

DECONSTRUCTING CONSTRUCTION LOANS



THE DIFFERENT TYPES OF CONSTRUCTION LOANS

There are a variety of construction contracts available and it's important you pick the right one for you. Here's 3 options to consider:

TURN KEY CONTRACT

This one's going to benefit you the most but it can make it harder for the builders. It's essentially a fixed price contract between you and the builder that specifies a fully completed property or renovation, including landscaping, driveways, painting and flooring in the new property.

Things to note:

A turn key contract only allows for minimal 'PC Sum' (non-fixed) costs, meaning that the costs shouldn't blow out once construction is underway.

This contract is exempt from RBNZ (Reserve Bank of NZ) rules. That means you don't need a 20% deposit - a 10% deposit is required for turn key contracts, and some banks may even stretch to allow 5% in special circumstances, making this an attractive option for those with good income but less savings.

Another advantage to you the client is that until the property has been completed and settled, you don't make any loan repayments or pay any interest, allowing you additional time to save before you start to pay off the loan.

LAND AND BUILD CONTRACT

This is the most common type of construction loan and builders love this type of contract. Like the Turnkey, it specifies completion of a ready to live in building with minimal 'PC Sum' costs.

The difference is that banks require a 20% deposit if it's an investment property (10% deposit is fine for first home buyers) and there are progress payments involved. These progress payments are interest-only funds that go to the builder at various stages of the project. Think of it as a 'pay as you go' approach. (see the next page for details on progress payments).

LABOUR ONLY/ PARTIAL CONTRACT

We wouldn't recommend you sign one of these bad boys unless you're relatively experienced in construction contracting and how it all works.

These contracts come in many forms but normally consist of a range of sub-contracts that are managed by either the client or a project manager. There might also be a labour only arrangement with the contractor.

These types of contracts are commonly used in the case of a kitset or relocatable home.

Lending for a labour only or partial contract is limited to the land value only unless the buildings are already permanently fixed to the land. LVR would typically be between 65% - 80% depending on the contract.

Other conditions for labour only / partial contracts:

- Quotes for materials and subcontractors required up front
- Progressive drawdowns are made against invoices
- Valuations for each drawdown stage are required to ensure any cost blowouts are identified early

PROGRESS PAYMENTS

Every construction contract includes a schedule of stages and payments required, which varies depending on the type and nature of the build.

Firstly, a 10% deposit will be required to secure the contract. This is then included in the first drawdown. Normally paid by cash or equity.

The second drawdown tends to be 20% of the total balance of the build contract.

To give you an idea of how the entire payments might typically pan out, the following rules of thumb can be used;

5% - 20%	Site works and foundations, permits and fees, architect fees (includes 10% deposit)
20% - 30%	Wall and roof framing - roof installed
15% - 30%	Internal and external lining, doors and windows, plumbing and electrical
10% - 25%	Room fit-out and finish, kitchen and bathrooms, floor and wall coverings
10%	Retention final payment made on the issue of Code Compliance Certificate (CCC)

LAND VALUE AND BANKS

If you're not intending to build within the next 12 months, the banks will lend up to 50% on bare land. If you do intend to build within 12 months, you can borrow up to 80% - 90% and then sort out your building contract before final approval.

If you're thinking about subdividing, this can get a bit complicated so it's worth talking to a specialist in this area.

MASTER BUILDERS GUARANTEES

These cover residential building work, full-contract and labour-only work carried out by a Registered Master Builder. Work by subcontractors, as well as materials and rot and fungal decay is covered, but conditions apply.

It's important to note that a Guarantee is not automatic upon hiring a Registered Master Builder - you need to complete the documentation with your own builder and ensure that it is sent through to Master Build Services.

BUILDERS RISK INSURANCE

Banks will always ask for your builder to provide builders risk insurance, as buildings are subject to many different risks while under construction. They could catch fire, be damaged by high winds, or fall victim to other force majeure.

THE BANK OF MUM AND DAD

HOW YOUR PARENTS CAN HELP

We understand that coming up with the full deposit is no easy task. But did you know there are ways around this? One common solution is using the "bank of mum and dad". Basically this means your parents contribute to the deposit, or become a limited guarantor.

The easiest option is for your parents to top your deposit giving the required deposit overall. (10 - 20% depending on which type of loan).

For this to work effectively, banks still require you to demonstrate that you have managed to save 5% of the deposit on your own. As long as 5% is saved, the bank doesn't care where the rest comes from!

WHAT ARE THE RISKS?

The banks give mortgagees quite a bit of leeway. After three months of being behind on mortgage payments, lenders will issue formal notice. It takes roughly six months of non-payment to get to the point where a mortgagee sale is on the cards. As long as you've got the lines of communication open, that's plenty of time to sort it out before it comes to that.

Although the loan documents won't say it specifically the lender will sell your property first. Your property makes up most, if not all of the loan value, so it makes more sense. Lenders also don't want to risk their reputations - selling out guarantors is a bad look. That said if money is still owed after selling your property (including any unpaid interest) the bank will start chasing your parents.

Minimising the risks for everyone is a matter of good insurance - income (or mortgage) protection and life insurance.

