



# CONSTRUCTION LOAN HANDBOOK

The idea of building your own home can be very exciting; but can also bring many questions and concerns to mind. The Lake Michigan Credit Union Team is here to help you through this process and help you to get the house of your dreams.

This book discusses the basics of the home building process. It has been designed to help you understand the construction loan process and answer commonly asked questions.

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Compliments of...



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## Builder Registration

- Builders already registered with Lake Michigan Credit Union do not need to re-register
- Builders new to Lake Michigan Credit Union must complete the Builder Registration form and provide copies of licenses and insurance certificates



### What is the Builder Registration?

Builder Registration is part of the process for a Lake Michigan Credit Union construction-to-permanent mortgage loan and includes a review of your builder's references and experience. The Builder must complete a form called Builder Registration that provides L.M.C.U. with information and authorization necessary for completing registration. L.M.C.U. also asks that the Builder provide copies of any licenses and insurance certificates.

### Why does my Builder need to register with Lake Michigan Credit Union ?

Since the loan amount is based on the improved value of the property, Lake Michigan Credit Union verifies that the Builder has the experience and ability to complete the project on time and within budget as indicated on the construction contract. Additionally, the Builder must be compliant with all applicable state licensing and worker's compensation laws.

### When will we know if my builder has been approved?

The loan officer will be advised within three business days after the receipt of a completed Residential Builder Application as to the approval or denial of the builder.

## Construction Loan Basics

### How long is my construction term?

Your construction term can be a span of either four, six, eight, or twelve months.

### What kind of communication will I have with the bank during the construction period?

#### 90 Days Prior to First Scheduled Principal and Interest Payment

- Clients will receive 90 days prior to their first scheduled principal and interest payment (per their original note) a "Notice of Construction Loan Maturity" letter informing them of the following:
  1. Scheduled completion date for the construction term.
  2. Scheduled first principal and interest payment.
  3. Request for updated taxes and insurance information to establish escrow (if required and/or preferred).
  4. Instructions for requesting an extension of construction time and fee for the extension.
  5. Instructions for canceling escrow (if no longer required).
  6. Deadlines for requesting extensions and submitting escrow information.

#### 60 Days Prior to First Scheduled Principal and Interest Payment

- Processing of escrow disclosure based on new tax and insurance information received from client for loans going into re-payment. If we do not receive new tax and insurance information when requested, the client's escrow will be based off of the original escrow disclosure prepared at time of closing.
- If a client had requested an extension of construction time, a Notice of Extension letter will be mailed to those clients.



### 30 Days Prior to First Scheduled Principal and Interest Payment

Clients will receive 30 days prior to going into re-payment a "payment letter" informing them of the following:

1. Request for notification of address change if not already done.
2. First principal and interest payment due date and last interest only due date.
3. Modification Agreement (enclosed if required)
4. Escrow payment required based on enclosed aggregate disclosure.
5. Amount of principal and interest payment and amount of monthly escrow payment.
6. Automatic Clearing House (ACH) form.



### **Extensions**

A refundable fee of .5 points is charged up front on all construction loans.

If the completion of the project runs long and an extension is needed this fee would be used towards that.

### **Early Completion**

If your construction is completed earlier than anticipated, you have two options:

1. Continue with construction interest payments until noted date to convert.
2. Request modification of the note and start repayment early. There are no fees associated with this request.

### **Loan Approval**

1. Your loan application is ready to be reviewed when the appraisal is complete and all pertinent financial information is received. Upon approval of your loan request, a loan approval letter will be sent to you. Shortly after, L.M.C.U. will contact you to schedule an appointment for the signing of the final papers. Signed documents will be sent to the county courthouse for recording.
2. DO NOT START CONSTRUCTION OF YOUR HOME UNTIL WE NOTIFY YOU IN WRITING.
3. THE MORTGAGE MUST BE RECORDED AND A NOTICE OF COMMENCEMENT FILED BEFORE ANY WORK CAN BE STARTED.
4. THE START OF CONSTRUCTION PRIOR TO OUR NOTIFICATION MAY RESULT IN THE CANCELLATION OF THE LOAN COMMITMENT.

### **Construction Contracts**

A fully executed all-inclusive contract including plans, specs, and cost breakdown must be received and approved by the underwriter prior to the loan closing. A contract shall include, but not limited to, the following:

- Builder's company name, address, and phone number
- Borrower's name
- Construction property address (parcel I.D. # or actual street address)
- Total contract amount prior to any deposits
- Detailed specs-material used to construct the dwelling
- Detailed cost-breakdown
- Plans/Blueprints of the home to be built
- Total contract price must include allowances or well/septic or well/sewer tap-in fees and lines to the dwelling or state included in total contract price
- Must include ALL deposits to the builder
- Contract must be signed by all parties

Allowances in the contract are paid out to the general contractor based on percentage of completion. The general contractor is responsible for paying out all allowances to homeowner.

