The Borrowers Guide to Construction



REDUCE
HOME LOANS

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The Borrowers Guide to Construction Loans has been designed to assist consumers gain a better understanding on how the construction lending process works and the specifics associated with construction lending and building a home.

The process can be confusing and overwhelming at times, but when you understand the basic process, you will be much more prepared.

Talk to your Mortgage Broker!

Your Mortgage Broker is here to assist you navigate this complicated process so it is important to engage them early in the process.

Your Mortgage Broker will:

01. Discuss your existing situation, your lending needs, requirements and obtain all necessary information pertaining to your lending application.

02. Explain the types of loans available to you from a range of banks and specialist lending institutions.

03. 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.

04. Provide an overview of the relevant costs associated with your loan application.

05. Provide an in-depth overview of the loan product or products you select.

06. Act as an intermediary between you and the lender by completing and packaging your loan application.

07. Liaise with your solicitor, real estate agent, accountant and any other related party to ensure a smooth and timely settlement.

08. Assist you in lodging your progress payment claims with the lender

09. Assist with any future lending requirements, whether you wish to check, change or top-up your loan.



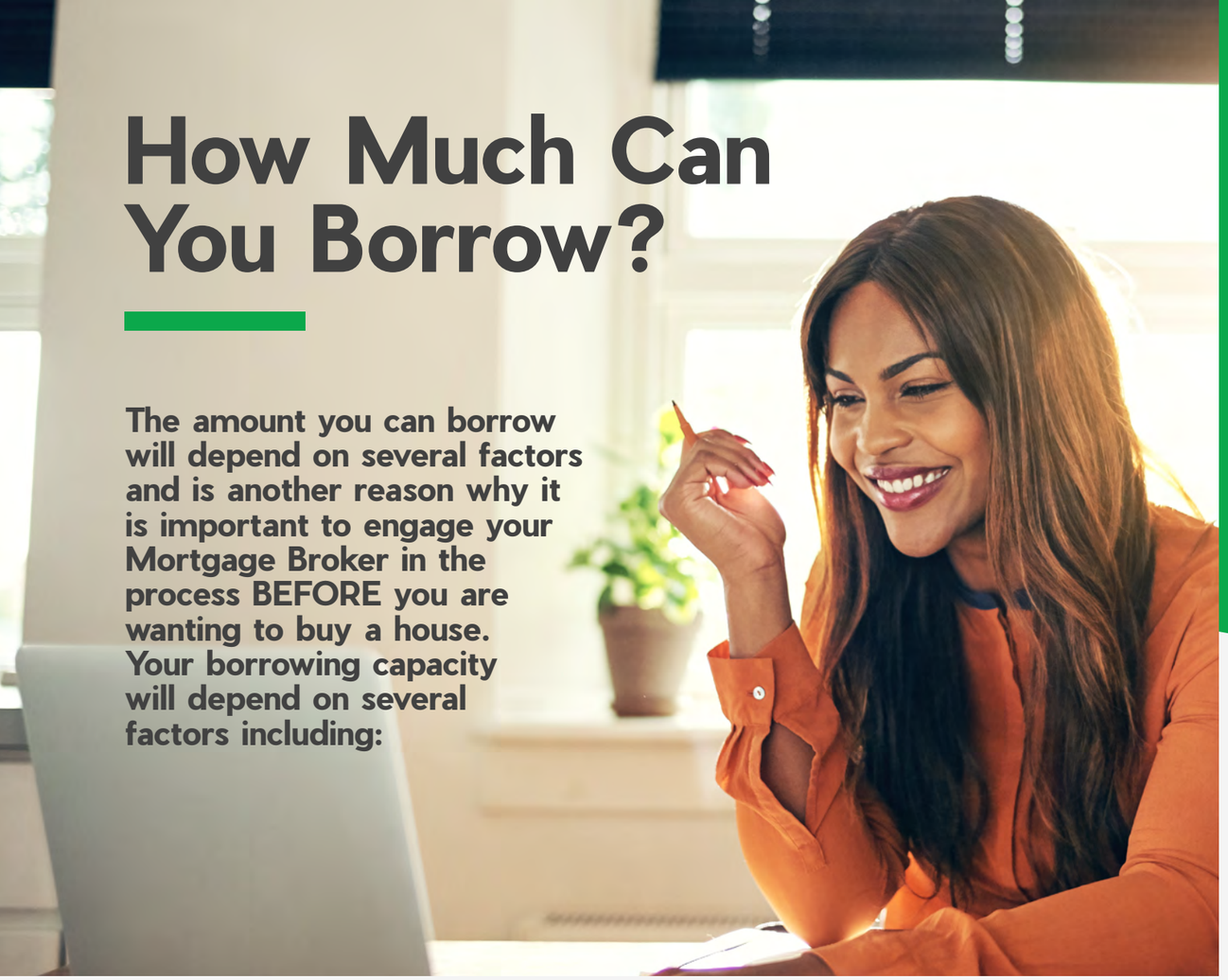
Preparation

THE KEY BEFORE GETTING YOUR KEYS

Before you start looking for a home or investment property, there are several key details to consider such as:

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

How Much Can You Borrow?



The amount you can borrow will depend on several factors and is another reason why it is important to engage your Mortgage Broker in the process BEFORE you are wanting to buy a house. Your borrowing capacity will depend on several factors including:

Your income

This includes your fixed remuneration and any bonuses or allowances you receive. It is important when discussing your income with your Mortgage Broker that you disclose the types of income as some lenders may assess different types of income at different rates. As an example, your overtime might only be assessed at 80% of your income, but if you were in essential services it may be assessed at 100%.

Your Financial Liabilities

This includes things such as credit cards, personal or car loan and HECS debt. It also includes After Pay and Zip Pay and any interest free loans you may have. Credit cards with no debt owing but still active also need to be disclosed.

