UFinancial.

CONSTRUCTION LOANS

A complete guide

Your complete guide to construction loans

Finding a property that meets all of your needs is not always easy. The process of building a home can be overwhelming, but it also allows you to design a home that fits your lifestyle. So whether you're renovating, knocking down an existing property and rebuilding or starting fresh, you might need a construction loan to make things happen. This guide will help you understand the process of building a new home.

What is a construction loan?

Taking out a construction loan allows you to borrow money gradually over the course of a construction project.

Types of construction loans

Loan type	Loan term	Redraw facility	Offset
Standard variable rate home loans			
A home loan to suit your needs and be ready for whatever life brings, with flexible product features like offset, redraw, various repayment options and more.	1 to 30 years	✓	✓
Low fee home loans			
A home loan with a discounted interest rate, low fees and some flexible features to suit your needs for the life of your loan.	1 to 30 years	✓	✗

Keep in mind

If you are borrowing money for non-construction purposes at the same time, then this needs to be originated as a separate loan account.

For example: If you are borrowing a total of $500,000: $450,000 for construction purposes and $50,000 for the purchase of personal goods - then you will have two separate loan accounts and will be required to make the minimum required repayments on both loans.

Once your construction is complete, you may choose to combine the non-construction and construction loan into one (this may require a new refinance loan application and is subject to the lender's approval) or keep them separate.

Licenced builder and contracts

The building or renovation must be built under a signed fixed price building contract by a licenced builder. Acceptable building contracts usually include:

Contract amount	Acceptable building contract
Up to and including $1 million	Fixed price building contracts only
Greater than $1 million	Fixed price building contracts or cost plus contracts (subject to our approval)

Considerations

- Construction loans in a Company and/or Trust must always be completed under a fixed price building contract.
- You can build a maximum of two dwellings (such as a duplex) on the same title, providing it's on a single building contract.
- A construction loan is only available for houses built and kept for personal investment or residential purposes.

Benefits

- You can draw money from your construction loan progressively as you need to pay for your costs (known as progress payments).
- While your loan is progressively drawn, you'll only pay interest on the amount you've used. These Interest Only payments are usually due on the 15th of each month and means your repayments are lower throughout this time.
- You can make additional payments into your construction loan at any stage. This reduces your loan balance and means you may pay less interest.

