

need to refinance and enter into a brand new loan of your choosing - such as a 30-year fixed rate conventional mortgage.

### **How to qualify for a construction loan?**

In order to qualify for a construction loan, you must show your lender you can handle making payments on a loan and the property itself will be worth what is being borrowed. Here are a few factors which play a role in determining if you can obtain the loan. Getting a construction loan is by far one of the best ways to finance building your home.

**1) Income:** Your lender will need all the income sources and proof of income, including W-2s, tax returns and paycheck stubs.

**2) Credit score:** Maintain a high credit score to show your lender you are a trustworthy person. In most cases a credit score over 700 is best.

**3) Debt-to-income ratio:** Your debt-to-income ratio is an indication to your lender regarding how much credit you depend on. To lower it, reduce your credit card or other loan balances as much as possible prior to applying for the loan.

**4) Down payment:** Talk with your lender regarding the best amount for a down payment. Typically, 20% is the minimum you need to put down for a construction loan - some lenders may require as much as 25% down. This ensures you are invested in the project and won't just walk away if things go wrong. In a construction loan, you may have to pay this amount at the start of the construction process.

**5) General Contractor/Builder:** Hiring the right contractor is important. You

may think the best way to save money is to self contract. Before going too far down the self contracting path, take a hard look at what is required to succeed at it and define the potential savings. Then decide if it is worth it. There are a few lenders who may not approve a construction loan with a self contractor. Also consider that an experienced contractor brings a wealth of knowledge to a project. This knowledge makes the building process go smoothly and more efficiently, resulting in lower costs and higher quality work. Plus with their experience, they know what materials and building details work and which are prone to failure. Your lender must approve your contractor before they agree to fund the loan. Your lender may even be a resource for a good contractor to help expedite the process. Work with your builder to design a home that is within the budgeted amount, provided by the lender after initial approval of your application.

**6) Floor plans and materials:** Your lender needs detailed specifications, including floor plans, as well as details about the materials that are going to be used in the home. Builders often put together a comprehensive list of all details (sometimes called the "blue book"); details generally include everything from ceiling heights to the type of home insulation to be used.

**7) Appraisal:** Although it can seem difficult to appraise something that doesn't exist, your lender must have an appraiser consider the blue book and specs of the house, as well as the value of the land that the home is being built on. These calculations are then compared to other similar houses with similar locations,

similar features, and similar size. These other houses are called "comps," and an appraised value is determined based on the comps.

**8) Approval:** Once the appraisal has been completed, final approval on the construction loan will take place. After approval, the construction loan is then finalized and closed. Construction on the home now begins!

### **Design the house to your budget**

It is important to start with a realistic budget. With clear budget guidelines, you will reduce your chances of getting a design that is over budget and will never be built. Even with clear budget guidelines, many projects will still come in over budget. If you find your preliminary plans are significantly over budget, you will need to cut cost or find more money. Here are a few ideas for cutting costs up front:

- Scale back on square footage
- Cut out luxury items such as jetted tubs or granite counter tops
- Hold off on the deck, porch, patio, or garage that can be added later
- Leave the basement unfinished
- Create an expandable design that can easily be added on to later

•Depending on your skills and time, do some of the finish work yourself such as interior trim, painting and landscaping

### **Home and neighborhood should be equal**

When building, there are two main issues, the ability to finance the home and the ability to protect your investment. In talking with your lender you will determine the best financing for the project. Matching the size and price of the home you build with the neighborhood can help protect your investment.

Building a home is not the time to leave anything to chance. Carefully weighing the items listed in this article is important so you know that the choice you make is the right one for you. If you have mortgage or construction lending questions, please contact Gloria Bohn, 605-665-4951, gbohn@firstdakota.com or Sandy Brown, 605-624-5845, sbrown@firstdakota.com Or go to FirstDakota.com to complete our prequalification application.

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