Your Living Expenses

Mortgage Brokers and lenders have an obligation to ensure they are not putting you into a loan that would cause you undue hardship. A key factor in assessing this is reviewing your living expenses. This is normally done by assessing your last 3-6 months transaction and credit card statements to assess how and where you spend your money.

One of the key benefits of working with your Mortgage Broker before you are ready to buy a property is that they can help you identify any changes in your spending habits that you could make to provide a more favourable view to the lender.

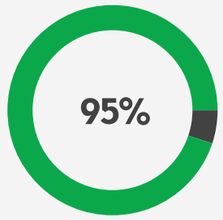
How Much Deposit Do I Require?

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%-20%. Sitting down with your trusted Mortgage Broker will ensure you know which options are available to you.

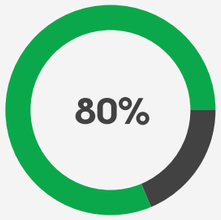
Most lenders will want to see evidence of consistent savings over a period of 3-6 months. This is to not only show that you have the funds to complete the transaction, but that you also have the discipline and commitment to pay your ongoing mortgage repayments once you settle your loan.

The amount of the deposit can be varied, some lenders will allow you to borrow up to 95% of the value of the property requiring you to only have 5% of the value of the property saved. This will require you to pay Lenders Mortgage Insurance (LMI). LMI is a cost which you, the borrower, pay at the settlement of your loan that protects the bank in case you default on the loan and they must sell the property at a loss. It is important to understand that LMI does not protect you if you get sick or lose your job. To avoid paying LMI you generally need to borrow less than 80% of the value of the property.

POSSIBLE TO BORROW UP TO:



AVOID LMI:



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What are the Costs Involved in Buying a Property?

The cost involved in purchasing a property is more than just the purchase price and can include such things as:

Bank Fees
This includes any application or valuation charges and can vary between lenders.

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. Your Mortgage Broker can assist you in calculating this amount.

Lenders Mortgage Insurance
This is a cost to you, the borrower, that is generally charged by the bank if you have less than a 20% deposit on the property. It can vary between lenders and your Mortgage Broker can assist you in calculating this amount.

Government Fees
These include things such as mortgage registration, transfer fees and title searches.

Legal Costs
Either a conveyancer or solicitor will review your Contract of Sale and ensure appropriate checks are conducted on the property with local government agencies.

