

Deconstructing construction lending

Squirrel

When you're building new, there are a few different options for finance.

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First things first – a construction loan can be for any of the below:

- Lending involving the construction of a new dwelling or structure (e.g. Garage)
- A loan for work that requires building consent
- A loan for kitset and relocatable homes.

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 benefits you 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 is fixed, meaning that the costs are decided up front.

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

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 main difference with a Land and Build Contract is that there are progress payments involved, with the builder invoicing for payment at certain stages of the project. This means that with a Land and Build contract you will be the one financing the build to completion, instead of your builder. This is one reason why in most instances a Land and Build contract may be lower than a Turn Key contract.



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.

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.

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 deposit will be required to secure the contract, normally paid by cash or equity. This amount can vary across build companies so it's important to thoroughly check the build contract.

Progress payments will be made by your bank directly to your builder. Typically your builder will email you an invoice for payment, which should match up to the payment schedule of your build contract. If you are happy that the works have been completed satisfactorily, the bank will make payment to your builder.

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 50 - 80% on bare land (depending on the bank). If you do intend to build within 12 months, you can borrow up to 80% on the land and possibly up to 90% if you have a build contract in place.

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.



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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

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.