deposit is required
- ✿ Eligibility for Home Owner Grant
- ✿ Other loan repayments and commitments

An important factor to consider is how comfortable you are financially to repay the proposed loan. It is imperative that you do not over stretch yourself, it is best if you sit down and work out a budget and understand how much you have left over to repay a loan comfortably. You should also factor in interest rate movements as this will affect your repayment amount.



*Some of the other costs would include:*

### **Stamp Duty**

This is a government cost that is usually the biggest expense outside the purchase price of the property. Stamp duty varies between the states and territory. For guidance on the approximate stamp duty cost would be in your relevant state, go to [www.stampdutycalculator.com.au](http://www.stampdutycalculator.com.au)

### **Loan Setup Costs**

This includes establishment fees and will vary pending on the lender and the loan product chosen. It is important to note that you may also require Lender's Mortgage Insurance (LMI) depending on your deposit size.

### **Conveyancing Costs**

Conveyancing is the process of which a property's ownership is transferred from the current owner (the vendor) to the buyer. A conveyancer is a legal representative that specialises in this field. Either a conveyancer or a solicitor will review your Contract of Sale and ensure appropriate checks are conducted on the property with local government agencies.

### **Getting a Deposit Together**

There are many options available in relation to how much you will need to come up with as a deposit. Depending on your situation it could vary from 5% to 20% or more. Sitting down with your trusted mortgage professional will ensure you know which options are available to you.





# The Mortgage Steps

## *Understanding the mortgage process*

### *The Mortgage Steps.*

There are 10 steps to the Mortgage Process.  
These are:

**Step 1:** Interview

**Step 2:** Completion of a Loan Application

**Step 3:** Lender Assessing Application

**Step 4:** Obtaining a Decision - Conditional  
Approval

**Step 5:** Valuation of Security being provided

**Step 6:** Lenders Mortgage Insurance

**Step 7:** Formal Approval

**Step 8:** Mortgage Documentation

**Step 9:** Insurance Requirements

**Step 10:** Settlement





### **Step 1:**

#### *Interview*

Your mortgage professional will discuss the home loans (with the necessary features and benefits that you require) that best suit your situation. They will go through numerous options that are available to see which is the most appropriate that will suit your needs and wants. Once you are happy with your selection of the loan product, the loan process will commence.

### **Step 2:**

#### *Completion of Loan Application*

Your Mortgage Professional will now complete the lenders application that you have chosen and will go through what is required in relation to all the necessary documentation which is to be included so they can lodge your home loan application. They will also go through your income situation to see if you will be able to service the loan that you are applying for. Upon receiving all the relevant documentation the Mortgage Professional will submit it to the chosen lender.

### **Step 3:**

#### *Lender Assessing Application*

The lender will assess your application to determine whether you meet their serviceability and credit requirements. This process includes confirmation of your income, employment, assessment of your supporting documentation and a credit check.

### **Step 4:**

#### *Conditional Approval*

The Mortgage Professional will receive a communication from the lender in the form of a conditional approval on your behalf. The lender will also outline any matters that need to be addressed before they can issue an unconditional approval.

### **Step 5:**

#### *Valuation of Security being provided*

The most common condition of an approval is valuation of the security being provided. The lender will order the valuation and the valuer would (typically) require the land contract, plans, and specifications and building contract of the house you are going to build. This could take up to 3-4 days to complete.



### **Step 6:**

#### ***Lenders Mortgage Insurance***

*This step will only be necessary if you have less than a 20% deposit or insufficient equity in an existing property.*

#### ***What is Lenders Mortgage Insurance?***

Lenders Mortgage Insurance (LMI) is one of the most popular ways to achieve the dream of home ownership sooner for borrowers that do not have a large deposit. Many lending institutions require borrowers to contribute a 20% deposit before they will agree to provide a loan. This is largely to protect against the risk associated with providing the borrower with the loan in the event that they default. By using LMI, lenders are able to pass on this risk to a mortgage insurer, which in turn enables them to offer the same loan amount but with less of a deposit. LMI should not be mistaken for Mortgage Protection Insurance, which covers your mortgage in the event of death, sickness, unemployment or disability.

LMI protects lenders against a loss should a borrower default on their home loan. If the security property is required to be sold as a result of the default, the net proceeds of the sale may not always cover the full balance outstanding on the loan. Should this be the case, the lender is entitled to make an insurance claim to the Mortgage Insurer for the reimbursement of any shortfall, calculated in accordance with the terms of the insurance policy. It is a once off premium and in a lot of cases can be capitalised with the loan.

### **Step 7:**

#### ***Formal Approval***

When a home loan application is formally approved (unconditionally approved) it means that all conditions and criteria required to assess a loan application have been supplied, assessed and approved. It is only when a home loan application is formally approved that the borrower can feel comfortable that they can obtain a home loan.



If you are buying a property it is advisable not to exchange contracts until such time that your loan has been formally approved. A formal Letter of Offer will then be issued by the lender. Mortgage documents will be prepared and will be sent directly to the applicant/s or the applicants' solicitor if that was requested in the loan application.

### ***Step 8:*** *Mortgage Documentation*

Now that the formal offer has been provided, mortgage documentation is prepared by the lender. This includes the letter of offer; mortgage documents; terms and conditions of the loan you have chosen and any other documentation that is pertinent to the lender's own guidelines.