Property Checks
It is always recommended that prior to purchasing a property, you hire professionals to inspect the property for structural defects, concerns, pest infestations, anything that could potentially cause damage to your property.

Removalist Costs
Will you do this yourself or hire a company?

Utilities
Set up of utilities which may include a connection fee and up to 2 months of charges as they may charge in advance.

Can I Afford It?

Please note, whilst it is good to review your living expenses and reduce discretionary costs, it is also important that you balance that with your lifestyle. You want to ensure that this is a budget you can stick to long term and not feel like you are sacrificing too much for the sake of buying a house. It is important to therefore factor rate increases into your calculation.

Types of Home Loans



There are several different types of home loans and your Mortgage Broker will assist you in choosing the right one for your specific needs.

Fixed Rate Home Loan

A fixed rate simply means that the interest rate is guaranteed for a certain amount of time – commonly between 1 year to 5 years.
The benefits of a fixed rate loan are that you know what your repayments will be over a specific time frame and you can budget accordingly. The interest rate is not going to go up (or down) over that period.

The disadvantage however is that fixed rates loans are not very flexible. There will be a limit to the amount extra you can pay off over the fixed term and fixed rate loans rarely allow you to redraw any surplus funds or have an offset account. The other thing to be aware of is that if you have to sell the property during the fixed rate period, you may incur break costs which could run into the 1000's of dollars

Interest Only Home Loan

An interest only loan is where the borrower only has to pay the interest accrued each month on the loan, rather than paying down the principle balance. Usually it is associated with investment properties in line with a strategy from the accountant or financial planner.

The benefits are that the repayment is reduced, thus freeing up cash for other purposes however, the principle will still need to be repaid and once the interest only period is over you will be paying off the principle at higher repayments than you would if you started paying the principle off from the beginning.

Variable Rate Home Loan

A variable rate means that the interest rate will rise and fall with the market over the period of your home loan. This can be in line with movements in the official cash rate by the Reserve Bank or it may be a decision by your financial institution to vary their rates.

The main advantage of a variable rate loan is flexibility. While you must meet your minimum monthly repayment, you can usually pay more if you want to. There is also no cost penalty if you decide to sell your property and move. You also generally can have access to an offset account, redraw or both.

The main disadvantage of a variable rate loan is that your minimum repayment amount may rise or fall at any time in line with either the Reserve Bank or a business decision by your financial institution. This can make it hard to plan especially for those on a tight budget.

Split Home Loan

A split loan offers the best of both, offering the certainty of a fixed rate and the flexibility of a variable rate.



Buying the Land

Before you can build your house, you need some place to build it. Buying the land is the first step on the road to building your new home and there are a couple of different ways this can take place.

DIY Land and Construction

You may find a block of land that you like, make an offer on it, have it accepted and then need to go and find the builder of your choice to build on that block for you. This is a good option if you are looking for something highly customised or you are wanting to wait a bit before building.

House and Land Package

This is the process where you secure both the land and construction at the same time but through two separate contracts. Generally, there are a select number of builders and designs that are on offer in this scenario and you can choose from them and make minor amendments.

Tip:

If you are buying the land and settling on it before you decide on a house to build, it is recommended to get a pre-approval for the construction to ensure there are no surprises with the lender when it is time to build.

Construction Loans

The Construction Loan is a loan that is drawn down in stages as your property is being built.

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. This process is helpful as you may still be paying rent or board at another location while your home is being built.
Most lenders also offer interest only repayments during the construction process which revert 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 building contract or a tender from a licensed builder.

This can be a challenge as you don't want to sign the building contract until you have approval from the bank that you can borrow the money but they need a contract to assess your loan. There are several solutions to this problem including negotiating a finance clause of at least 3 weeks into your contract or providing a draft contract. Some banks will provide approval on a tender but the problem here is things often change between the tender and contract stage and you would then require the bank to reassess.

You should also note that you will need to use your saved funds or equity before drawing down on your Construction Loan.

