

Use a Construction Loan to Build the Home of Your Dreams

By: Brian Watkins, Senior Vice President, Director of Private Banking, and Greg Benton, Commerce Bank Mortgage Banker

Admit it — you've dreamed about it for years. You've always wanted to build a custom home on that perfect piece of property — a house that reflects your taste and unique desires down to the last detail. If you're up for the challenge and ready for an adventure, "homesteading" from scratch on a piece of undeveloped land can be the experience of a lifetime.

"So where do I begin?" you ask. Building a custom home can be very complicated and expensive. That's why you may want to use a construction loan (a legitimate financial tool) to turn your dream into reality. In fact, a construction loan may be the only loan you'll ever apply for on an asset that doesn't exist — not yet anyway!

Construction loans are utilized for a variety of purposes: primary residences or vacation homes. They can also be used for local tear-down/rebuild projects that are popular these days as well. We've all seen larger homes or houses with more amenities built to replace older structures in highly sought-after locations and premium neighborhoods.

How do you get a construction loan?

To acquire a construction loan, an aspiring home builder usually starts off with architectural plans as the basis for estimating the projected value of the finished dream house. Once your plans are approved and accepted by all interested parties, construction loan providers generally offer you a loan based on a percentage of the completed, projected value of the house. As a rule of thumb, the construction loan providers will require you (the borrower) to make a 20% down payment, leaving a remaining loan value of approximately 80% of the projected value to provide the funds necessary to build your new home.

What's the next step?

This is the point where your homestead journey can get a bit complicated. Construction loan providers don't just hand over a lump sum to you. Instead, they disperse the loan funds in installments (called "draws") as needed during various stages of your construction project.

"Homesteading" Is a Journey

"Homesteading is a journey involving many participants along the way. It takes experienced 'guides' to navigate the path from envisioning a new home to finalizing the last of your punch list items on the final walk-through with your builder.

"Everything starts with a construction loan — a short-term loan that provides both the financing necessary to build the house and the safeguards to ensure expenses are measured and monitored throughout the process."

– Brian Watkins, Senior Vice President,
Director of Private Banking



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For instance, a concrete contractor will likely request payment after foundations are poured and set. As the construction progresses, other building trade contractors — such as brick layers, carpenters, roofers, plumbers, electricians and painters — will want payment for the services they provided. Likely there are additional costs for other items such as property titling, inspections, appraisals, landscaping and interior finishing millwork.

A typical custom-built home can take 6–18 months to build — perhaps longer in an economy plagued by supply issues and labor shortages. There will be many check points to navigate payment dispersals, and they are specifically designed to ensure no stalls or delays occur during the progress of your home's construction. Your construction loan provider should be your ally from the first building blueprints to the final walk-through of your completed home.

What happens when the construction is finished?

When the building phase is completed, the construction loan is paid back immediately when a more traditional long-term mortgage is put in place. Provided you had no cost overruns and your home appraises at the original projected value, obtaining the mortgage loan financing is not nearly as arduous a process.

Some loan providers offer a financing package that includes both the construction and mortgage loan. Some lenders may offer to lock in the interest rate for the long-term mortgage financing in advance while the home is being built. With this feature, if interest rates rise during your construction phase, you will already know that your mortgage financing remains stable.

We can help.

Building a custom residence involves many contributors to guide you along the way — especially if you need to take out a short-term loan for construction and a second, longer-term mortgage to permanently finance your new home once the project is complete. It's good to have an experienced advisor help navigate the financial crossroads on the way to making your dream home a reality. For those interested in discussing a construction loan as an option, contact Commerce Financial Advisors today.



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Brian Watkins

Senior Vice President, Director of Private Banking

Brian is senior vice president and director of private banking for Commerce Trust Company. He is responsible for the system wide oversight of all private banking activities for Commerce Trust. He joined Commerce in 1995 and served as a commercial lending manager prior to transitioning to his current role with Commerce Trust in 2013. Prior to joining Commerce in 1995, Brian was a branch manager with Boatmen's Bank. Brian attended Saint Louis University, where he received his bachelor of science degree in finance as well as his master of business administration degree. He serves on the Alumni Board and Father's Club Board for St. Louis University High School. Brian is also active in his parish with Mary Queen of Peace in Webster Groves.



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