Plan, Build, Enjoy!

Everything you need to know about funding a new build or renovation

From foundations to fit out – a construction loan can help you get there...

Building a brand new home or completing major renovations on an existing property are some of the most exciting projects we can undertake as home owners.

If you're planning to build your dream home or give your existing home a major face lift, it can be worth considering a construction loan. This guide explains how construction loans work and takes a look at the pluses and potential downsides.

If you'd like to know more about construction loans, or you're ready to start your next building project, please contact your local Mortgage Choice broker. We can lay firm foundations to help you find the loan best suited to your needs.

Contents

What is a construction loan?

Building works call for a steady 'drip feed' of funds to meet ongoing costs as construction work progresses. Unlike a traditional home loan where the funds are made available to borrowers in a single lump sum, a construction loan lets you draw on the loan balance when payments need to be made to your builder at key stages. These payments are known as progress payments.

While work is still progressing you will be asked to make only interest repayments on the money that has been drawn down. So, at the start of your loan, you can expect small repayments, and these will gradually increase as your building project nears completion.

It means you aren't paying interest on money you haven't used as you would with a traditional home loan, and with a construction loan the repayments will be far lower until your project is complete.

Construction loans normally have a variable rate and in general you can expect a maximum Loan to Valuation Ratio ("LVR" – the maximum proportion of the property's value you can borrow) of 95%. This is something worth speaking to your Mortgage Choice broker about as the situation varies widely between lenders.

WORTH KNOWING...

Lenders often set a maximum timeframe for the complete draw down of your loan, usually within 6 months.

If you are not planning to build until later, the land may need to be purchased separately on a land loan.

Applying for a construction loan...

Boost your chances of loan approval by knowing what's required upfront.

In some ways the process of applying for a construction loan is much the same as for a standard home loan. Your lender will want to see proof of your income such as pay slips or a contract of employment as well as bank or investment statements showing evidence of savings. These all show the lender that you have the financial capacity and personal discipline to repay the loan.

But unlike a traditional home loan, when you apply for a construction loan you are asking your lender to provide funding for an asset that isn't yet built. That's why your lender will ask for some additional documents including:

- A signed HIA/MBA fixed price building contract explaining details of the project's specifications, any possible variations, allowances and all costs.
- Council approved building plans. It isn't normally a problem if these plans aren't available when the loan is initially approved but you may need to provide them before you can draw down on the loan funds.
- Evidence that you are using a registered builder – such as a copy of your builder's licence.
- A copy of your builder's insurance policy.
- Quotes for any additional work not covered by the main building contract (e.g. landscaping, driveway, fencing, etc).

This may sound like a lot of extra paperwork but these are all documents that go hand in hand with organising any major building project. Having all the necessary paperwork also gives you extra confidence that you are dealing with a reputable builder and meeting council specifications.

Check if you're eligible for any home building incentives

Some state and territory governments offer stamp duty concessions and other incentives when you build a new home rather than buy an established dwelling.
Check the website of the revenue office in your state or territory to see if your state offers any incentives (see Table 1).

State / Territory Revenue Offices

State / Territory	Website
ACT	www.revenue.act.gov.au
NSW	www.osr.nsw.gov.au
NT	www.revenue.nt.gov.au
QLD	www.osr.qld.gov.au
SA	www.revenuesa.sa.gov.au
TAS	www.sro.tas.gov.au
VIC	www.sro.vic.gov.au
WA	www.treasury.wa.gov.au

Table 1

Making progress payments...

Once your loan is approved, the funds will be provided in a series of payments. These are usually made in line with various milestones that have been achieved by your builder. Importantly, these stages should be outlined in your building contract. You should note that the lender will usually release loan funds only once your own personal contributions have been used.

The loan draw downs are often referred to as 'progress payments', and they are typically made at six important stages of construction:

1. **Preparation:** This is the preparation stage when your builder will organise council approvals, source materials and line up a team of skilled tradespeople so that work on your project can commence.

2. **Slab (or base floor):** At this stage the site for your home is prepared and the concrete slab (also known as a 'pad') is poured. Depending on the nature of your block of land, this stage may also involve levelling the land and constructing retaining walls.