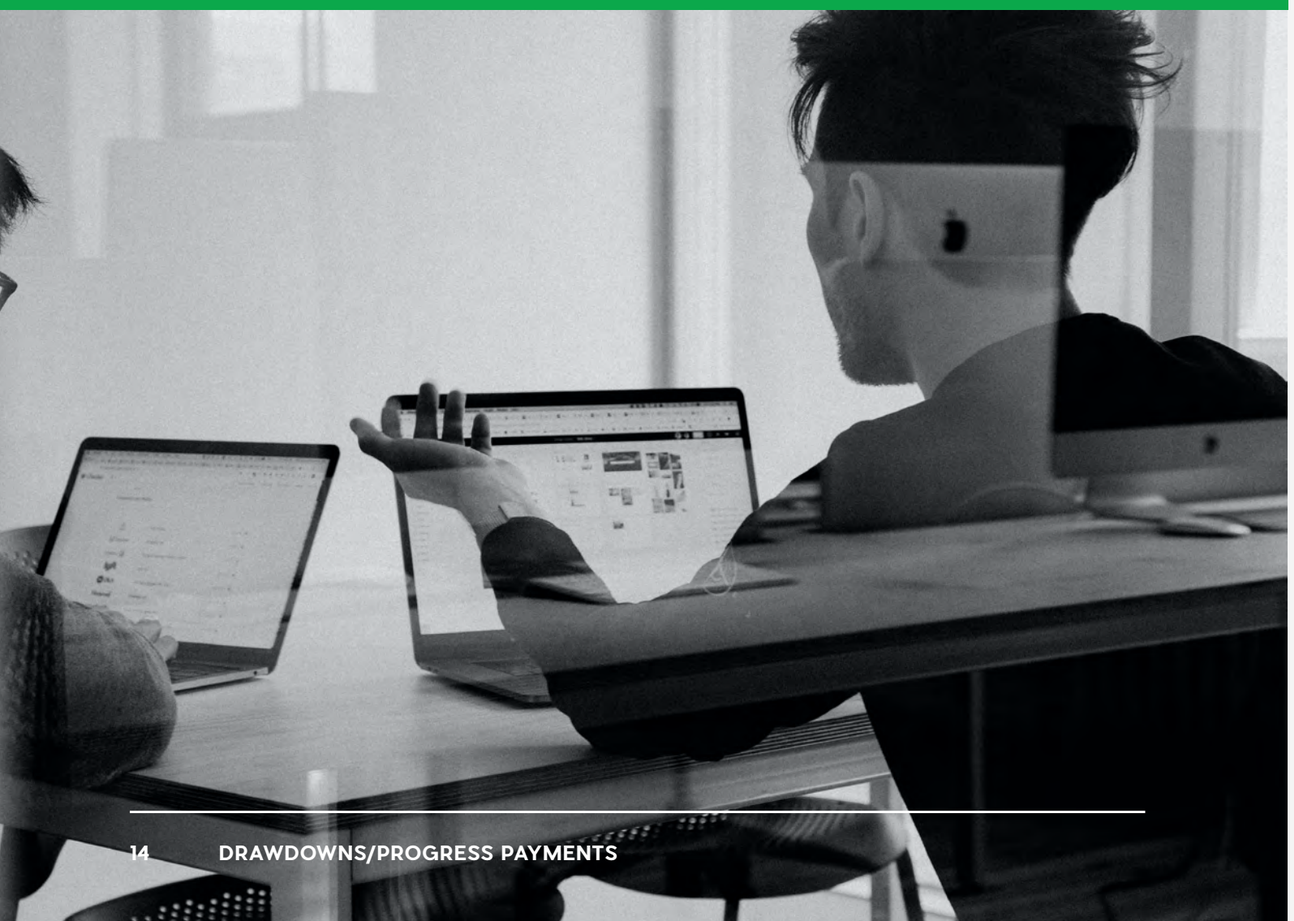
Always check with your Mortgage Broker if you would like to make any variations to your building contract, prior to proceeding.

Upon completion of your property, the Construction Loan usually reverts to a standard variable rate home loan.

What are Drawdowns/Progress Payments?

