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CFG's CONSTRUCTION LOAN PROGRAM FAQ's

Q. When can I buy the lot using a construction loan, and when do I have to first get a lot loan?

A. If you have found a lot, and you wish to use one of our low rate "single close" construction loans to acquire that lot, you need to have a long enough "close of escrow" written into the purchase contract on the lot so that you can obtain plans and select a builder in that time period. A construction loan can only close with architectural plans, a signed contract, and a cost breakdown with a builder based on those plans. From a practical standpoint, if you enter into a contract to purchase a lot, and you haven't yet begun the process of developing plans with an architect, you're probably going to have to obtain a lot loan or pay cash for that lot. The situation where it is easiest to use a "single close" construction loan to purchase the lot is when the lot is owned by the builder, and the builder has architectural plans for that lot that suit you.

Q. Can your programs be used to finance major remodels or even a "teardown"?

A. Yes. This "rehab" construction loan can be a refinance on the home in which you live, or an acquisition rehab loan used to acquire a property and provide the funds for rehab/addition.

Q. If we already own our lot, how do we determine how much we can borrow?

A. How much you can borrower is based on two sets of criteria. There will be an amount for which you can qualify using full income and asset documentation and a maximum debt ratio. The maximum loan amount will also be limited to 80% (to $1M loan amount) of the lesser of two numbers representing the value of the home to be built. One of those values is based on what the property would be worth in today's market, if finished already as planned. The other number is a cost number based on the current value of the property plus new construction costs. Above $1M loan amount we can do 75% to $1.5M, 70% to $2M, and 60% to $3M.

Q. Should we pay off our lot before we apply for a construction loan?

A. There is probably no reason to pay off your lot loan prior to the construction loan funding. If you have a lot loan, the new construction loan will pay off that lot loan just like any refinance would. The lot and the new improvements constitute only one piece of real estate, and the lot loan has to be paid off so the construction lender ends up in first lien position. If you pay the lot loan off prior to applying for a construction loan, you may be handcuffing yourself by putting too much cash into the deal. Construction loans are almost always "no cash" out loans, so it may not be possible to get this cash back on acceptable financing terms until one year after the home is complete. You are often better off having cash on hand during construction to handle upgrades and changes, especially if you are doing a loan without a contingency. In some cases, depending on your loan amount, acceptable loan-to-value percentage, and how much cash or equity you have in the deal, the lot may need to be free and clear to meet these criteria, but there is no overriding guideline that the lot needs to be free and clear in all cases.

What is a contingency, and should I have one?

A. A contingency is a line item in your cost breakdown that does not have a specific element of your build associated with it. If, during the course of construction, you decide you want some additional work done, or you decide you want to upgrade your materials (from granite tile to a slab of granite for example), you can used the money in your contingency item to do this. Without a contingency, you would have to pay "out of pocket" for these changes, since the loan amount on a construction loan cannot be increased during construction. A contingency is generally a good idea if there is room enough in your appraisal or total cost such that you are not already at the maximum loan to value percentage allowed at your loan amount. Naturally, you also have to be able to qualify for the higher loan amount necessitated by the inclusion of a contingency. You only pay interest on the amount borrowed, so you are not charged interest on unused contingency funds. By virtue of raising your loan amount, the inclusion of a contingency will slightly increase your points and some of your title and escrow fees.

Q. Do we need to sell our current home before building a new home?

A. In terms of qualifying, if we can prove at least 30% equity in your current house, we can obtain a rent survey on this property, and we can use an industry standard 75% of those market rents to offset the principle, interest, taxes and insurance payments on your current residence. If you are already renting, your rent will be ignored by the underwriter. If you need the proceeds from the sale of your current house to close escrow on the construction loan, you'll have to sell your current residence prior to, or simultaneously with, the funding of the construction loan.

Q. If we have to bring money into the deal, when do we have to bring it in?

A. The answer to this question is dictated by the fact that we are talking about "single close" construction loans. There is not another close of escrow when the house is done. If you were buying a "spec" house from a builder, where the construction financing and the property were in the builder's name during construction, there would be a close of escrow at the end of construction when you purchased and took title to the property. That is not the case here.

With a "single close", you already are on title, and you already have your permanent financing. If you have to bring $100,000, for example, into this deal to make it work, that $100,000 will be brought in up front at the close of escrow of this construction loan. If that $100,000 exceeds the amount of money needed to pay off the lot loan and pay closing costs, the excess money will be put in an FDIC insured, interest bearing account in your name at the lending bank, and this money will be dispersed prior to borrowed funds being used.

No lender will allow you to bring in your funds later, at the end of the build for example, to finish the project. Understandably, they will worry that you will no longer have the funds, and they will end up with an unfinished house as their collateral. It is surprising how many borrowers, and even how many inexperienced loan officers, do not understand this part of construction lending when they first get involved.

Q. Can we start construction using our own funds, and get a construction loan later when we need it?

A. In the days when there were many different construction lending options, some lenders allowed this. At this point in time, it can severely limit your construction loan options if you do more than push around some dirt, do site improvements like utilities and retaining walls, or do anything more than a slab foundation. Another possible problem with starting the build "out of pocket" is that when you are applying for a construction loan, your reserves have been depleted, and your file is not as strong.

Q. Can we use any builder?

A. All construction lenders will request that a builder approval questionnaire be completed by the builder. The lender will check: “happy homeowners” for whom the builder has completed similar projects, vendor references to insure they have substantial open credit, and sometimes other construction lenders with whom the builder may have worked. They may also run a credit report or business credit report, checking in particular for IRS delinquencies. IRS liens can bring your build to a halt. The builder approval process is not only good for the lender, but often it is good for you if the builder is not a relative. Often they will perform a much more thorough check than you might, though any legitimate, well-capitalized builder will easily pass this approval process. A general rule of thumb is that the builder should have done a minimum of two construction jobs within the last two years on the scale of the proposed build.

Q. How many draws can my builder get, and where does the money go?

A. We will have the builder propose a draw schedule. A rule of thumb is that lenders don’t usually like to do draws at less than 3 week intervals, but nothing is cast in stone. If frequency of draws is a hot issue for your builder, the arrangements can usually be handled. The more draws though, the more you will pay in inspection and admin fees.

Can I act as my own general contractor?

A. On our single close construction loans programs, owner builder is currently only available to someone who is themselves a builder/remodeler, who can themselves pass the builder approval process, and whose full doc income does not included capital gain income but rather construction job income. If these criteria are met, the lender would have to be convinced by circumstances that the builder is truly building their own home, and not doing a “semi-spec” deal. A construction lender nightmare is a “for sale” sign popping up mid-way through the build. We do have a private money program that allows owner/builder, but is not a single close program. Call for details.

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Q. Can the interest charged for the entire construction period be paid by the construction loan?

A. Yes. An “interest reserve” account is permitted but not required. Anticipated interest for the construction period becomes part of the loan amount. In this case, the borrowers does not get a monthly bill for interest (single close construction loans are interest only during the construction period). As with a contingency item, “interest reserves” only make sense if there is “room in the deal”, and the borrowers are not already at the maximum allowable “loan-to-value” ratio, or at the maximum loan amount for which they can qualify. “Interest reserve” accounts are particularly useful when the borrowers are already making a house payment on their current residence.

If you are ready to begin your Construction Loan, click below:

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