3. **Frame:** This is where your new home starts to become a reality. Teams of carpenters will work to erect the wall frames and roof trusses giving you an idea of how your home will look.

4. **Lock up:** This is always an exciting stage as your home is really beginning to take shape. The walls are bricked and the roofing is complete. Windows and doors will be fitted so that your home is weatherproof and can be securely locked when the builders depart each evening.

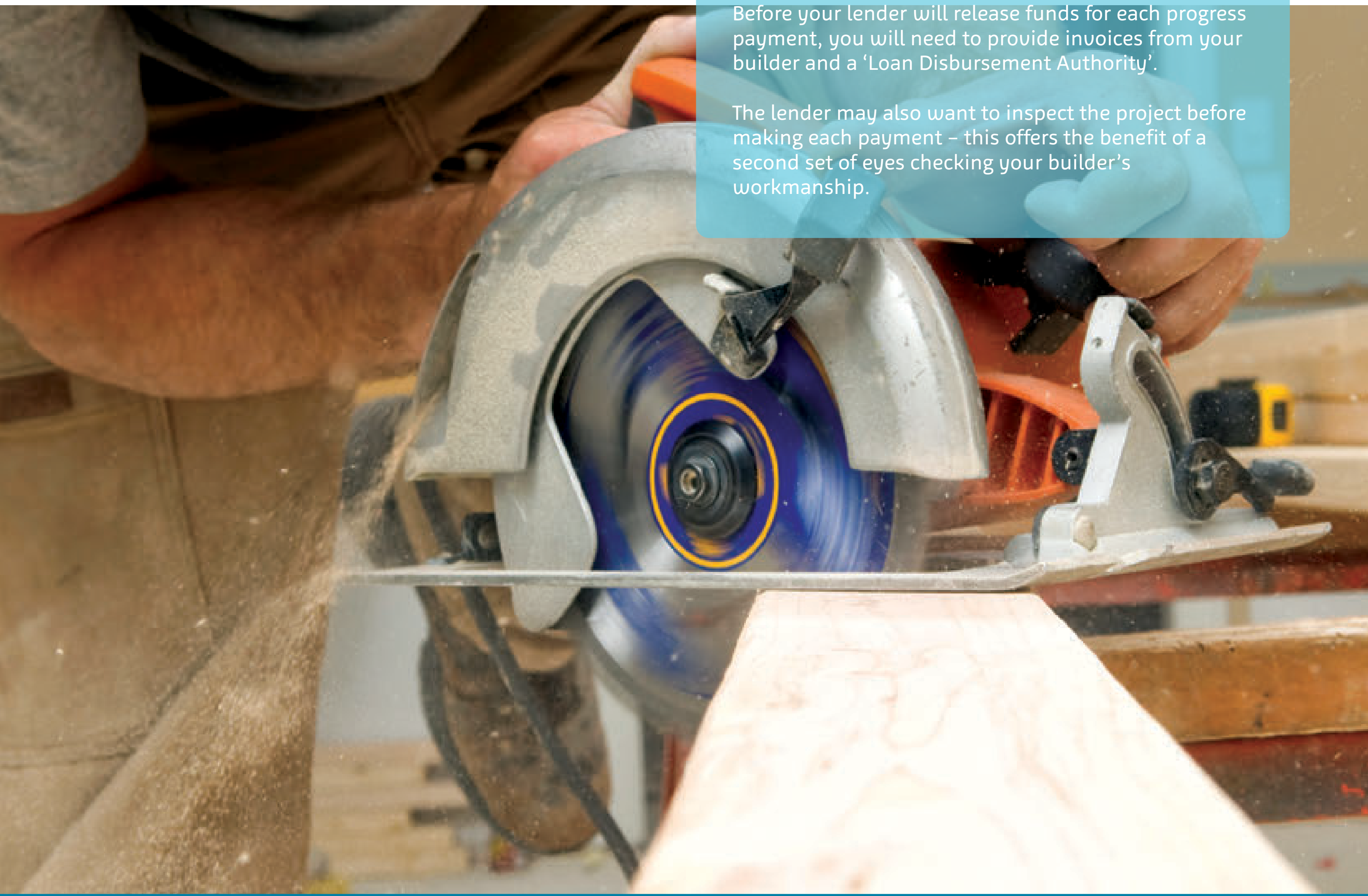
5. **Fit out:** This will see the installation of your choice of bathroom, kitchen and laundry. Walls will be painted in your choice of colours, tiles will be set and floor coverings laid. By now you'll be eager to move into the new building and make it your home!