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

Builders will usually 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. 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.



Many Construction Loans have approximately five draw downs. These drawdowns are often at the following stages but may vary depending on your building contract:

1. Deposit
This is generally paid after you have had your loan approved, before any building starts and the loan commences. This allows the builder to finalise the plans and any variations. The builder will then send the proposal to your local council for building approval.

2. Slab Complete
This is the stage where the foundation is laid. It includes measuring out the design on the site, pouring the footings and foundations, under slab drainage, moisture barrier and termite protection.

3. Frame Complete
This includes installation of internal and external support structures, including walls, conduits for electrical and plumbing, the roof frame, sheeting, gutters and insulation.

4. Lock Up Stage
It is at this point that all windows, doors and remaining walls are completed and you can quite literally “lock up” the property.

5. Fit Out Stage
All the internal work such as plumbing, electrical (including lights and power points) and other fixtures and fittings will be completed. This also includes things like cornices, tiling, cabinetry and shelves, all the features that make a house a home.

6. Practical Completion
All painting and installations are complete and you are ready to move in.

How Do Construction Valuations Work?

Generally speaking the bank will instruct the valuer to review the value of the land, (either from the Contract of Sale or from their own valuation if you already own the property) and the cost of building the house from the construction contract and specification. They will then assess it in comparison with the value of other similar houses in the area.

The result will either be the cost of the land plus the value of the improvements or the valuation amount in comparison to other properties in the area, whichever is the lowest.

What Additional Documents Do I Need?

In addition to your standard documents relating to income, expenses and other debts, you will also need to provide the following:



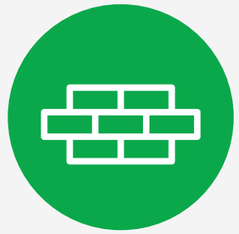
Building Contract

This includes things such as the building stages, the drawdown schedule, how long construction should take and the final price.



Building Plans

This is the specific drawing that outline what it is you are building, they don't need to be council approved at this point but are required to provide the valuer with an idea of what it is you are building.



Specifications

This outlines the type of materials you are using including the quality of the finishings and appliances.



Quotes for Additional Works

It is important to read your building contract carefully as sometimes there are things not included and you may have to get quotes for these additional works. Typical things not included could be:

- SWIMMING POOL - SHED
- LANDSCAPING AND RETAINING WALLS
- DRIVEWAY - FENCING

What Do You Need to Provide After Approval?

Once your loan has been approved and you have provided the approval to your builder, they will start the process of finalising the plans and sending them to council for approval. Once this is completed, you will need to provide the following to the bank prior to them releasing funds for the construction:

- Signed Contract (fully signed by builder and purchaser)
- Signed Specifications (fully signed by builder and purchaser)
- Council Approved Plans
- Builders Risk Insurance
- Arrange insurance covering the full replacement value and ensure that your lender is listed as Mortgagee.

Owner Builder

You may decide that you have the skills and resources to either build your home yourself or manage the process, this is called an Owner Builder. Whilst there are the obvious advantages of saving money and building the house exactly to your specifications, there are some things you need to take into consideration before you proceed down this path.

Level of Experience

Whilst you are not required to be a licensed builder to get an Owner Builder license, the majority of the lenders now will require you to have experience building a home before they would lend to you in an Owner Builder scenario.

Loan to Value Ratio

The banks consider Owner Builder lending to be higher risk and as a result will lend a lower loan to value ratio, generally around 60-65%. This means you would need to have significantly more equity or cash in the project before they would consider you.

Cashflow

Like a standard construction loan, the lender will only release the funds once the stage has been completed. They will generally send a valuer out to inspect the progress and if satisfied, release the funds to you. The challenge this can present is that you need to have the cashflow to pay for things before the bank reimburses you, so having funds to complete is imperative.

Speak to your Mortgage Broker to find out more about if Owner Builder would be right for you.

Tools to Assist You

To ensure you have the best experience possible, we have provided a few handy checklists:

Required Documents Checklist

This will allow you to prepare for your first meeting with your Mortgage Broker and ensure you have the right documents ready, to avoid delay.