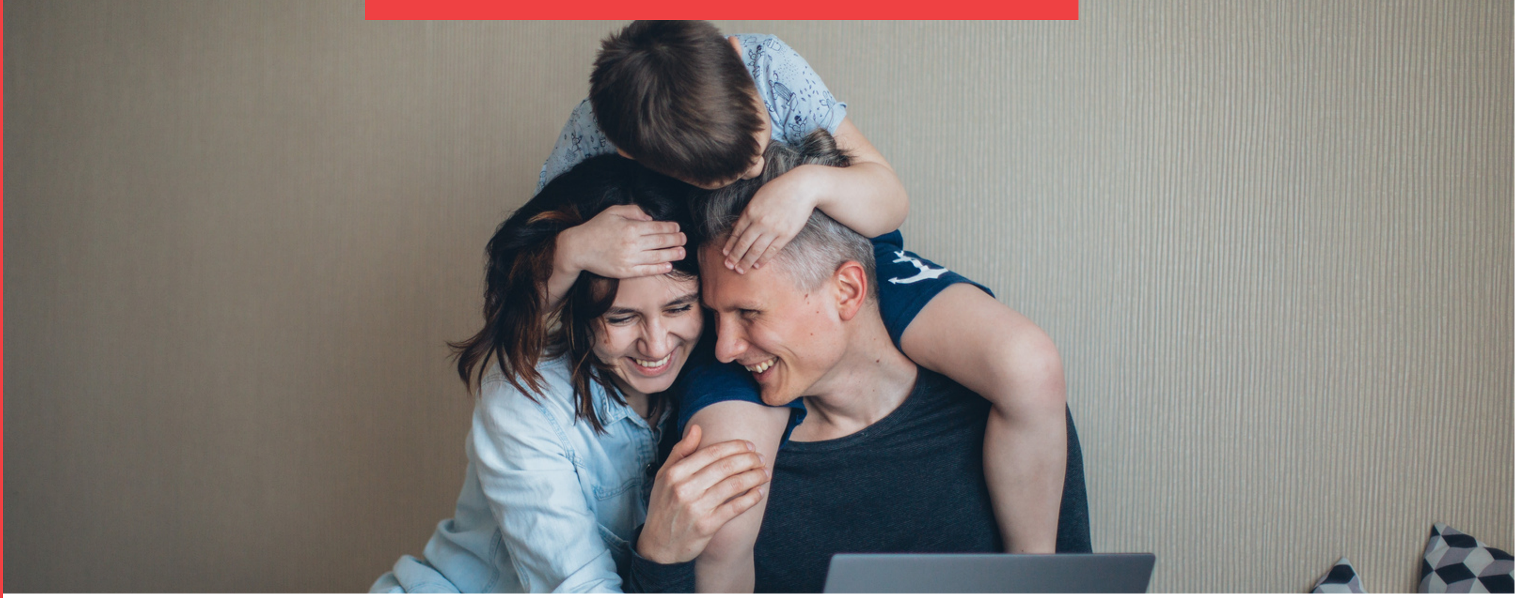
Trade-offs

This loan type may not be right for you if:

- You want the certainty of knowing exactly what you'll be paying each month.
- Before your construction is complete, you want to switch your construction loan to another home loan product type, for example a Fixed Rate home loan. Switching your loan isn't available on this loan type while it's being progressively drawn.
- You want to build dwellings for the purpose of immediate sale.
- You want to construct more than two dwellings on the same title.

Timeframes

- You must commence building within 12 months from the Disclosure Date and construction must be completed 24 months from the Disclosure Date on your loan contract.
- If not, approval of the loan or any undrawn portion of the loan may be withdrawn and a new construction loan application may be required. Our standard lending criteria applies.



How much deposit do you need?

For a construction loan, a commonly desired target is 20% of the property price as most lenders like to limit their exposure to a loan-to-value ratio (LVR) of 80%.

But don't worry if you haven't reached that magical number because some lenders will give you the option of paying for LMI (lender's mortgage insurance). LMI might be a helpful tool, allowing you to borrow up to 95% of the value of a property, meaning you only need to contribute 5% upfront.

How much can you afford?

You may have a dream home in mind but first, you need to know if you can afford it. As a guide, a mortgage calculator can be a great place to get a rough idea of your borrowing capacity, but it won't take into account all of your personal circumstances or eligibility for a loan. The amount you will be able to borrow will depend on a lot of factors.

These include how much you earn, how much you've saved, your expected future financial power, your credit history and a number of other factors such as:
Your savings history, any debt you hold, your monthly expenses including discretionary items, your personal information, the type of loan you want, as well as the term and interest rate.

Many people confuse their borrowing capacity with their affordability.
Your borrowing capacity is the amount of money a lender will loan to you based on your financial situation. Even though current interest rates may seem affordable, the banks will use a higher rate (2 to 3% higher) when calculating your borrowing capacity. Your affordability has more to do with your lifestyle, the choices that you make daily, and your future plans.

Planning your build

Now that you know how much you can afford, you can start planning your build.

Do your research

Whether you’re building on an existing piece of land or considering buying land to build your new property, it’s important to do your research.

Availability

Find out what’s available in your ideal location and price range. Options may include a new estate, acreage or demolishing an existing property

Sustainability

Make sure the land is suitable for the kind of property you want to build. You should consider size, shape and orientation in comparison to the sun, as well as how high it is above sea level if it’s in a flood-prone area.

Infrastructure

Consider the location and accessibility of services. This includes: power, water, sewage, storm water and drainage, telephone, gas and broadband internet lines, accessibility to shops, public transport, education and healthcare facilities etc.

Rules & Regulations

Local councils have regulations which may affect what and how you build, including where on the land you place your property, what type of fencing you have and more. Make sure you find out what the restrictions are before you buy, as well as details of any upcoming development applications that may increase or decrease the value of your property. Being aware of the rules and making sure you abide by the regulations could save you time, money and make it a hassle free experience.

Choose a builder and / or architect

It's important to spend time finding the right builder for your project. Get recommendations from friends or family, contact the Master Builders' Association and invite various licenced builders to quote on your new property.

By law, all contractors must show their license on all advertising, stationary and signage. You can check the validity of the Builder's License details through state government websites online.

Draw up plans and get a fixed price building contract

The builder should provide detailed plans and outline accurate costings for each aspect of your property. Make sure the contract they provide covers everything and agree to a timeline for completion.

It's a good idea to have your building contract checked out by a solicitor or conveyancer before you sign it.