6. **Completion:** You're on the home stretch now. All that remains is for appliances to be installed and landscaping completed if this is included in your building contract. Once these are finished, your builder will walk through the property with you to ensure everything is completed to your satisfaction. A representative of your local council will inspect your home one last time to check that it complies with the relevant building codes.

WORTH KNOWING...

Before your lender will release funds for each progress payment, you will need to provide invoices from your builder and a 'Loan Disbursement Authority'.

The lender may also want to inspect the project before making each payment – this offers the benefit of a second set of eyes checking your builder's workmanship.



A closer look at the costs...

It is important to have a clear idea of exactly what you're going to pay with any loan, and a construction loan is no different. Make sure you understand what you'll be up for – and when you'll be asked to pay.

Fees to be aware of

You may be asked to pay loan fees each time you draw down part of the loan. These fees usually comprise:

1. **Inspection fees:** As noted earlier your lender may want to physically inspect your home each time a progress payment falls due. This lets your lender check that construction is progressing at an acceptable rate and to an acceptable standard of workmanship. A fee may be levied for each inspection, and while the cost is often between $100 and $200, the fee may vary according to the lender and location of your property.

2. **Drawdown fee:** Some lenders charge a fee to cover the costs of making the loan funds available. You may be asked to pay a single fee at the start of your loan or a smaller fee each time you request a progress payment.

Insurance

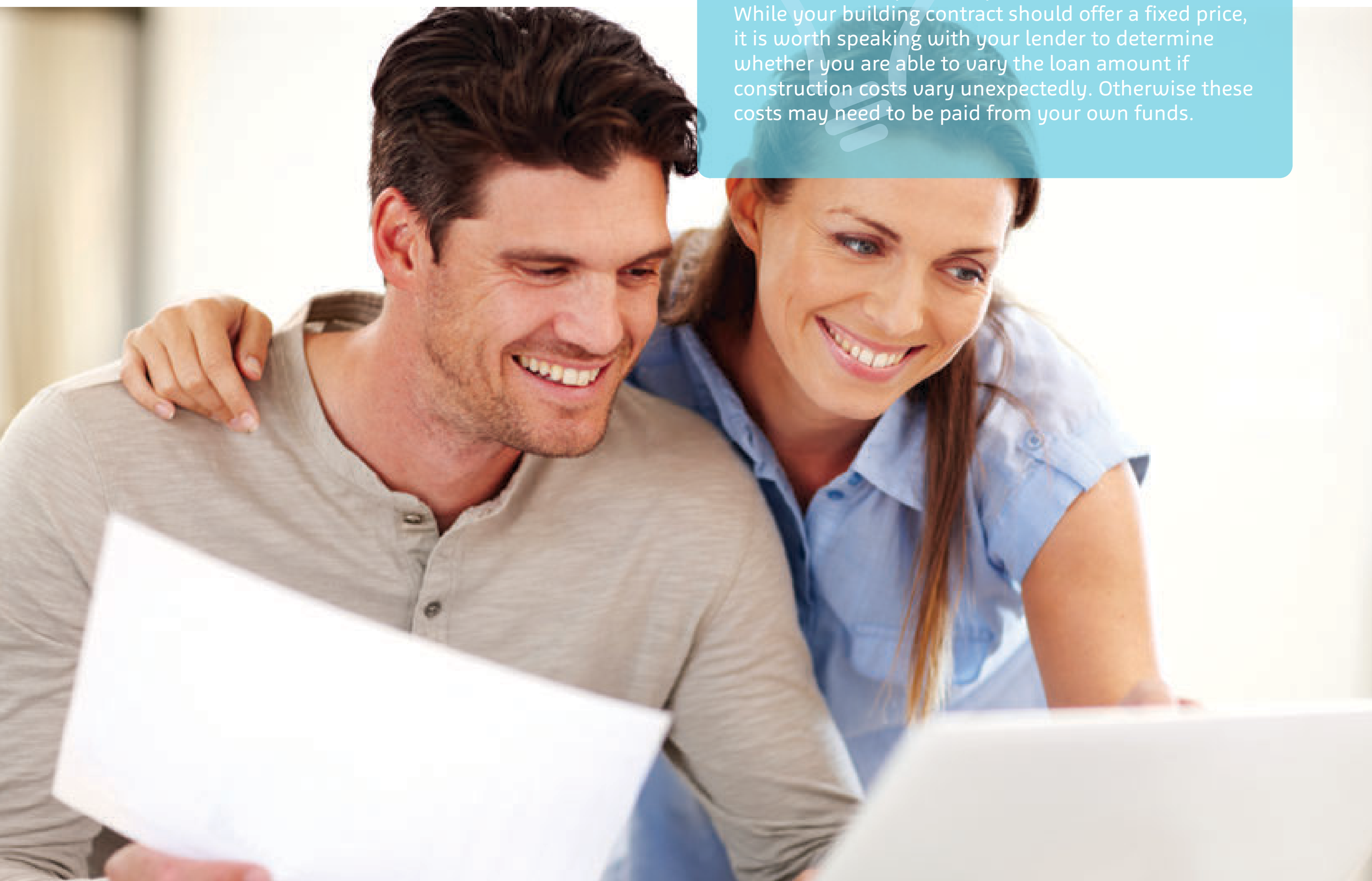
As a rule, insurance companies will not provide cover for homes that are under construction. In those instances where cover is available the premiums can be costly and the policy may feature a raft of exclusions.

