Construction loan: inside secrets to building your new home

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When it comes to money it's amazing how fast any loan officer becomes an instant expert at construction loans. You must keep in mind that all loan officers are salespeople. Yes, I know they have fancy titles like loan officer or vice president but the title is nothing but a fancy name for loan salesperson.

Loan salespeople usually have one main goal in mind when helping you with your loan request and that is the commission. By the way, the fancy name for commission in the loan business is called a loan fee, points or yield spread premium (YSP).

Now don't get me wrong, there are a lot of good honest sales people (loan officers) that work very hard at providing you the best service and rates. What's important is distinguishing the good from the bad.

The following questions allow you to quickly find out if your loan officer is experienced at construction loans.

1. How long have you been doing construction loans? 5 years or more is best.

2. What is the loan to cost (LTC) required for construction loans? This is cash equity such as down payment on land. This can range from 5 to 20%.

3. What is better? The voucher or draw disbursement system and why? Draw is now the most popular because the customer has the control of the money.

If the loan officer (sales person) can answer these questions with no problem then they have passed a pretty good litmus test.

If you really want to throw a curve at them, ask the loan officer if they have ever built a home themselves and what type of construction loan did they get.

If you find a loan officer that has gone through the experience of building a home themselves then the odds are you have found an experienced loan officer.

2. Qualifying for your construction loan, exactly how is it done?

The first thing your loan officer wants to see is your completed loan application. The loan application called the (1003) will tell a story of your financial picture.

The completed loan application will tell the loan officer many things including,
1. What type of loan you want.
2. How much money you need.
3. Your social security number.
4. Your current employers.
5. A list of all you assets (money) and liabilities (bills).
6. How much money you make.
7. How much real estate you own.

Once the loan officer has your loan application in hand they can determine whether you can qualify for a loan. One of the first items pulled is your credit report. The credit report is going to tell 3 main important things.

1. Show your current credit score. The credit score can range from 500 to 800.
2. Show a complete list of all your monthly liabilities (bills).

3. Show all past credit problems including bankruptcies, foreclosures and late payments.

With this information the loan officer will do an analysis to determine if you can qualify for the loan amount that you're looking for.

This analysis determines a ratio called the (income to debt ratio) and depending on the banks underwriting guidelines this ratio will usually range from 36% to 45%.

The income to debt ratio is the percentage of monthly debt payments (including your new mortgage payment, taxes and insurance). This ratio should not exceed 36% to 45% of your monthly income.

Some banks will allow you to exceed this ratio if you have an excellent credit history and excellent credit score.
The current and the most popular method of qualifying for a loan today is the stated income loan.

Stated income allows you to qualify without verifying your income on your tax returns, W 2's or pay stubs. The only thing the bank verifies when applying for a stated income loan is your credit score, liquid assets and that you're employed.

3. How not to be taken by the oldest trick in the book "Bait and Switch"?

The mortgage lending business is notorious for baiting and switching.

Baiting and Switching is when a loan officer or advertisement offers you one thing and then tries to sells you something else.
Typical signs of baiting and switching are obvious, some basic examples are:

1. Over the phone, you are offered a much lower rate than any other quote and once you've sent in your application the rate you were quoted has all of a sudden vanished.
2. You are offered a construction loan with no points and no loan fees. What you are not told is that you are paying for it with a higher interest rate and the costs are built into the loan.
3. You are told that you will not have any payments while you're building. What you're not told is that all construction loans have this option and it's called "interest reserves" and the payments are added to the loan amount.

Remember three important facts and you will always be in good shape.

1. If it sounds too good to be true there's usually a reason.
2. Always get your quote in writing, (ask for a good faith estimate).
3. If you are satisfied with the rate and construction loan program that you are quoted, ask to lock it in upfront.

On the flipside, it is very important to realize that most loan products typically go hand in hand with banking guidelines. These guidelines are provided to loan officers to coincide with the customer's qualifications.

For example, if you have a very high (FICO) credit score with land free and clear, you have more loan options than the person with a very low (FICO) score and no land equity.

4. Now for the biggest secret of all, ready? All banks have access to the same rates and the only reason everyone ends up with a different rate is directly related to how much your loan officer and bank is going to profit from you. You should probably read that one again.

Your loan officer gets paid like all sales people either by:
1. Salary plus commission
2. Commission only.

It doesn't matter if you walk directly into a bank or work with a broker, basically everyone gets paid the same.
If you walk directly into a bank the loan officer most likely gets a basic salary and a percentage of the loan origination fee (points and yield spread premiums). If you work with a broker the broker usually works on a straight commission (points and yield spread premiums).

Becoming a broker allows the loan officer the ability to offer their customers the best loans with the most options.
It always amazes me when I see TV commercials or hear radio commercials advertising $395, zero closing costs. I always wonder if people understand how they can do that.

Ok, here is how it is done.

The inside secret is that in exchange for these low or zero closing costs the lenders will make their profits and cover the costs of the loan by charging you a higher interest rate.
This higher interest rate pays what they call in our industry a (YSP) yield spread premium.

By charging you a higher interest rate over the life of the loan the bank can easily afford the commercials, commissions, payroll, and cover the costs of the loan while still making a profit. Also the service is usually very poor and impersonal.

So the next time you see advertising with no closing costs you will know exactly how they are doing it.

So please remember that there is no such thing as a free lunch in any business. Business wouldn't be business if there were no profits. The most important thing is that you want the best loan available at a fair price with an experienced loan officer.

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