

## Renovating or building?

Get your finances sorted so you can focus on bringing your dream to life.



Renovating or building guide

# Building, buying off the plan or renovating?

## Building your new home

There are several advantages in building from scratch. You can customise your home to your own tastes and needs, ensure it has higher levels of sustainability and energy efficiency than older homes offer, and lower maintenance costs. Plus, you have the protection of a new home warranty.

On the flip side, building can be a drawn-out and stressful process, and can come with hidden costs and greater levels of uncertainty.

You'll also need to navigate the multiple relationships and costs involved with employing an architect, drafts person or project home developer, the builder and tradespeople.

House and land packages come with the advantage of a fixed-price contract that includes all major costs. But you need to be wary of issues such as 'site variations', which add to the cost. A sloped block, for example, may incur higher site variation costs than a level lot.

Longer term, buying into a housing estate can limit the short-term capital gains on your home.

## Buying off the plan

Buying off the plan allows you to buy a home, often an apartment, that either hasn't yet been built or is under construction.

One of the major advantages is the potential savings on stamp duty, which may be based on land value only. And the deposit may be as little as 5–10% of the purchase price, with the balance payable on completion.

This could help you save money and give you extra time to arrange loan finance.

But there are possible downsides. If the property market cools after you sign the sale contract and before your home's complete, you may end up paying above market price for your property. This could affect your loan approval. Similarly, interest rates can change in the intervening period, making it more difficult for you to afford the repayments.

Buying off the plan involves a leap of faith in the developer and the quality of construction. Even the best display suites are no substitute for the finished product.

## Renovating an established home

Renovating your existing home can be more affordable than selling your home and buying a new property. Likewise, buying an affordably priced 'renovator's delight' to refurbish can be financially rewarding and emotionally satisfying.

It's important to remember that home improvement projects often run over budget. Seek the advice of a licensed builder or architect about potential costs before doing anything, and don't forget to speak to your local real estate agent to ensure you don't overcapitalise.

'Overcapitalising' is what happens when a property is improved over its resale value. This is what could happen if you spend more money on renovations than those renovations add to the property value. For example, you spend \$150,000 on renovations. When you come to sell the property, you find the improvements have added only \$100,000 to the property's value. You would have overcapitalised by \$50,000.



### Tip: Make sure you have all the facts

It's common for unexpected expenses to come up when building or renovating. Your building contract should offer a fixed price, but it's worth speaking with your lender to see whether you can vary the loan amount if costs change unexpectedly. Otherwise, these costs may need to be paid from your own funds.

# Finding the right finance options

## Renovations

Understanding how you're going to fund your home renovation is just as important as deciding on the design and fittings you'd like.

It's possible to fund minor home improvements through cash savings and/or a personal loan, but if you're planning a major project, you could also consider using your home loan as a source of finance.

## Redraw

If you're ahead on your home loan repayments and your loan offers a redraw facility, you could withdraw any extra repayments you've made. This is a low-cost option, but you'll be limited to the value of additional payments made in the past, which may not be enough to cover your renovation costs.

## Loan top-up

If you're happy with your current loan and lender, a loan top-up can be a simple way to access extra funds. This could involve taking your loan back to its original level or adding a bit extra.

While topping up your existing loan may involve less paperwork than refinancing to a new loan, your lender could ask for a new valuation of the property. This will usually be based on the property as it stands, and the impact of your planned renovations may not be taken into account.

Bear in mind that topping up your loan will mean higher loan repayments, so you should be careful to calculate whether this is affordable for you.

## Loan refinance

It's worth considering a new loan that could offer a better rate or improved features. A major renovation can be the cue to consider refinancing.

If you've owned your home for some time, you may have built up considerable equity in it. A loan refinance can be a great way to access this equity as a source of low-cost funds for your renovation.

In some cases, the new lender may want to value your property. This helps the lender confirm the size of the loan you're eligible for. Take some time to present your home in the best possible light to maximise the valuation.

## Line of credit loan

A line of credit home loan lets you borrow funds as you need them up to an approved value. It can be a handy option for renovators who may need to make payments at different times for materials and/or builder's fees. Along with flexibility, a line of credit can be cost effective as you pay interest only on the funds drawn down.

You can also fund your renovations with a construction loan (see next page), which may allow you to save money as you will only pay interest on the progress payments.

**A mortgage broker can crunch the numbers to help you select the funding solution that best meets your needs.**

# Financing a build: construction loans

## Applying for a construction loan

Applying for a construction loan is much the same as applying for a standard home loan.

Your lender will want to see proof of your income (such as two of your most recent payslips or most recent tax return and tax assessment notices), evidence of savings (such as bank statements) and record of money you owe (credit card or loan statements).

These show you have the financial capacity and personal discipline to repay the loan.

Unlike a traditional home loan, when you apply for a construction loan, you're asking your lender to provide funding for an asset that isn't yet built, which means the lender will ask for some additional documents. These may include the following:

- The tender or copy of a fixed-price building contract detailing all building specifications, variations, allowances and costs.
- A copy of the plans for the new property approved by the local council or building surveyor. Generally, these won't have to be approved at the time of application, but they must be approved before drawdown.
- Evidence that construction is being undertaken or supervised by a registered and insured builder who takes full responsibility for the build and can provide appropriate guarantees as required (e.g. a copy of your builder's licence and insurance policy).
- Details of your insurance.

