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New Construction Considerations

Even as bountiful as home inventory has been in most of the country, you can still be stuck not finding the right home to buy. In that case, you may want to build your home. This can be great for customizing your house to your tastes and lifestyle, but it's different than buying an existing home. Here's what you need to know.

The Loan is Different

Home construction loans are short-term, higher-interest loans that provide the funds for you to build your home. Construction loans typically have an end date, usually a year, and during that time, the property must be built and the certificate of occupancy issued. These loans have variable rates that move up and down with the prime rate.

You will need to provide your lender with a construction timeline, detailed plans and a realistic budget. Once you're approved, you'll be put on a draw schedule that follows the project's construction stages. During this time, you'll be expected to make interest-only payments. The lender will pay out money as the construction progresses. Borrowers are typically only obligated to make interest payments on funds drawn to date until the construction is completed.

An appraiser or inspector will check the house periodically to make sure additional draws can be made. You should expect about four to six inspections during the construction of your home.

When the home is finished, you may have the option to convert the construction loan to a traditional mortgage (a construction-to-permanent loan) or to get a separate mortgage to pay off the construction loan.

What Construction Loans Cover

Construction loans typically cover the cost of the land for your home, contractor labor, building materials, permits, appliances and landscaping. Home furnishings are not included. You should also make sure your construction loan includes a contingency reserve to cover unexpected costs that arise during construction. This can also serve as a cushion for upgrades once constructions begins.

Also talk to your contractor and lender about what happens if your project faces significant timeline issues due to supply chain difficulties, weather or other delays. Your lender may also require a prepaid homeowners policy that includes builder's risk coverage to cover things that can happen during construction, such as a fire or vandalism.

Your lender may also not allow you to act as the builder. Building a home is a complex process on many levels, and they'll want full confidence that it's done correctly. No matter what your background and experience are, they are likely to want a separate builder on the project.