Out of Contract items

These are additional improvements or renovations being completed in conjunction with your construction, however may not form part of the fixed price building contract. They are restricted to non-structural works, such as floor and window coverings. Additional improvements like pergolas, landscaping and swimming pools can also be classed as Out of Contract items.

All additional work or items you intend to purchase (or receipts if you have already purchased the items such as kitchen appliances, bathroom tiles, a swimming pool etc.) must be formally quoted for both supply and installation. If you don't provide receipts or quotes for these items then our valuation will be performed on the value of your property without them. There are certain limits which apply to Out of Contract items.

Have your plans approved

This is usually done on your behalf by your builder or architect. It's important to ensure that this is done early, as this can take some time to be reviewed and approved by the local council (or accredited consultant acting on their behalf) and sometimes may require amendments before it's approved. When approved, the local council or authorised agent (acting on the council's behalf) will generally place a stamp or provide a council letter as appropriate, on the plans and specifications as evidence.

Apply for a construction loan

Before you apply for a home loan, make sure you consider additional costs such as Stamp Duty, legal fees and costs associated with your loan.

Finalising your construction loan

In addition to your loan application documents (such as evidence of your income, expenses, assets and liabilities), there are other specific documents you'll need before building can commence. Most of these documents can be obtained from your builder and are generally needed to complete necessary valuations. After receiving all required documents, if your application is approved you'll receive a letter of offer and contract for your new construction loan.

How many building stages are there?

Your Progress Payment Schedule will typically have a schedule of 5-6 stages (also known as milestones) during the construction period. The table below will help you understand the general process, but keep in mind that each construction journey is different and all payments to your builder are made after the relevant stage is completed.

Slab

During the first stage of construction, your foundation slab is measured and poured. Approximately 15-20% of funds required (this may also include your initial deposit to your builder, which is typically 5% of your building contact price depending on your state/territory).

Frame

The exterior frame and/or walls of your property are put in place. This may also include support structures, conduits for electrical and plumbing as well as gutters and insulation. Approximately 20% of funds required.

Lock-up

At this point remaining windows, doors, external walls and roofing is typically installed. This means you can actually 'lock up' your property. Approximately 20% of funds required.

Fit Out

During the fit out stage, the internal fittings and fixtures are installed such as your lights, power points and other electrical and plumbing fixtures. Approximately 30% of funds required.

Completion

The final stage involves the conclusion of contracted items such as fencing and site clean-up. It's usually also when final detailing and painting is completed. Approximately 10% of funds required.

Managing your repayments

Before we release any money from you construction loan, you'll need to use all your equity contribution (your own savings) before any money from your loan can be released. You'll need to provide the lender proof that you've made payments to the builder.

As each stage of your construction is completed, your builder will provide you with an invoice. These need to align with the Progress Payment Schedule that is provided with your building contract. We then use these invoices to make progress payments to your builder that cover the cost of your build.

Provide authority to pay the builder by writing:

'I authorise payment of this invoice',

your name and date on the invoice you received from your builder.

Sign the invoice, in accordance with the method of operation you have chosen for your loan.

Forward the invoice to your Mortgage Broker.

If you have more than one construction loan account open, state the loan account number the invoice should be debited from.

Providing authorisation confirms you agree your builder has successfully completed the particular stage and the lender can pay your builder for the work completed. This process will be followed and repeated for all progress payment requests until your property is complete.

Understanding the different types of loans

When it comes to home loans, there are two very important things you need to consider:

1. TYPES OF INTEREST RATES

Most types of home loans will have these three options:

VARIABLE INTEREST RATE
A variable interest rate is a loan with an interest rate that is influenced by market conditions. If interest rates go up, so do your repayments. If they go down, your repayments will, too.

FIXED INTEREST RATE
That name says it all. Fixed-rate loans will have a 'locked' rate for a certain period, usually between one and five years. With a fixed interest loan, you will know exactly how much your repayments will be. These types of loans offer certainty and security. The downside is that your repayments won't decrease if interest rates fall.

SPLIT INTEREST RATE
The best of both worlds. Part fixed, part variable. With a split home loan, your repayments are split into a fixed-rate component and a variable-rate component. For example, let's say you borrow $500,000, you can fix $300,000 and keep $200,000 variable.

This sort of loan lets you enjoy the benefits of an interest rate drop and also protects you from being fully affected if they rise.

2. TYPES OF REPAYMENTS

Home loans are made up of two parts: the principal and the interest.

