



Could 2008 be the year you renovate?

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Renovating your home, whether it is a second story addition or a kitchen remodel, can be one of the most rewarding things that you can do to your house. Not only will you get years of enjoyment from the renovations, you'll also improve your equity considerably.

However, it can also be one of the scariest processes to start, particularly when it comes to financing! How to begin, where does the money come from and how does the loan work are the questions homeowners ponder before they decide to remodel. It's especially confusing these days when mortgages and banks are making the news daily!

Fortunately, there are still lots of choices for the homeowner considering remodeling. Understanding the process and the structure of available loans can be a little overwhelming, but maybe this quick description will help shed some light on remodeling and construction financing. These are the four most common financing programs:

1. Equity lines: These were popular over the last few years when the Prime Rate was very low. As Prime has increased, this option has become less attractive. Equity lines are based on the current value of the house. The mortgage company will get an appraisal of the existing home and will lend on a percentage of that (there are still 100% equity lines available). They will calculate this percentage and take out the balance of the current first mortgage. This will be the amount available to use for a remodeling project.

Example: \$300,000 home with a current \$200,000 first mortgage. If you are obtaining a 90% equity line, you would have \$70,000 available:

$$\$300,000 \times 90\% - \$200,000 = \$70,000.$$

Think of it this way: an equity line is like a checking account on which you pay interest. It will be based on the Prime Rate and the monthly payment will be based on the amount drawn against the line for that month.

2. Construction to Perm loan (based on future value): This option has become more popular in the recent years. It allows you to access the future value of the house once the remodel is complete. One of the big changes in the recent months with the "credit crunch" is that most lenders require that you own the house for at least a year before you are allowed to use the future value. In this type of financing scenario, the appraiser will complete an appraisal based on the plans and specs of the project. They will compare recent sales in your neighborhood that are similar to what your house will be once the project is completed. Almost all mortgage companies will lend 80% of the future value and some will go as high as

90% of the future value. The percentage is calculated from the subject upon completion appraisal and the amount left after paying existing mortgages and closing costs is the amount available for the project.

Example: \$650,000 future value X 80% = \$520,000 less existing \$300,000 first mortgage = \$220,000 available for project and closing costs.

The rate is usually locked during construction and tied to Prime or at the rate for the permanent financing. During construction, the bank pays the builder draws and the amount paid monthly is based on the amount drawn. After construction is complete, the loan converts into the permanent loan (30 year fixed, adjustable, etc.). Most lenders will offer a locked rate for the permanent financing at the beginning of construction as well as a float option if rates are better at the time of completion.

3. Construction to Permanent (using acquisition cost): If you have owned your property less than a year or it's an investment property, more than likely you won't be able to access the future equity of the property just yet. This doesn't mean that financing isn't available for your project. You will be able to find financing; it will just be based on the acquisition cost vs. future value. Otherwise, the loan structure will be the same.

Example: \$400,000 purchase price +

\$250,000 remodeling/construction/closing costs = \$650,000 X 90% = \$585,000 for purchase and costs. You contribute \$65,000 for down payment.

4. The old fashioned way: Cash! Obviously cash is the easiest and, if you have it available, by all means the best source of funding.

Hopefully, this brief description has helped untangle the web of construction financing. Each borrower's needs and circumstances are different, so this list does not by any means encompass every type of loan or scenario.

If you decide to remodel, we hope you get years and years of enjoyment from the finished project and if all goes well, maybe a little equity as well!