### ***Step 9:*** *Insurance Requirements*

With the new liabilities that come with owning property, it is important to consider or review your insurance requirements to ensure you are appropriately covered. There are four main types of insurance you should consider:

- Home Insurance
- Contents Insurance
- Life Insurance
- Income Protection

You may need to start your insurance cover prior to settlement.

### ***Step 10:*** *Settlement*

After the mortgage documents are signed, witnessed and sent back to the lender, then settlement is arranged via your solicitor/conveyancer or if there is not a necessity for a solicitor/conveyance then the Mortgage Professional will be involved to ensure settlement is completed.



# Construction Loans

## Drawdowns/Progress Payments



### **What are drawdowns?**

*In a construction loan your builder is usually paid in drawdowns (sometimes known as progress payments) which occur as various stages of work are completed.*

*Many construction loans have approximately five drawdowns. These drawdowns are often at the following stages, but may vary depending on your building contract:*

- *Slab complete*
- *Frame completed*
- *Outer brick work completed*
- *Lock up stage*
- *Workable completion*

*Builders usually will send you a progress invoice each time a progress payment is due. Your lender may also require you to sign a progress payment form that they will provide and you would need to send this form to the lender along with the progress invoice. Once the progress payment is approved by the lender, the builder will be paid from your loan account.*

In a construction loan your builder is usually paid in draw downs (sometimes also known as progress payments) which occur when each part of the work is completed.

This means that your monthly mortgage repayments slowly increase as the construction moves forward until finally, at completion of construction, the loan repayment reaches its full monthly repayment amount.

Many lenders also offer interest only repayments during the construction process which then reverts to principle and interest repayments once the construction is complete.

To qualify for a construction loan you will need to have council approved plans and a fixed price tender from a registered builder. You should also note that you will need to use your saved funds or equity before drawing down on your construction loan.

For many building contracts a progress inspection at every mortgage loan drawdown is arranged by the lender. Always check with your mortgage professional if you would like to make any variations to your building contract, prior to proceeding.

Upon completion of the dwelling, the construction loan will revert to the loan product originally chosen by you.

# Construction Loans



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## **What is the maximum percentage you can borrow?**

There are some construction loans that may allow you to borrow up to 95% of the value of the property plus some funds to cover the cost of Lenders Mortgage Insurance.

After your loan is approved what other items do you need to provide prior to commencing construction?

- ✿ Signed Contract (fully signed by the builder and purchaser)
- ✿ Signed Specifications (fully signed by builder and purchaser)
- ✿ Building Services Authority (BSA) Insurance (QLD only)
- ✿ Builders Public Liability Insurance
- ✿ Arrange insurance covering the full replacement value and ensure that your lender is listed as mortgagee





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# Tips

## *Things to remember*



### *Know your building contract*

Finding a reputable builder is the first thing to do after you've made the decision to build. Next, you will need to enter into a building contract with a licensed builder. The contract is a legally binding document. Ensure you read the fine print!

Is it your responsibility to go through the terms and conditions with your legal representative. Never sign anything unless you are 100% certain you understand what it means.

Ask the question of your builder – do you have all the necessary insurance policies in place? Not all lenders will need to sight the following documents, but some will. Either way, it is strongly recommended that you obtain copies of the following documents from your chosen builder:

- ✿ Builders License
- ✿ Home Warranty Insurance (NSW/QLD) – also known as Builders Warranty Insurance (VIC), Building Indemnity Insurance (SA), Home Indemnity Insurance (WA), Housing Indemnity Insurance (TAS), Building Warranty Insurance (NT)
- ✿ Employers Liability and Workers Compensation

**REMEMBER:** At the completion of your construction, you will need to obtain an Occupation Certificate, also known as an Occupation Permit, from your local council.

**FIRST HOME OWNERS:** Thankfully there are several Government Incentives and benefits available to provide a little helping hand. For more information visit [www.firsthome.gov.au](http://www.firsthome.gov.au)



# Useful Websites

- ✿ Building Commission  
[www.buildingcommission.com.au](http://www.buildingcommission.com.au)
- ✿ Master Builders Association  
[www.masterbuilders.com.au](http://www.masterbuilders.com.au)
- ✿ Home Design Directory  
[www.homedesigndirectory.com.au](http://www.homedesigndirectory.com.au)
- ✿ Builder Services Authority  
[www.bsa.qld.gov.au](http://www.bsa.qld.gov.au)
- ✿ Office of Fair Trading Home Building Service  
[www.fairtrading.nsw.gov.au](http://www.fairtrading.nsw.gov.au)
- ✿ First Home Owner Grants  
[www.firsthome.gov.au](http://www.firsthome.gov.au)



# Need help?

## *What a mortgage professional can do for you*

*Nearly half of Australian home buyers now use a mortgage professional to find them the home loan that best suits them.*

*Mortgage Professionals have the expertise, the contacts and experience to ensure you get the right loan for you.*

*Furthermore, we take on the legwork so you don't have to.*

- ✿ Discuss your existing situation, your lending needs, requirements, and obtain all necessary information pertaining to your lending application.
- ✿ Explain the types of loans available to you from a range of banks and specialist lending institutions.
- ✿ Based on the information provided by you and utilising specialist lending software, match your lending requirements to a selection of loan products offered by a diverse range of lenders.
- ✿ Act as an intermediary between you and the lender by completing and packaging your loan application.
- ✿ Liaise with your solicitor; real estate agent; accountant and any other related party to ensure a smooth and timely settlement.
- ✿ Assist with any future lending requirements, whether you wish to check, change or top-up your loan.







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*Ready to get started?*

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