## Construction and Permanent Loan Payments

### When are my construction payments due?

Interest-only construction payments are due monthly by the 15<sup>th</sup> of the month.



### How is my construction payment calculated?

Construction payments are interest-only based on the amount disbursed and are due monthly. The monthly payment is based on a daily interest calculation.

#### Example:

Loan amount:	\$100,000
Amount Disbursed:	\$50,000
Construction Interest Rate:	4.5%
Days in a year:	365
Daily Interest Calculation:	$\$50,000 \times .045\% = \$2,250/365 = \$6.16/\text{day}$
Payment Calculation:	$\$6.16 \times 30 = \$184.80$

\*The example above is for explanation purposes only. Each loan is reviewed and underwritten individually. The percentage used to compute your monthly payments may be different than shown in the example.

### What is the timing between my last construction payment and my first permanent payment?

Your final construction loan payment is due on the 1<sup>st</sup> of the month following completion of your home and conversion to your permanent loan. Your first permanent loan payment is due on the first of the following month.

#### Example:

Date home completed:	10/10/2015
Date Final Disbursement Sent:	10/17/2015
Conversion Date:	10/31/2015
Final Construction Loan Payment Due Date:	10/31/2015 — 11/1/2015
First Permanent Loan Payment Due Date:	12/01/2015

### How am I billed for my first permanent loan payment?

You receive billing in the mail for your first permanent loan payment the month after conversion and payment is due two weeks after you make your final construction loan payment. See timing example on previous page.

## Modifications

Loan modifications may be available prior to the loan converting to principal and interest payments provided one of the following took place during construction:

1. Borrower applied \$5,000 or more toward the principal balance of the loan while in construction.
2. Construction term was extended causing first payment date and maturity date to be adjusted.
3. Customer requested to be placed into re-payment earlier than anticipated first principal and interest payment per the Note and provided all construction is 100% complete.

## Conversion

### What is conversion?

The process of converting your loan from the construction loan to the permanent home loan.



### When do I convert to my permanent loan?

Construction loans will be converted from construction to principal and interest based on the original note date provided no extensions have been granted.

### When do I finalize terms of my permanent loan?

30 to 60 days prior to the construction completion date or when the home is 90 percent complete, a L.M.C.U. Conversion Specialist will contact you to discuss your permanent home loan terms.

### How do I convert to my permanent loan?

After your final disbursement has been made, your home is completed and you have satisfied all loan conditions, you will sign conversion documents provided by your L.M.C.U. Conversion Specialist. You need to sign these documents in the presence of a notary and return them to L.M.C.U. In the envelope provided within 10 days of the receipt.



## Draws

### What is a Draw?

A disbursement of construction loan funds.

### What is the Draw Delegation Authorization?


The Draw Delegation Authorization is a form you may sign to authorize your Builder to request and receive draws without your further consent. You are not required to sign this form, but if you do, it is not necessary for you to approve, sign and submit a draw request each time a draw is needed.

### What happens during the draw process?

1. Borrowers are provided a Construction Loan Guide prior to closing and or at closing to review and sign acknowledging that they understand the Construction Loan requirements and how disbursements will be handled on their loan.
2. During construction, the builder/borrower may request periodic payments on construction loans by contacting the construction loan department directly.

3. When a request for payment is received by the builder/borrower, the Construction Loan Specialist office will order all required documents to process the draw (foundation survey, inspection, mechanic lien update) the same day the request is received. All requests submitted by the builder/borrower for payment must be for completed work.
4. 2<sup>nd</sup> trip foundation surveys are required on **ALL** first draws. A foundation survey will also be required on Fannie-Mae Home-Style Loans when the improvement involved breaking new ground.
5. Mechanic lien updates are required on all draws and construction projects that are 90% complete and prior to final disbursement except for Fannie-Mae Home-Style Loans which require a lien update with each disbursement.
6. Mechanic lien updates may be required on all draws if we have been notified of potential problems. Fees for additional lien updates to be collected from the borrower prior to placing the draw request.
7. Endorsement to ALTA Policy is required from Title Company prior to processing final disbursement stating that all work is done, all funds are disbursed, and we (Lender) have full coverage.
8. Inspections to be performed by the original appraiser on the loan using the Bank approved Inspection Form. All inspection reports to be accompanied with photos of the property at time of inspection capturing what work had been completed a time of inspection.
9. All final inspections will require front, back, and street view photos of the property along with a fully completed 442 Fannie Mae completion certificate re-certifying the original appraised value.
10. Occupancy permits must be received prior to making the final disbursement or converting a loan from construction if required per the county in which the property is located.