The principal is the initial amount you borrowed.
The interest is the amount the lender charges you for borrowing the initial amount.

Most types of home loans will also have these two repayment options:

PRINCIPAL AND INTEREST REPAYMENTS
A very popular repayment option for most. Each repayment you make reduces the principal, as well as the interest. So gradually, your repayments will be paying off more of the principal and less interest because you're chipping away at the balance from the start.

INTEREST ONLY REPAYMENTS
Interest-only repayments delay the repayment of the initial amount borrowed – the principal – for a period of time. You only start paying off the principal at the end of that period.

During the interest-only period, your repayments will be significantly smaller, but over the life of the loan, you'll end up paying more interest.

Your loan repayments while you're building

While your loan is progressively drawn, you'll be required to make interest payments to cover the interest accrued on your loan.

Keep in mind that the interest accrued during your construction period may gradually increase.

This is because your owing loan balance increases as we continue to release money to pay your builder's invoices. The table below breaks down the typical repayment requirements during and after your construction.

While your loan is progressively drawn:

- You pay the interest amount that has accrued on the loan.
- Interest accrued is calculated based on your loan's interest rate and the owing balance of your loan.
- Interest Only payments will be direct debited from your nominated account.

When your last progress payment is paid:

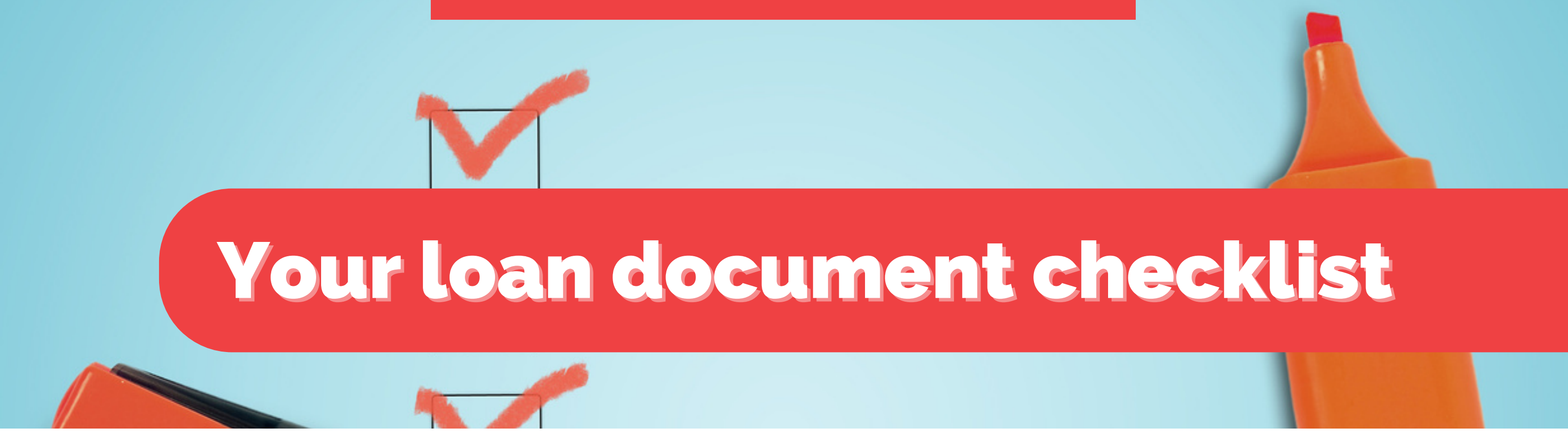
- A final interest payment will need to be made on the same day your last progress payment is made.
- It's important to have adequate money in your nominated direct debit account to cover this.
- Your contracted loan term (typically 30 years) officially commences from this day.
- Progressive Drawing Fees will be totalled and charged to your home loan as a lump sum.

Your loan repayments after your last progress payment is paid:

- Will switch to Principal and Interest repayments if this is what you chose at origination; or
- May remain as Interest Only, depending on the Interest Only period you chose at origination.