That's why it is so important to deal with a reputable builder. Licensed/registered builders must have insurance in place that protects you against non-completion of the project, structural defects and public liability claims.

Once construction is complete you will need to take out your own building insurance – in fact, this will be a requirement of your loan. Along with building insurance, it also makes good financial sense to take out contents cover. Using the same insurer for both home and contents insurance often means securing a discount on the combined policy. Comparing premiums across a range of insurers will help you get the best deal possible.

tip MAKE SURE YOU HAVE ALL THE FACTS

When completing a building project or major renovation, unexpected expenses can sometimes arise. While your building contract should offer a fixed price, it is worth speaking with your lender to determine whether you are able to vary the loan amount if construction costs vary unexpectedly. Otherwise these costs may need to be paid from your own funds.



Managing your loan during construction...

A construction loan can be very budget-friendly while your home is being built.

While your home is being built your loan repayments will normally be interest-only. No repayments of principal are required until the full balance of the loan is drawn down. And interest is calculated only on the funds used to date.

This means you will have lower monthly repayments at a time when you may be paying rent on temporary accommodation or purchasing key items to furnish your new home.

That said, many lenders will accept additional repayments during construction and these will come straight off the loan principal, helping you get ahead with the loan and save on long term interest charges.

Budgeting for your repayments

Your builder will provide a detailed schedule of progress payments in your contract, and this will form a guide for your monthly loan payments. Remember, you will only be asked to make interest payments.

As a guide, let's say Liz and Andrew use a $300,000 construction loan to build their new home. We'll assume the interest rate is 6.0% p.a. with a one month gap between each progress payment.

