

Financing Options for Your Remodeling Project

You are going to do it! You're committed to the grand project you have been dreaming of. You know what you want to do and have the right general contractor to do it. However, the question in today's economy is "where or even can I get the money to finance it?"

The financing landscape has changed so dramatically in the last 2-3 years (and is still changing) it is imperative to be aware of the different options available to the homeowner. With home values declining, low appraisals and banks tightening guidelines and eliminating construction lending programs, not being able to obtain the proper financing will quickly dash any hope of completing that dream project.

Traditionally homeowners have financed their remodel/renovation projects borrowing against the equity they currently have in their homes; either with a Home Equity Lines of Credit (HELOC) or taking out cash by refinancing their existing mortgage. This scenario works fine where the cost of their intended project is less than the equity they are able to "tap into."

Here is where today's market makes this so much more challenging. Not only have home values gone down in most areas, but lenders have tightened their lending qualifications. The days of being able to get a HELOC up to 100% of your home's appraised value are long gone. Most banks these days won't go beyond the 70% – 80%. This coupled with lower appraised values seriously limit borrowers' ability to obtain the funds needed for their remodeling project. If you don't have enough equity in your home you are going to have to come up with the balance of funds "out of pocket." Simply, you are limited to what your home is going to appraise for today!

There is another option that is being used more and more as people become aware of it. The Construction-to-Permanent Mortgage (CP) is a mortgage product offered by a few lenders that combine a traditional construction loan with a traditional mortgage; a mortgage with a construction "kicker." The homeowner is approved for a new mortgage based on the COMPLETED value of the construction project. The appraisal will be done using the construction contract, specifications and blueprints of the project proposed. The mortgage rate is determined, locked and the CP is closed before the project even starts. At the closing, the borrowers' existing mortgage is paid off; the contractor is then paid for his work during the construction phase through payouts or "draws," providing waivers of lien for any work completed. During construction the borrower owes interest only payments on the monies that have been paid out, not the entire mortgage amount. When the project is complete the borrowers now start their regular principal and interest mortgage payment. There is no need for a second closing or modification; the mortgage is already closed. The main benefit with this program is the ability to base financing on the completed value of the project, not what the home is currently worth.

Scenario:

Present Value of Home (PV)	\$400,000	Existing Mortgage	\$200,000
		\$200,000 Proposed Remodel Project	

Option 1: HELOC or Cash Out Refinance

PV	\$400,000
LTV	80%
New mortgage	\$320,000
Less: payoff	(200,000)
	\$120,000 Funds available for project

Option 2: Construction-to-Perm Mortgage

PV	\$400,000	Existing mortgage	\$200,000
Construction	<u>200,000</u>	Construction	<u>200,000</u>
Completed value	\$600,000	New mortgage	\$400,000

\$200,000 Funds available for project

Being able to base your financing needs on your completed or future value allows you to finance the entire project. You may be able to do a larger project since you aren't limited to what your current equity position is.

There is no one way best for financing your dream project, everyone's scenario is different. But as you can see, being aware of the different financing tools and options available can help determine not only where your funds will come from but the size and scope of your project as well.

John Forssander
Sr. Loan Officer / Construction Specialist
U.S. Bank
(847) 610-0138
john.forssander@usbank.com