11. Draw affidavit forms must be fully executed by all parties prior to a draw disbursement being issued. The builder must complete the amount requested and the mechanic lien waiver on the draw request form having their signature notarized PRIOR to the borrower signing the draw request. 
12. A draw request form will only be valid for 10 business days from the date of the builder's signature being notarized. Anything over that will be considered invalid and will require a new draw request form before processing the draw.
13. A draw request form can never be used twice even if all the funds authorized by the borrower were not previously disbursed. A new draw request form will be required.
14. The borrower should NEVER sign a blank draw request form or sign prior to the builder completing the builder affidavit.
15. Once the inspection report and endorsement letter from the title company is received by the construction loan specialist, the amount of funds available will be determined based on the percentage of work completed per the inspection report.
16. The construction loan specialist will inform the builder of the amount available and request that they forward the executed draw affidavit form to their attention.
17. Under no circumstances will a draw request form be accepted if the borrower signed before the builder, no dollar amount is filled in, or without all parties signing the request.
18. Once all required draw documentation is received by the construction loan specialist and reviewed for accuracy, the draw will be processed. The construction loan specialist will notify the builder once the transaction has been processed.

### What documentation does the bank need prior to the first construction disbursement?


- Permits
- Survey
- Course of construction insurance
- Building permit
- Any state specific pre-construction documentation
- Any other requirements as specified in your pre-construction requirements listed in your approval letter

### What documentation is required prior to the final disbursement?

You need to provide the following documentation:

- Homeowner's Insurance Policy
- Flood Insurance Policy, if applicable
- Certificate of Occupancy
- Final Lien Waiver
- Satisfactory Final Inspection (ordered by L.M.C.U.)

### Taxes and Insurance

- Course of Construction or Builder Risk insurance is required prior to closing or the first draw 
- For loans with escrows, funds are collected at completion of the home to set up escrow accounts
- You are responsible for payment of property taxes during construction
- You or your Builder are responsible for any Course of Construction or Builder Risk Insurance renewals during construction
- Homeowner's Insurance is required prior to the final draw
- For loans with escrows, you receive an escrow analysis based on your improved property value after your home is completed, and you have converted to your permanent home loan
- Taxes may increase based on property improvements

### What is Course of Construction Insurance?

This is insurance that covers any loss or damage to your property during construction. Lake Michigan Credit Union requires that you obtain a Course of Construction insurance policy prior to closing.

Builder Risk is acceptable in lieu of Course of Construction. Your Builder would obtain this policy. Costs associated with this policy are typically passed on to you through the costs outlined and agreed to in the construction contract.

If the Course of Construction or Builder Risk policy expires prior to completion of your home, you or your Builder will be responsible for renewing that policy so that the property is insured for the duration of construction.

### Why do I bring funds to closing for my tax and insurance escrows?

Based on your loan-to-value percentage, L.M.C.U. may require you to bring funds to closing to set up an escrow account for the payment of taxes and insurance.

### Who pays the taxes during construction?

You are responsible for paying taxes to your county or municipality during construction.



### What is Hazard Insurance?

A Builder's Risk Insurance policy with coverage in at least the amount of the loan, along with a paid receipt for the first year's premium, will be required at the time you sign your loan documents. Coverage for Theft of Materials will also be required. Prior to moving into your new home, you will need a Homeowner's policy (i.e. Hazard Insurance). Many Builder's Risk Policies automatically convert to Homeowner's policies upon completion of construction. Check with your insurance agent to see what type of policy is best for you. Make certain that the insurance policy shows Lake Michigan Credit Union as the mortgagee. Please have your insurance agent add the L.M.C.U. mortgagee clause to the policy, we can provide that information upon request.

### When do I obtain a homeowner's insurance policy?

Prior to the final draw, you need to obtain a standard homeowner's insurance policy and provide L.M.C.U. with the declaration page of the policy.

### Why do I receive an escrow analysis after I have converted to my permanent loan?

Depending on when your taxes are due, you receive an annual escrow analysis from L.M.C.U. After the improvements have been made to your property, the tax assessments may increase. Your initial escrow deposit is based on the amount of taxes assessed on an unimproved lot. At the permanent loan stage, the escrow deposits are based on the amount of taxes assessed on improvements.

The initial deposits for your homeowners insurance is based on an estimated value; there may be an increase in your monthly insurance amount depending on the amount of your annual premium.