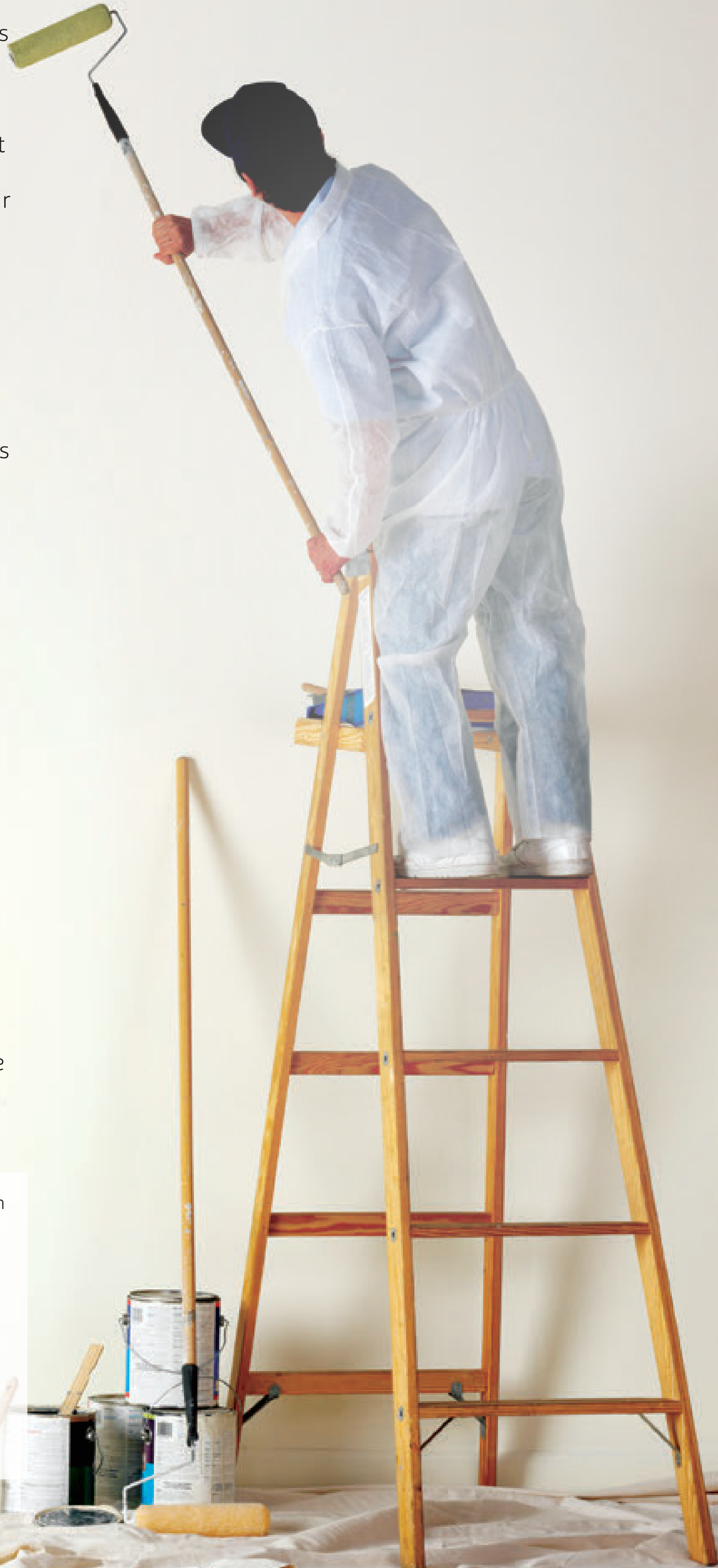
As Table 2 shows, interest is charged only on funds that have been drawn down at the time of each progress payment. Bear in mind, sometimes a stage may complete fairly quickly and you may receive two progress payments in the same month.

When construction is complete and the progress payments have been finalised, your loan will revert to principal and interest payments and you will start repaying the principal sum borrowed over the chosen loan term.

If you are taking out the loan as an investor you may be able to continue making interest only repayments. This is something to check with your lender.

Construction stage	Progress payment	Loan amount drawn down	Monthly loan repayment
Stage 1 – Preparation 10%	$30,000	$30,000	$150
Stage 2 – Slab 10%	$30,000	$60,000	$300
Stage 3 – Frame 20%	$60,000	$120,000	$600
Stage 4 – Lock up 20%	$60,000	$180,000	$900
Stage 5 – Fit out 20%	$60,000	$240,000	$1,200
Stage 6 – Completion 20%	$60,000	$300,000	$1,500

Table 2



Your home is now complete!