WHAT IF MY PARENTS WANT TO SELL THEIR HOUSE?

As a guarantor their property will have a mortgage secured over it. In the event they want to sell it we can transfer the security to another property, or we can use some of the proceeds from the sale of their property as security (in the form of a term deposit.)

GIFTING VERSUS A "LOAN"

As a parent, the contribution can be given as gift or as an interest-free loan. The majority of parents prefer to treat it as a loan because if their kids' relationship ends they don't want their deposit viewed as relationship property. (Not super romantic, but way smarter). If your parents prefer to do a loan, we can sort them out with a deed of debt template - they can fill it in themselves and use it with the banks.

HOW WE CAN HELP

We work with you and your parents to make sure the mortgage is manageable, that the risks are well managed, and that your parents can be removed as a guarantor within 3-5 years.

IN SUMMARY

THE BENEFITS OF HAVING A GUARANTOR ARE THAT:

the loan will be approved

no low equity fees

better deal for the kids (market rates)

No registered valuation requirement on the loan pre-approval

THE RISKS FOR A GUARANTOR ARE:

your parents property is used as security by way of mortgage

DEPOSIT BONDS

IT'S CHEAPER THAN BORROWING A DEPOSIT

Squirrel is now working with Deposit Power (a division of CBL Insurance) to provide deposit guarantee bonds into the NZ real estate market for first home buyers and buyers with long settlement dates. In some situations we can issue deposit bonds for up to two years.

WHAT IS A DEPOSIT BOND?

A deposit bond is a bond or guarantee issued by Deposit Power (and underwritten by CBL Insurance) that can be used instead of a cash deposit when buying a property. It will be particularly useful if your money is tied up elsewhere and for anyone buying off-plan.

If you don't have cash readily available, a deposit guarantee bond is cheaper than borrowing the deposit. Many banks will charge an overdraft rate of interest (up to 15%) or at the very best a floating mortgage rate (up to 6.75%.) The cost of a deposit bond is a **one-off up front fee:**

TERM	BOND PRICE	EQUIVALENT FINANCING RATE*
<6 months	2.50%	5.00%
6 - 12 months	3.00%	3.00%
12 - 24 months	5.00%	2.50%
25 - 30 months	6.00%	2.50%
30 - 36 months	7.00%	2.33%

EXAMPLE

Property purchase:	\$600,000
Deposit Power Guarantee term:	4 months
Deposit Power Guarantee amount:	\$60,000
Total fee collected:	\$1,500 (2.50% of \$60,000)

The fee is charged up front as single one-off fee. It can be charged to your credit card or paid in cash.

WHAT ABOUT USING KIWISAVER?

KiwiSaver can now be withdrawn before settlement provided the deposit is held in trust until settlement.

However, what this misses is:

1. it takes about ten days to process KiwiSaver so this won't work for auctions
2. if the settlement is some time off, it precludes you from increasing your KiwiSaver withdrawal
3. it assumes you have all of your deposit available and don't need to still save some of it.

HOW MUCH CAN YOU SAVE BY NOT USING KIWISAVER?

If you are buying off-plan then chances are you won't be settling for at least 12 months. If you are eligible for the First Home Subsidy then staying in KiwiSaver will give you another \$2,000 per person subsidy.

In 2014 the average return on a growth fund was 8.50% so if you had \$30,000 invested that's another \$2,400 in earnings and assuming a household income of \$120,000 then another \$3,600 of employer contributions.

CAN I USE MY KIWISAVER?

If you are a first home buyer you can withdraw KiwiSaver contributions made by you and your employer to use as a deposit towards your new home. You can only do this if you've been on KiwiSaver for more than three years.

In addition, if you earn less than \$130,000 and are buying for less than \$600,000 you may be eligible for a HomeStart Grant of up to \$5,000 per borrower.

The HomeStart Grant is \$1,000 for each year you've been in KiwiSaver, up to a maximum of \$5,000 for five years. If you're a couple buying a house together and you both qualify for a grant, you could receive a combined grant of up to \$10,000.

If you are off plan or building new then you could double your HomeStart Grant up to \$20,000 for a couple.

To be eligible to withdraw some or all of your KiwiSaver you must:

- have contributed at least 3% of your income to a KiwiSaver scheme for at least three years;
- have a combined 10% deposit (including KiwiSaver) and
- be buying your first home.

To get the additional subsidy, you must also:

- be planning to live in the house for at least six months,
- have a single income under \$85,000 or a combined yearly income of \$130,000 or less (before tax) two buyers,
- be buying a house under \$600,000 in Auckland, \$500,000 in other major metropolitan areas, and \$400,000 across the rest of New Zealand.

GETTING YOUR MONEY OUT

You can now withdraw funds from your KiwiSaver to put towards your initial deposit (previously this was only possible upon going unconditional). If you have a conditional sale and purchase agreement you can choose to make your withdrawal at the point of deposit or when you settle.

If KiwiSaver isn't an option for you, then you'll want to make other arrangements for this amount such as a deposit bond, which we can also help you with.

Squirrel helps kiwis

get into \$1.4 billion of property every year. We have access to more lenders and best of all our advisers are paid salaries, not commission which means our advice is impartial.

Got questions? Get in contact!

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