If you plan to contribute some of your savings to the construction payments, your lender will also need to know the amount at application stage. Contributing savings to construction is separate from your deposit for the loan. Deposit requirements for a construction loan are the same as a standard home loan – you will usually need 20% of the loan amount to avoid paying Lenders Mortgage Insurance.

## Accessing your construction loan

Once your loan is approved, the funds will be provided in a series of payments. These are usually made in line with various milestones outlined in your building contract and then met by your builder. The lender will not usually release loan funds until your personal contributions – if any – have been used.

The loan amounts withdrawn are often referred to as progress payments, and are typically made at six important stages of construction:

- 1. Preparation:** Your builder has organised council approvals, sourced materials and lined up a team of tradespeople so work on your project can begin.
- 2. Slab (or base floor):** The site is prepared and the concrete slab is poured. Depending on your block of land, this stage may also involve levelling the land and building retaining walls.
- 3. Frame:** Wall frames and roof trusses are erected, and the new home starts to take shape.
- 4. Lock up:** At this stage, the walls are bricked and the roofing is complete. Windows and doors are fitted so the home is weatherproof and can be secured.
- 5. Fit out:** This is the internal stage, when the bathroom, kitchen and laundry are installed, walls are painted, tiles set, floor coverings laid and electricals installed.
- 6. Completion:** At this point, all that remains is for appliances to be installed and landscaping completed (if included in your building contract). Once done, your builder will walk through the property with you to check for defects and ensure everything is completed to your satisfaction. A local council representative will inspect your home one last time for compliance.

## A closer look at the costs

As with any loan, it's important to have a clear idea of exactly what you're going to repay – and a construction loan is no different. Make sure you understand what you'll be up for, and when you'll be asked to pay.

### Loan fees

You may be asked to pay loan fees each time you draw down part of the loan. These usually comprise two types of fees:

- 1. Inspection fees:** Your lender may want to inspect your home each time a progress payment falls due. This lets them check that construction is progressing at an acceptable pace and to an acceptable delivery standard. A fee may be levied for each inspection, and while the cost is often between \$100 and \$200, it may vary according to the lender and location of your property.
- 2. Drawdown fees:** Some lenders charge a fee to cover the costs of making the loan funds available. You may be asked to pay a single fee at the start of your loan or a smaller fee each time you request a progress payment.

### Insurance

Most insurance companies won't cover homes that are under construction. When cover is available, the premiums can be costly and the policy can include a raft of exclusions.

This is why it's important to deal with a reputable licensed or registered builder. They must have insurance that protects you against non-completion of the project, structural defects and public liability claims.

Once construction is complete, a requirement of your loan will be that you take out your own building insurance. It also makes good financial sense to take out contents cover. You can often get a discount if you use the same insurer for both home and contents insurance. Compare premiums to get the best deal possible.

## Managing your loan during construction

A construction loan can be very budget friendly. Your repayments will generally be interest only until your home is completed, and you won't need to repay any of the principal until the full loan balance is drawn down.

Interest is calculated only on the funds used to date. This means you'll have lower monthly repayments at a time when you may be paying rent on temporary accommodation or buying items for your new home.

You can make additional repayments during construction. These will come straight off the loan principal, helping you get ahead financially and save on long-term interest charges.

## Budgeting for your repayments

Your builder will provide a detailed schedule of progress payments in your contract.

## Tip for investors

If you're taking out the loan as an investor, you may be able to continue making interest-only repayments. This is something your Mortgage Choice broker can help you check with the lender.

## Building incentives

It's a good idea to check if you're eligible for any home building incentives. Some state and territory governments offer stamp duty concessions and other incentives when you build a new home rather than buy an established dwelling.

Check the website of the revenue office in your state or territory to see if they offer any incentives.





## Case study: Liz and Andrew

Liz and Andrew use a \$300,000 construction loan to build their new home. Their interest rate is 5.00% p.a. with a one-month gap between each progress payment.

Interest is charged only on funds that have been drawn down at the time of each progress payment. Some stages are completed faster than others, and sometimes they receive two progress payments in the same month.

When construction is complete and the progress payments have been finalised, their loan reverts to principal and interest payments, and they will start repaying the principal sum borrowed over the chosen loan term (see the table below.)

### Progress payments and loan repayments

Construction stage	Progress payment	Loan amount drawn down	Monthly loan repayment
Stage 1 – Preparation 10%	\$30,000	\$30,000	\$125
Stage 2 – Slab 10%	\$30,000	\$60,000	\$250
Stage 3 – Frame 20%	\$60,000	\$120,000	\$500
Stage 4 – Lock up 20%	\$60,000	\$180,000	\$750
Stage 5 – Fit out 20%	\$60,000	\$240,000	\$1,000
Stage 6 – Completion 20%	\$60,000	\$300,000	\$1,250

# When your build is complete

Congratulations, this is the moment you've been waiting for! Your new home is complete and ready for you to move in.

## Final documents

Your lender may want to inspect the property and complete a final valuation before making the last progress payment to your builder. You'll need to provide several documents to complete the sign-off process.

These include:

- A Certificate of Occupancy that shows the building is safe to live in. Depending on your state or territory, this document may be known as an occupancy permit, final occupation certificate or certificate of classification.
- Your builder's final invoice.
- A comprehensive building insurance policy with your lender noted as the mortgagee.

## Switching to a standard loan

Once you've made your final payment to the builder, your loan will switch to the standard home loan or loan package you've agreed on with your lender. Other options such as switching to a fixed rate may be available, although additional fees may apply.



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