This is the moment you've been waiting for. At last you can see, feel and touch your home – it's real, it's yours and it's just waiting for you to move in.

All that remains is a few simple formalities to complete your exciting journey.

Final documents

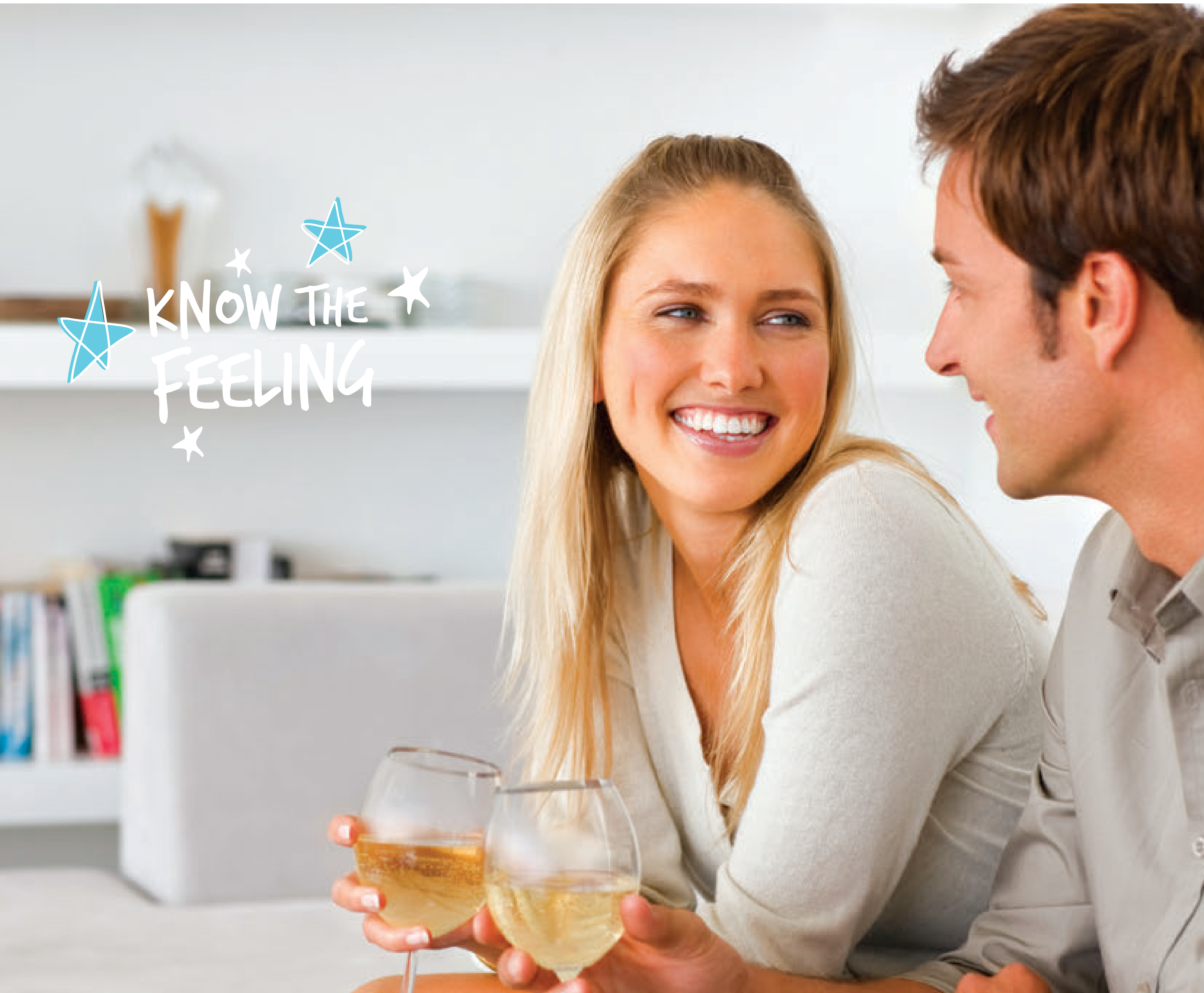
Your lender may want to inspect the property and complete a final valuation before making the last progress payment to your builder. You will need to provide several documents to complete the sign-off process. These include:

- A Certificate of Occupancy which shows the building is safe to be lived in. Depending on your state or territory this document may be known as an Occupancy Permit, Final Occupation Certificate or Certificate of Classification.
- Your builder's final invoice.
- A copy of your home building insurance policy.