Budget

It is important to understand what you spend and what you can afford. Your Mortgage Broker will review this with you, but this document will help get you started.

Preparing for Settlement Checklist

There is a lot to think of when you are buying your home and this will assist you in ensuring there are no delays on settlement day.

REQUIRED DOCUMENTS CHECKLIST

IDENTIFICATION

- ☐ **Driver's License**
- ☐ **Medicare Card**
- ☐ **Passport**

STATEMENTS – less than 30 days old

☐ **Transaction Statements**	3-6 months to verify income & living expenses
☐ **Savings Statements**	3-6 months to verify savings & funds to complete
☐ **Home Loan Statements**	In the event of refinancing, 6 months loan statements will be required, otherwise a minimum of 1 month statement to verify details of the loan
☐ **Credit Card Statements**	1-3 months may be required

PAYG INCOME

☐ **Pay Slips**	Last two pay slips, less than 30 days old
☐ **Payment Summary**	Most recent may be required
☐ **Employment Contract**	May be required to validate overtime/bonuses

SELF EMPLOYED INCOME

☐ **Tax Returns**	Last Two years of personal/business/company/ trust income tax returns no older than 24 months old.
☐ **Notice of Assessments**	Last two notice of assessments, no older than 24 months old
☐ **Financial Statements**	last two years financial statements for the business

ADDITIONAL INCOME DOCUMENTS

☐ **Rental Income**	Rental ledger or letter from the real estate agent
☐ **Centrelink Benefits**	Most recent Centrelink letter, less than 30 days old, outlining details of benefits

POTENTIAL ADDITIONAL DOCUMENTS

☐ **Superannuation Statements**	Depending on your circumstances, your most recent superannuation statement may be required
☐ **Share and Dividend Income**	Share statements and personal tax returns may be required
☐ **Building Contract and Plans**	For construction loans
☐ **Contract of Sale**	For purchases

MONTHLY BUDGET

FOOD EXPENSES

Food & supermarket	$
Coffees, lunches takeaway	$
Cigarettes & alcohol	$

DISCRETIONARY EXPENSES

Entertainment	$
Domestic holidays	$
Clothing, shoes & accessories	$
Hairdressing & grooming	$
Phone, Internet & pay TV	$
Media streaming & subscription services	$
Gifts & celebrations	$
Other discretionary expenses	$

CHILDREN AND EDUCATION EXPENSES

Public education costs	$
Private education costs	$
Tertiary & vocational education	$
Childcare	$

HEALTH & WELLNESS EXPENSES

Gym fees, sport, other health & wellness	$
Private health insurance	$
Doctor, dentist, pharmacy, glasses	$
Life, trauma, income insurance	$

TRANSPORT EXPENSES

Recreational vehicle running costs	$
Essential vehicle running cost	$
Public transport, taxis, ride share, commuting airfares	$
Essential vehicle insurance	$

PROPERTY EXPENSES

Primary residence running costs	$
Primary residence body corporate	$
Secondary residence running costs	$
Secondary residence body corporate	$
Investment property running costs	$
Investment property body corporate	$

OTHER EXPENSES

Pets	$
Child or spousal maintenance	$
Current rent expense	$
Ongoing board expense	$

TOTAL MONTHLY $

PREPARING FOR SETTLEMENT CHECKLIST

PAYG INCOME

☐ **Funds to complete**	In the nominated account at least 2 days prior to settlement
☐ **Building insurance**	Organized and provided to the mortgage broker
☐ **Utilities**	Electricity/Gas/Internet/Phone/Pay TV organised
☐ **If currently renting**	Notice has been given to real estate and utilities disconnected at old address
☐ **Forward mail**	Re-direction organised
☐ **Organise removalists**	
☐ **Set up direct debits**	Transfer all direct debits to your new account including things like Netflix and mobile phones

Notes

Get in Touch

REDUCE
— HOME LOANS —

Name:

Mobile:

Email:

Website:

ABN:

Credit Representative Number:

This is general information only and is subject to change at any given time.

Your complete financial situation will need to be assessed before acceptance of any proposal or product.