



CONSTRUCTION LOAN FACT SHEET

Building an investment property or home is a complex process that involves multiple parties including builders, contractors, lenders, solicitors, accountants, quantity surveyors and the council.

This step by step guide will help you understand what to expect throughout the construction process.




How construction loans work

Unlike regular home loans where you typically receive a lump sum of the loan amount at settlement, construction loans are paid out in periodic progress payments from the lender at different stages of construction.

As a guide, there are usually up to five progress payments at stages including slabs poured, frame up, brickwork complete, lock up and practical completion. Although it depends on the size and design of the build timeframes for each stage are generally as follows:

- The slab or base stage: 1-2 weeks
- Frame stage: 3-4 weeks
- Lockup stage: 4 weeks
- Fit-out or fixing stage: 5-6 weeks
- Practical completion stage: 7-8 weeks



Some lenders will send a valuer to check the work has been completed to an acceptable standard before releasing the next payment. This can be a handy double-check measure for you!

Each progress payment is called a draw down, and interest is only charged on the amount drawn down at the time interest is calculated. So, if you have approval for a \$250,000 loan but have only drawn down \$80,000 – you'll only be charged interest on that \$80,000 until you make further draw downs.

Loan repayments are also interest only during the construction period, providing comfort and security to renovators and home builders by minimising their repayments during an expensive and busy time.

Depending on the loan and lender, at the end of the construction process your loan can either revert to principal and interest or you may be able to keep it as interest only.

The Application Process

When you apply for a loan, the lender will need a copy of the building contract/tender and the plans. They'll ask their valuer to estimate the on-completion value of the property and will assess your loan on the lesser of the land price plus cost of construction or the on-completion value.

Once your loan has been approved, the lender will issue a loan offer for you to sign and return, just like with any other home loan. When your builder is ready to begin receiving payments from the bank he'll need to provide additional documents, such as the final council approved plans, his insurance & drawdown schedule.

How do you request that the bank pay your builder directly?

- The builder will send you an invoice.
- You'll then complete and sign a drawdown request form (available from your lender).
- Send the drawdown request form and the invoice to the construction department of your lender.
- The lender may require a valuation to confirm the work that has been completed so far.
- The funds will be advanced to your builder generally within five working days.
- Repeat this process for each progress payment required by the builder.





The Stages of Construction

There are typically 5-6 stages of construction that are important to understand.

1. Clearing of the site

Depending on the nature of the land, there may be soil testing, site levelling and clearing undertaken prior to actual construction.

2. The slab or base stage

As the name suggests, this is simply the foundation of the property. It includes measuring out the design on the site, pouring the footings, under slab drainage, moisture barrier and special mesh for termite protection.

3. Frame stage

This includes the installation of your internal and external support structure, along with walls, conduit for electrical and plumbing, the roof frame and sheeting, gutters and insulation.

4. Lockup stage

It's at this point where you can literally start "locking up" the property because your windows, doors and remaining walls will be installed. It's also safe for plumbers, electricians, cabinet makers and other tradesman to begin fitting out the property.

5. Fit-out or fixing stage

This includes the installation of plumbing, electrical (including lights and powerpoints) and other fixtures and fittings.

The design features that make the property a home will also be added such as cornices, tiling, cabinets and shelving, reveals and architraves.

6. Practical completion stage


This is basically where all painting, installations and detailing have been completed and you're effectively ready to move in.

How does it work?

Let's imagine that you've bought your land and provided all the relevant documents you need to get formal loan approval including a signed building contract and council approval.

With most lenders, construction will need to start within 6 months and be complete within 24 months so it's important to get started as soon as you can.

The first thing you'll normally have to do is pay your builder an upfront deposit to cover the initial cost of materials. However, this depends on the building contract you've negotiated.





Generally, the deposit will be around 5% of the total building costs.

Your lender can cover this cost if you've provided them with all the relevant building documents and make the lender aware of the upfront deposit from the outset.

Once the deposit is paid, the builder will commence work.

What about additional works?

Depending on your building contract, your driveway will still need to be poured and landscaping undertaken. Other additional works may include installing your garage door, a verandah or even a shed.

Again, most building contracts don't include these additional works (particularly swimming pools, which is a specialty area) so you'll need to organise your own contractors for these jobs.

Nevertheless, once construction is complete, you generally have 3-6 months to notify the builder of anything you notice that needs to be fixed or repaired.

During the stages of construction, some aspects of the property can sometimes be overlooked or not completed to a high standard of quality. It's important to make a list and make the builder aware in one go rather than going back and forth, which can cause delays.

Bear in mind, you may only notice problems during certain times of the year or in certain weather conditions, such as noticing a hole in the roof or a blocked stormwater pipe when it's raining.


When do I make each progress payment?

The building contract should detail the progress payment schedule, which in itself should align with the completion of each stages.

In an ideal situation, you'll receive an invoice from your builder at the end of each stage. This is known as a 'progress claim'.

All you'll have to do is simply sign their tax invoice and the bank will then authorise the next drawdown for your construction loan once they receive the signed invoice.

Once the builder has been paid for their completed work, they will then move on to the next stage of construction.





How much do I pay at each stage?

The amount paid at each progress payment stage is based on a percentage of the total costs of completion.

Generally, the amount you pay at the different stages of construction is as follows:

- The deposit: 5%
- The slab or base stage: 15%
- Frame stage: 20%
- Lockup stage: 20%
- Fit-out or fixing stage: 30%
- Practical completion stage: 10%

Is the progress payment schedule in your best interest?

In most cases, around 90% of the construction loan is drawn down at the lockup stage even though it will still take around 3 months or more before construction is complete and you can move in.

That means you'll basically be making full mortgage repayments even before you take possession of your property.

Please ensure you get appropriate legal advice from a properly licensed conveyancer before signing a building contract.

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