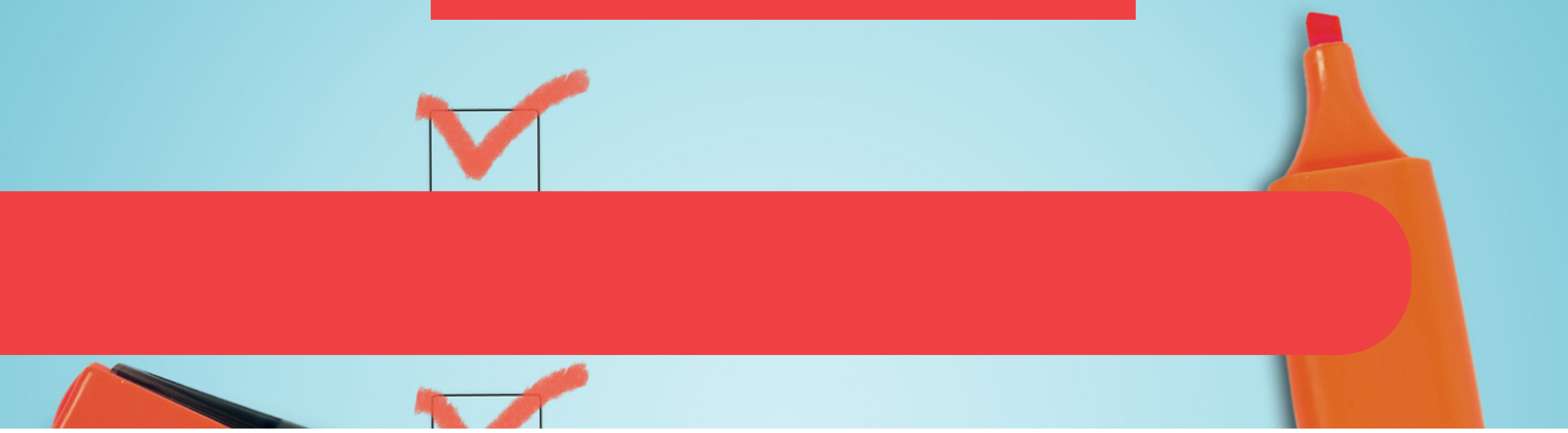
What this means for your home loan:

Principal and interest repayments	Interest only payments
Your loan balance will start to reduce with each repayment you make in line with your loan contract	By paying Interest Only payments you will not reduce your principal loan balance for the period that your loan is interest only.



Your loan document checklist

Prior to Formal Approval	☐ Draft Building Contract or Builders Tender. ☐ Draft Progress Payment Schedule (this is usually included with the Building Contract). ☐ Draft building plans (with elevations). ☐ Receipts for any items you've already purchased (e.g. kitchen appliances, installation of a patio by another contractor etc.) that are not included in your Building Contract. ☐ Quotes for any Out of Contract items you intend to purchase (e.g. bathroom tiles, swimming pool, fencing, landscaping, driveway etc.) that are not included in your Building Contract (where applicable). Remember: If you don't provide receipts or quotes for these items then the lender valuation will be performed on the value of your property without them. Contract of sale for the land (where applicable).
Prior to commencement letter being issued	☐ Executed and signed Building Contract. ☐ Final Progress Payment Schedule (this is usually included with the Building Contract). ☐ Agreed schedule of finishes and specifications. ☐ Building plans (with elevations) for your construction, which have received Council or authorised agent approval (acting on the council's behalf) (if required). If you're waiting for Council approval on additional improvements, for example a pool or shed, we will only provide money for these once approval has been received. ☐ Contract Variations (where applicable). ☐ Quotes for any Out of Contract items that are not included in your Building Contract (where applicable). ☐ Builder's Insurance (Contract of Works) showing: · Insurance amount equal to or in excess of the Building Contract Price · Name of the property owner · Name of the building company · Address of construction property within Australia or marked as 'Anywhere in Australia'. · Expiry date of the insurance policy ☐ Public Liability Insurance showing: · $5 million minimum · Expiry date of the policy · Address of construction property within Australia or marked as 'Anywhere in Australia'.



During construction

☐ Signed progress payment invoices.
☐ Receipts for any items you have already purchased (e.g. kitchen appliances, installation of a patio by another contractor etc.) that are not included in your Building Contract.

To ensure that your builder is paid on time, lenders usually request the progress payment invoice signed and dated (refer to page 14), at least:
• 5 business days before it's due for contracts less than $1 million; and
• 12 business days before it's due for contracts above $1 million.

Before your final progress payment

☐ Final signed progress payment invoice.
☐ Any final variation(s) to the Building Contract (where applicable).
☐ Building Insurance Policy (e.g. Certificate of Insurance, Certificate of Currency or Home Building Policy Schedule).
☐ Certificate of Occupancy and Compliance or equivalent (for your records).

