

# Steps in the Construction Loan Process

*The following information is provided as a general guide to the construction loan process. For more specific information, please contact your lender and/or attorney.*

## Step One - Pre-qualification

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*Pre-qualification provides an estimated building budget for the borrower (i.e., how much money the bank is willing to loan you based upon your financial situation and value of the proposed house..*

- **Verbal** - Borrowers verbally provide their loan officer with income and debt information. A building budget amount is given at this time based upon the information provided. Pre-qualification is only as accurate as the information provided by the borrower(s). No application has been taken at this time.
- **Credit Report** - The documented payment history of anyone issued a line of credit. For example: car loans, student loans, credit cards, etc. We recommend that borrowers review their credit reports at the Pre-Qualification stage to identify potential problems and/or errors. If you discover errors it may take months for the credit bureaus to make corrections. Your loan will be stalled while your credit history is being corrected, so do not wait to check your credit and make corrections as needed.
- **Credit Bureaus** - Below are links to the three major credit bureaus; you should **check your credit report with all three bureaus.**
  - **TransUnion:** <http://www.transunion.com/>
  - **Experian:** <http://www.experian.com/>
  - **Equifax:** [http://www.equifax.com/home/en\\_us](http://www.equifax.com/home/en_us)
- **Time Table** – You should begin construction loan paperwork at least three months (preferably sooner) prior to your target date for beginning construction.
- **Loan Amount** - The loan amount provided in a pre-qualification takes into consideration the construction costs and land acquisition (if applicable). Please be advised that if the loan amount does not cover these expenses, the borrowers need to show the proper assets to cover the difference.

***It is VERY IMPORTANT to note that a pre-qualification is not a mortgage approval. The borrower(s) must make a formal application and the bank must issue a mortgage commitment letter that designates approval.***

## Step Two - Application

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*Application is the formal request for a mortgage approval. When filled in with the borrower's personal information and submitted with income and asset documentation, the lender underwrites and either approves or denies a borrower's request for a mortgage.*

- **Application** – The loan application may be made in person, over-the-phone, or on-line. The borrower's personal information is collected and added to the application document. The application and the appropriate mortgage loan disclosures are sent to the borrower(s) to sign and forward back to the lender. **DO NOT submit original documents to your lender. Make copies of all documents and expect multiple requests for the same document.**

- **Good Faith Estimate** - The loan officer will provide the borrower(s) with an itemized list of estimated costs that the borrower(s) may incur during the mortgage transaction. **Assume that your actual costs will be higher and plan accordingly. Please note: closing costs do not include escrow deposits (see below).**
- **Underwriting** - Once the loan officer receives the application, disclosures, and income and asset information, an underwriter reviews your request for a mortgage. **Expect to be asked to provide additional documentation at this stage of the process.**
- **Mortgage Commitment Letter** - Upon approval, lender issues the commitment letter to officially state, in writing, under what terms the mortgage is considered approvable. Usually, the terms of the loan are called loan conditions.
- **Closing Conditions** - The documentation that needs to be obtained prior to closing a loan. Standard closing conditions include, but are not limited to, the following examples: building permit, an acceptable appraisal, title insurance, source of the funds (money) needed to make down payment and closing costs, signed contracts between the borrower(s) and builder, and any applicable insurance policies (builder's risk insurance).

### ***Step Three - Appraisal***

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*Establishes the value of the future home on the borrower's building site. The lender determines the loan amount from this figure.*

- **Building Contract** - A signed and binding agreement between the borrower(s) and builder. This agreement lists the scope of the work to be completed by the contractor and at what price. An appraisal can be ordered from the builder's quote.
- **Building Plans** - In order to initiate the appraisal, your loan originator needs a set of your house plans (blue prints). The plans need to show dimension and elevation. You can submit your preliminary plans for appraisal purposes as long as you do not make any major changes to the footprint of the house. For example, changing the square footage, adding a bedroom or bathroom, or taking a designated room away is considered a significant change. Moving the position of a window or stairs is acceptable. Making major changes also changes the loan because you have then altered the bank's appraised collateral (your house). Your dealer will provide you with a full set of plans.
- **Specifications (Specs)** - A listing of all of the materials that are to be used during the construction process. This information enables the appraiser to determine what materials are going to be used and to assign proper value to the home. Your dealer will provide you with a specifications sheet.
- **Time Frame** - Depending on the property location and availability of the appraiser, we recommend allowing 2-3 weeks for appraisal completion.

### ***Step Four - Disbursement Schedule***

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*Illustrates how loan monies are paid-out during construction based on a predetermined set of draws. Draws are paid as work progresses during the construction phase of the loan.*

- **Disbursement Schedule** - The disbursement schedule lists the allocation of loan funds to be paid by the lender as various phases of the project are completed. For example, when the foundation has been poured the bank will schedule an inspection to verify that the foundation is actually poured. The bank will then release funds to you to pay the foundation contractor. Partial payments may be available when the work has not been completed in full.

Advances may be available should your subcontractor require a deposit prior to starting work.

- **Change Orders** - Any change orders that are not given to the loan officer prior to the mortgage closing will not be incorporated into the draw schedule. The borrower(s) will be responsible for any change orders to their construction contract.
- **Finalizing Disbursement Schedule** - Upon completion of the disbursement schedule, both the borrower(s) and builder are asked to review and approve the disbursement schedule.
- **Disbursement Revisions** - Changing the disbursement schedule before initial settlement is acceptable with the approval from the lender. Revisions after initial settlement are also subject to the approval of the lender. You should thoroughly review the disbursement schedule with the builder prior to the start of construction.