Switching to a standard loan

Once the final payment is made to the builder your loan will switch to the standard home loan or loan package that you have agreed upon with your lender. Other options such as switching to a fixed rate may be available, with or without additional fees.

Now you're free to move in, celebrate with friends and family and make a fresh start in your brand new home. Enjoy!



Your Mortgage Choice broker makes it easy...

With so many loans and lenders to choose from it makes sense to seek help selecting the loan best suited to your needs.

How your Mortgage Choice broker can help

The role of a Mortgage Choice broker is to help you decide on the loan that best fits your circumstances.

Using specialist Loan Qualifier software, your broker will sift through the home loans offered by up to 28 of Australia's leading banks and lenders to pinpoint the product(s) that have the right features and competitive rates to meet your needs.

What can you expect?

Your Mortgage Choice broker appreciates that you lead a busy life. That's why we offer the flexibility to meet with you at the time and place that suits you best.

The first thing your broker will do is listen. This is a critical step for your broker to get a thorough understanding of your circumstances, your needs and your goals.

Only then can he or she help you work out your options.

Along with a selection of suitable, competitively-priced loans, your Mortgage Choice broker will also help you determine if there is a state or territory grant or stamp duty concession that you could be eligible for to help fund your new home.

What will it cost?

Here's some great news. The service provided by your Mortgage Choice broker comes at no cost to you.

We are paid by the lenders we work with, after your loan settles. That means you can take advantage of expert help with your next home loan without worrying about the cost.

tip CALL US TODAY

When you're ready to refinance, or if you'd just like to know more about how it could work for you, contact your local Mortgage Choice broker, or visit us at MortgageChoice.com.au.

Why choose Mortgage Choice?

- There is no charge to you for our home loan service because the lender pays us after your loan settles.
- Our brokers are paid the same rate of commission regardless of which home loan you choose, as long as it's a residential home loan with one of the lenders on our panel.
- Access to up to 28 of Australia's leading lenders, including the major banks.
- We make it easier for you by preparing the paperwork, lodging the application and doing all of the follow up on your behalf.

The information contained in this booklet refers only to loans provided by our panel of lenders with whom Mortgage Choice Ltd has an arrangement under which it receives commissions and other payments. Not all brokers sell the products of all lenders.

Jargon explained...

Contract
A contract is an agreement entered into voluntarily by two or more parties, each of whom intends to create one or more legal obligations between or among them.

Interest Only (IO)
A loan in which only the interest on the principal is repaid with each repayment for a specified period.

Land Loan
This type of loan allows you to purchase vacant land on which you intend to build a home within a specified period of time.

Loan to Valuation Ratio (LVR)
The ratio of the home loan amount compared to the valuation of the security. Commonly called LVR e.g. for a loan of $270,000 on a home valued at $300,000, the LVR is $270,000 divided by $300,000 then multiplied by 100, and expressed as a percentage i.e. 90%.

Mortgage
A form of security for a loan usually taken over real estate. The lender (mortgagee) has the right to take the property if the borrower (mortgagor) fails to repay the loan.

Principal
The outstanding loan amount on which interest is calculated.

Principal and Interest (P&I)
A loan in which both principal and interest are paid with each repayment during the term of the loan.

Progress Payment
An instalment of a larger payment made to a contractor for work carried out up to a specified stage of the job.

Term
The length of a loan or a specific portion within the loan.

Valuation
A report required by the lender, detailing a professional opinion of property value.

Variable interest rate
An interest rate that varies during the term of the loan, in accordance with market forces.

08 9355 1099

MortgageChoice.com.au/Leteisha.Pileggi1