### Why will my taxes increase when my home is completed?

The value of your property will increase when the construction of your home is completed. At that time, the taxing authorities will re-assess the amount of taxes based on the increased value.

## Delinquency Procedure

- An updated delinquency report for construction loans will be provided to each construction loan specialist on a regular basis.
- The construction loan specialist is to review that report for assigned loans showing past due and review the account to verify that a payment has not been applied incorrectly. If determining that the account is delinquent, the loan specialist will place a flag on the account: "NO FURTHER DRAWS TO BUILDER UNTIL ACCOUNT IS PAID CURRENT."
- A courtesy "reminder" call will be made on or before the 15<sup>th</sup> of each month by the assigned construction loan specialist for accounts that are less than 30 days past due.
- No draws are to be made on construction loans that are delinquent.

## Frequently Asked Questions

### What is a "One-Note" or a "Single Close" construction loan?

#### Why is it a good loan?

A "single close" construction loan is also your permanent financing.

We typically qualify all construction loans on a 3-year adjustable rate or a 30-year fixed rate loan. We do offer the ability to modify your note to another program (i.e., 15 year fixed) for a small fee upon completion. This is more cost effective than having two loan closings. Being a note modification and not a refinance, the process is as simple as signing a few pages and sending them back to the lender.

### Do we have to own our lot free and clear?

No. We will pay off your existing land contract or lender.

### Does this mean I have to sign new loan documents?

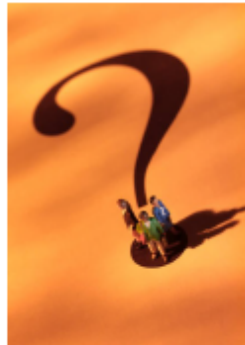
Absolutely not! That's the beauty of our Construction-to-Permanent Loan. Your loan documents were created specifically to cover both the constructing and permanent phases of your loan. You can be assured that you have permanent financing when your home is completed.

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

Generally, you will be able to borrow a percentage of the future value of the house, regardless of how long you've owned the lot or the total cost of the build. Lot equity can be used as a source of down payment as long as the appraisal value is adequate.

### What does an Appraiser appraise?

Well, there obviously is no building to go by. However there is a plot of land and specific building plans for your new home. There are also recent sales of similar properties in the area that the appraiser uses to appraise the completed project.



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

Yes. In these cases the amount which can be borrowed is usually based on the future value of the house after the construction. Exceptions to this would be if the Borrower had less than 20% "in the deal" based on total costs, or the loan balance would be more than the site value (after the old house was torn down) in a "teardown" situation. This type of construction loan can be a refinance on the home in which you live, or an acquisition loan to acquire a property which will be remodeled to be used as your residence.



### Can we use any builder?

Our construction lending department will request that a builder approval questionnaire be completed by the builder. They will check: "happy homeowners" for whom the builder has completed similar projects, vendor references to insure they have substantial open credit, and other construction lenders with whom the builder may have worked. They will also run a credit report, checking in particular for IRS liens. The IRS can come in and seize the builder's account in cases of severe delinquencies, which could bring your builder to a halt. The bottom line is that this builder approval process is not only good for the lender, it is good for you. They will probably 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.

### Why does the Contractor have to be approved?

This protects the interest of both the Borrower and the Lender. The process takes 3-5 days and consists of credit and credential checks. This should not be a guarantee or a warrantee of the contractor's quality of work or performance.



**Can I act as my own general contractor?**

Being an Owner/Contractor is available only to someone who is themselves a builder/remodeler, and who can themselves pass the builder approval process. The construction lender's worst nightmare is a "for sale" sign popping up mid-way through the build.

**When does the construction loan term begin?**

The construction loans typically have a 12 month term which begins on the date the borrower signs loan documents. There are certain loan programs where the build time is shortened to a 6 ,9 or 12 month term.

**How do the loan payments work?**

During the course of construction, interest is paid only on the principal amount disbursed on the loan.

**How is interest calculated and paid during construction?**

Interest is charged on disbursed balances, not the whole loan amount. Borrowers are billed every month for the interest due on the loan.

**What if the appraised value is lower than expected?**

Most appraisers do a very good job of coming up with a fair value. In the event that the home appraises for less than cost, the amount over the appraised value would need to be paid by the customer.

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

Not necessarily. Consult with us first, and we will be able to determine whether you qualify, and for which loan program. 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 on the construction loan, you'll have to sell your current residence prior to, or simultaneously with, the funding of the construction loan.

**What if the project costs are more than estimated?**

Cost over run is a legitimate concern, whether caused by unforeseen circumstances or extras added later in the projects. We recommend having an allowance for extras added in for this very reason. Otherwise, cost overruns will need to be paid out of pocket.



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