## ***Step Five - Initial Settlement (Closing)***

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*The signing and recording of mortgage documents by the borrower(s) that permits the borrower(s) to close on the construction loan and start construction.*

- **Closing Agent** - The lender will generally choose the title company or attorney they wish to review and execute their settlement documents.
- **Closing Package** - The lender sends the closing agent (title company or attorney) a set of closing instructions and closing documents. The instructions tell the closing agent how the lender wants the closing documents to be executed (signed).
- **Title Insurance** - The title company or attorney prepares and sends title insurance to the lender. Title Insurance must be for the loan amount to be obtained. Title Insurance insures the lender that there are no outstanding liens on the property. Without title insurance, the lender will not close on a mortgage.
- **Property Taxes** - The lender receives current tax information on the borrower(s) property from the attorney or title company.
- **Closing Costs/Fees** - Up to this point, your loan officer provided the borrower(s) with a Good Faith Estimate of Settlement Charges. At closing, actual figures are obtained from both the lender and settlement agency (title company or attorney) and are recorded on a HUD statement. **You should expect to pay higher fees than were quoted in the Good Faith Estimate.**
- **HUD** - The HUD statement details what the fees are and to whom they have been paid. Your closing costs at initial settlement may vary from the Good Faith Estimate. Check with your lender prior to closing to avoid unpleasant surprises.

*Please note that initial settlement is when the mortgage note is recorded and construction can begin. Money cannot be disbursed until the mortgage has been recorded.*

## ***Step Six - Construction***

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*During construction, money is disbursed to the borrower(s) and builder to fund the building process until completion.*

- **Deposit Money** - Money payable to the modular home dealer before house construction has begun. This money is used as deposit to the manufacturer. A deposit of this kind may be available at initial closing. If applicable, this deposit is shown on the disbursement schedule. Generally, a 10% deposit is required. **Make sure your lender knows that you need a**

**draw for the house deposit prior to closing. The dealer will provide you with an invoice for the deposit.**

- **Reimbursement for Borrower Deposit** - Money payable to reimburse the borrower for any monies paid out of pocket prior to the start of construction. Not all borrowers are eligible for reimbursement. Sufficient equity and approval from the construction department is required to obtain reimbursement. Borrowers must provide sufficient proof of deposits paid to manufacturers and contractors in order for reimbursement. For example, canceled checks and paid invoices.
- **Draw Request** - Upon completion of the required draw items the borrower may order an inspection to request funds.
- **Inspections** - A property inspection prior to the release of funds. The lender performs periodic inspections to determine that work is progressing according to the disbursement schedule. When the inspection is received, the lender releases funds based on the inspector's assessment. If the items within the requested draw are not completed, a partial disbursement based on the inspector's recommendation and the approval of the construction department may be released. **Banks charge for inspections, so try to combine several inspections (well, foundation, septic, etc.) to save yourself money.**
- **Draw Checks** - Payment for work completed based on an inspection report. The checks are normally sent to the borrower(s). Please note: The borrower's account must be current in order for the draw check to be disbursed.
- **Title Search** - A title search is performed prior to each draw to assure the lender that no liens have been placed on the property since initial settlement.
- **Interest Only payments During Construction** - During the construction phase, the borrower(s) are required to make interest only payments. Please ask your loan officer for details.

## ***Step Seven - Rate Lock***

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*The rate lock is the formal acceptance of a rate for the permanent mortgage. In addition to the outstanding mortgage balance, the rate lock dictates what the payments will be over the life of the loan.*

- **Floating Rate** - An interest rate that is not locked in and is moving with the current interest rate market. It is common for construction loans to have a floating rate since the structure will be completed at a later, undetermined date.
- **Locked Rate** - both the borrower(s) and lender have formally accepted the initial interest rate for the permanent loan.
- **Automatic Rate Lock** - if the borrower(s) fail to lock in the permanent interest rate prior to modification, the lender may automatically lock in the interest rate.

*Please Note: Borrower(s) want to be very aware of how rates are moving. To track interest rates call your loan officer.*

## ***Step Eight - Modification***

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*Modification is the process of converting the construction loan into the permanent mortgage.*

- **Modification Process** - Converting the construction loan into the permanent mortgage. The modification process starts once the lender receives the final inspection.

- **Final Inspection** - The last inspection performed to insure that the house has been completed to the same degree at which it was initially appraised. The final inspection is required in order to convert into the permanent mortgage.
- **Modification Package** - The documents sent from the lender to the closing agent that allows the borrower(s) to “modify” their mortgage. At this time, the borrower(s) can apply any monies left over from the construction loan or from their own pocket to reduce the final loan amount. If applicable, tax and insurance escrows are set up at this time.
- **Escrows** - An account set up with a lender that holds property taxes and insurance out of the monthly PITI payment made by the borrower until they are due. **Escrow deposits are separate from “closing costs” and can amount to many thousands of dollars, payable at closing. Contact your lender prior to modification to determine how much money you will need at loan modification.**
- **Final Lien Search** - A final lien search is needed to assure to the lender that no liens have been placed on the property since initial settlement. Upon receipt of a “clean” final lien search, loan modification can occur.
- **Modification Fees** - Outstanding fees due to the lender at the time of modification or loan conversion. These fees usually include, but are not limited to the following items: outstanding construction interest, interim interest on the permanent loan, an escrow deposit for taxes and insurance (if applicable), courier fees for overnight draw checks, and inspection fees.

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