The lender will also perform a final inspection to ensure that construction has been completed as per the original plans and specifications. This will be arranged by the lender once they receive the above listed documents.

IMPORTANT

This checklist may not cover all individual circumstances and scenarios and there may be times where your lender may require other documents from you. Our brokers will advise you if this applies to you.

Common questions

What happens if there are changes or variations to my planned construction?	It's important to let your lender know immediately if there are any variations or proposed variations to your planned construction as this may impact your loan arrangements. Your lender may also need to complete a new valuation based on the variation and this may increase or decrease the value affecting the money we lend to you. Generally, you'll need to ensure you have sufficient money in your own savings to cover the additional cost or any shortfalls.
What happens if I go over budget or need extra money?	Your lender will only make payments up to the amount stated on the Progress Payment Schedule for each stage of construction. If you've exceeded this amount, you're responsible for paying any costs associated with the construction from your own money. Alternatively, if you need to borrow additional money, this will be treated as a new construction loan application. Keep in mind your lender may ask for updated application and construction documents and may need new inspections and valuations.
What is the difference between a fixed price and cost plus contract?	A fixed price contract is where the builder has agreed to complete the building works for an agreed fixed amount. A cost plus contract is where the builder agrees to complete specific work for an amount, however the contract contains rise and fall clauses, which allow the builder to charge for increased labour or material costs. Generally these are provided for contracts over $1 million. Not all lenders accept cost plus contracts.
Do lenders offer construction loans to owner builders (where you're doing the work myself)?	No, lenders do not offer construction loans under an owner builder basis, there must always be a contract with a licensed builder.
Will I need a construction loan every time I want to renovate my property?	No, a construction loan with progressive drawings isn't always needed. For example when you're wanting to complete internal renovations to your home such as kitchen or bathroom upgrades or cosmetic changes like new flooring and painting your home. In these instances you may be able to apply for a Top Up to an existing home loan you hold and the money may be paid in one lump sum.

Can I choose which loan account progress payments are paid from?	Yes, you can. If you have more than one construction loan account open for the same property build. When signing and returning your builder's invoice to your lender, please state which loan account number the invoice should be debited from.
What happens if my construction takes longer than 24 months?	Money from your construction loan will usually remain available for 24 months from the Disclosure Date shown on your loan contract. Should your construction not be completed within this timeframe, your loan may be considered fully drawn. This means that your: • Loan will no longer be considered a construction loan; • Your repayment will switch to the type you selected at origination; and • Any undrawn loan balance will be removed. If you require additional money, you'll need to re-apply.
How can I ensure the quality of my construction?	It's your responsibility to ensure that you are satisfied with the quality of construction and you should conduct regular checks on your builders' workmanship. If you're unsure of what to look for you may choose to pay for a qualified person to conduct checks and obtain reports to confirm the work is satisfactory before you sign and authorise a payment to the builder.
What should I do if I have a dispute with my builder?	If you detect substandard workmanship or materials at your construction site, or have any other disputes with your builder, contact your lender as soon as possible. You should also inform the builder of your dissatisfaction and depending on the severity of the matter your solicitor may also need to be informed. Please note: • Your lender won't become involved with the dispute, however they will stop making progress payments to your builder. • Do not attempt to complete the build of your property yourself.
What do I need to do before I request the last progress payment and finalise construction?	When you're ready for the final payment to be made to your builder, you'll need to provide your lender with the final invoice (authorised, signed and dated). Your lender will arrange for a final inspection on your property. If all items are completed and acceptable to your lender, your final payment will be processed. Your lender will ask for a copy of your Home Building Insurance policy (e.g. Certificate of Insurance or Certificate of Currency or Home Building Policy Schedule). Also remember to obtain a copy of your Certificate of Occupancy and Compliance or equivalent (depending on your State or Territory) from your local council (for your records).
When can I move in?	Around a week after practical completion of your property you should be ready to collect the keys, make any final payments and move in. You should receive a copy of all relevant warranties and certificates as per your contract. Make sure you have the builder's written authority that the construction is complete and it's safe to move in.

IT'S EASIER WITH A BROKER.

If there's something you don't understand or need more explanation, please email or call us today!

Scan to book a free chat:

CONTACT:

Phone : +61 396 869 087
Fax : +61 386 790 576

Email : here4u@ufinancial.com.au
Web : ufinancial.com.au

Address :
Level 4 / 580 St Kilda Road
Melbourne VIC 3004

Australian Credit Licence: 389087

UFinancial.