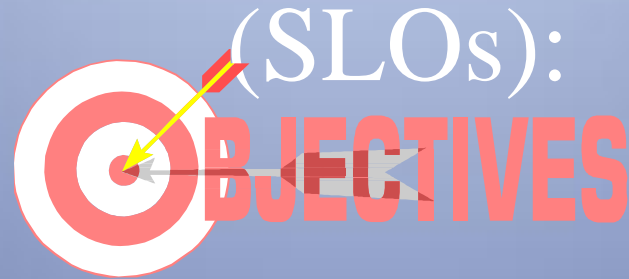


LESSON FIFTEEN

CONSTRUCTION FINANCING



STUDENT LEARNING OUTCOMES



1. *Explain the basic principles of construction lending.*
2. *Learn the technical vocabulary associated with construction lending.*
3. *List five sources of construction loans.*
4. *Contrast differences between take-out and interim loans.*
5. *Enumerate those items that determine the cost of a construction loan.*
6. *Outline the steps taken in filing a mechanic's lien.*
7. *Spot why construction loans are self-contained, self-servicing loans.*

I. ASPECTS OF THE CONSTRUCTION LOAN

- A. Loan proceeds are used to finance some kind of construction.
- B. Requires special monitoring to ensure the construction project is completed.
- C. Creates risk to the lender.
- D. Construction loans are a temporary or interim loan.
 - Permanent, or take-out loan
 - Bridge or swing loan used to pay off the construction loan

1. E. Major guidelines:

1. The lender must be assured of loan repayment.
2. Minimum cash required; the lender may loan up to 85% of the project costs.
3. The maximum loan amount that the lender will commit to is ensure the project is completed and the lender will recoup all the funds loaned.

F. Spec Home: Construction loans are extended to developers who are seeking to build a project then immediately sell it.

G. Payments to builder: The lender does not advance the total building funds . Funds are released as a “draw”– where the funds are taken from the construction budget to pay material suppliers and contractors to help ensure that the loan proceeds used for the construction, often subject to permits or inspections.

II. TECHNICAL VOCABULARY

1. Construction Loan defined: an interim or short-term loan designed to provide funds for the actual construction of improvements (homes or commercial buildings) on land.
2. Building Loan Agreement. Contract between borrower and lender establishing the obligations and duties of both parties during the period of construction.
3. Construction Contract. Agreement executed by owner and contractor specifying project to be built, cost, method of disbursement, and other limiting conditions.
4. Cost breakdown. Listing of individual project's component costs, including the building contractor's overhead and profit.

TECHNICAL VOCABULARY

5. Feasibility Study. A study as to whether the proposed project is practical, financially sound, and can be built at the projected cost.
6. Floor Commitment. A commitment specifying a higher amount upon the performance of conditions (ceiling), but guarantees a specified amount upon satisfactory completion (floor).
7. Loss of Priority. Loss of first lien position by the construction loan to potential mechanic's lien claimants due to either
 - a. Prior commencement of work or
 - b. Optional loan advances.
8. Mechanic's Lien. Lien filed by contractors, sub-contractors, or materialmen due to failure of obligated party to pay as agreed.

TECHNICAL VOCABULARY

9. Obligatory Advance. A construction fund advanced in accordance with the schedule of disbursement.
10. Optional Advance. Advances of construction funds that are not in accordance with the schedule of disbursement.
11. Plans. Detailed schematic of the proposed project, including both the structure and components.
12. Schedule of Disbursement. A schedule specifying the method of disbursements during the period of construction.
13. Source of Repayment. Source of payoff for the construction upon completion, normally a takeout commitment.
14. Specifications. Detailed listing of materials or equivalent to be used in performing the construction project. The list is specific as to size, shape, manufacturers, quality and quantity.

TECHNICAL VOCABULARY

15. Subordination Agreement. This is an agreement under which a prior trust deed loan is made inferior or in lesser position to an otherwise junior loan, typically used where a loan on raw land is subordinated to a new construction loan.
16. Takeout Commitment. A commitment to make a permanent loan by a financially responsible lender upon completion of the project in accordance with previously submitted plans and specifications after complying with commitment conditions.
17. Tri-Party Agreement. Also called a *Buy-Sell Agreement*. This is an agreement between borrower, construction lender, and permanent lender relative to future delivery of the construction loan upon completion.

Construction

III. TYPES OF PROPERTIES

- A. Wide Scope
- B. Financial analysis

IV. SOURCES OF FINANCING

- A. Commercial banks
- B. Savings banks or Thrifts
- C. Real Estate Mortgage Trusts (REMTs)
- D. Life Insurance Companies
- E. Others

Construction

V. Kinds of Construction Loans

- A. Construction-Permanent Combination, called package loan
 1. Firm commitment
 2. Contingent commitment
- B. Short-term – Interim straight construction loan

VI. LOAN COSTS

- A. Loan tie-in
- B. Expenses
- C. Prepaid Interest

VII. PROCESSING A CONSTRUCTION LOAN

A. Preliminary Interview Stage

B. Feasibility Stage

C. Formal Processing Stage

1. Appraisal

2. Financial Analysis

3. Source for Repayment of the Loan

4. Presentation to Loan Committee

D. Closing and Follow up

Construction

VIII. Mechanic's Liens

A. Lien priority

B. Protection

IX. RESIDENTIAL HOME BUILDING STEPS

#1 Analyze the numbers

#2 What kind of house

#3 The Building Plan

#4 Contractor

#5 Financing

#6 Management

#7 Closing the loan and moving in

CAUSES OF FLUCTUATIONS IN INTEREST RATES

- **PRELIMINARY INTERVIEW STAGE**
- **FEASIBILITY STAGE**
- **FORMAL PROCESSING STAGE**
- **CLOSING AND FOLLOW-UP**