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Luminate

Home Loans



Renovation Mortgages

Understanding what a renovation mortgage is, the options, and the process



What is a Renovation Loan?

Simply, a renovation loan is a mortgage, just like any other mortgage, but one that includes additional funds to do renovations to a home. It can be used for either purchasing a home or refinancing a home. The loan would close on the property in its current condition, the renovation funds are placed in escrow (like a savings account), work begins immediately after closing, and the money is paid out of escrow as the work is completed. It is a one-time close transaction, so once renovations are completed, there is nothing else you need to do. You just make your regular monthly mortgage payments like any other mortgage.

Why would I want or need a Renovation Loan?

There are many reasons a Renovation Loan can be used. The main reason is where a regular type of mortgage is based on the current condition and value of the property, a Renovation Loan is based on the future value and future condition of the property. In a Renovation Loan transaction, an appraiser will review bids from a contractor for proposed work to be done to the home and base the value and condition of the home on the assumption of that work being completed.

Here are some common reasons that a Renovation Loan is needed or wanted:

- Property in its current condition won't pass appraisal standards (distressed properties)
- Outdated property needs/wants to be updated
- Saving your cash/savings and using the future equity in the property to finance renovations

Are these "Exotic" loans?

No. The Renovation Loans are programs that are backed by Fannie Mae (conventional) and FHA (government). Terms of the loan are generally set up as 30 or 15 Year Fixed rates. On average, interest rates will be 0.25% - 0.375% higher than a regular mortgage. Certain factors, such as credit score, loan size, and location may cause adjustments (for any type of loan).

What limitations are there for renovations that can be done?

More details will be provided in succeeding sections, but in a general sense, the main two limitations are that the renovations have to be permanent fixtures to the home (no furnishings) and that the future appraised value must support the proposed renovations.

FHA 203 (K)

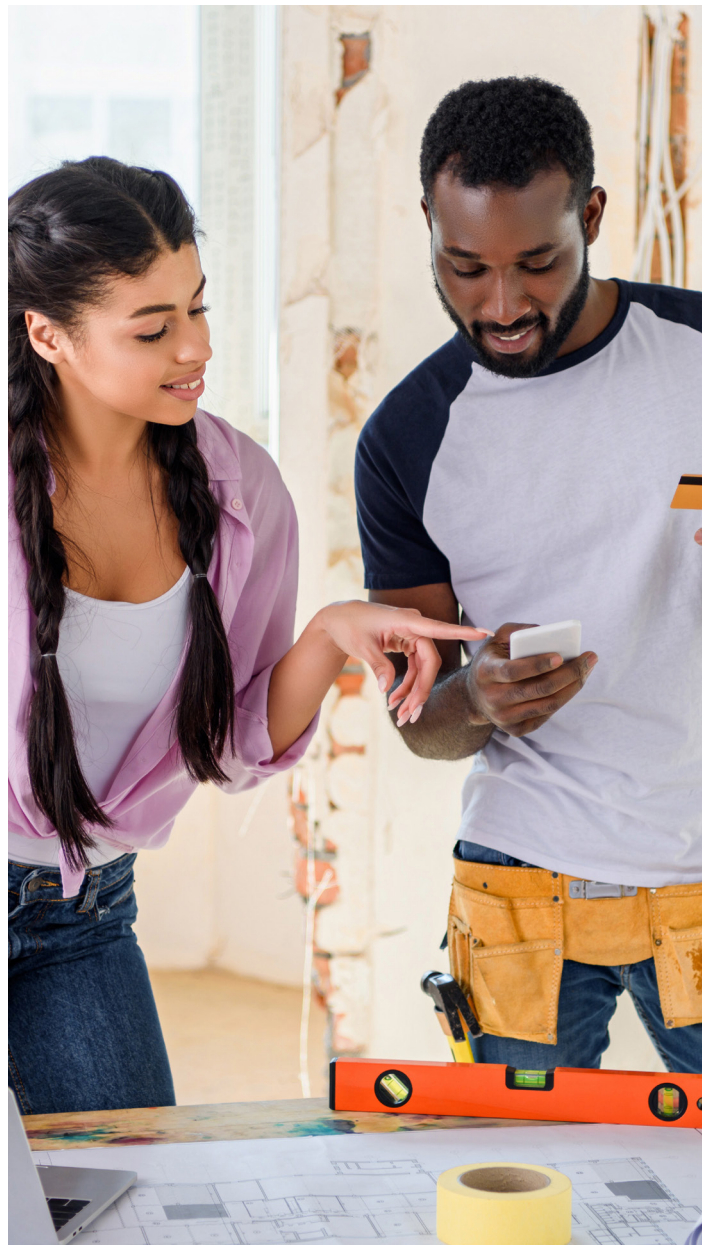
- Government insured loan
- Loan limits to FHA's limit of \$294,515 (select counties have higher limits)
- No limit to amount of renovation costs (minimum of \$5,000)
- Cosmetic and structural repairs allow. No luxury items
- Owner-occupied transactions only. 1-4 unit properties
- 3.5% down payment

FHA 203 (K) Limited/Streamline

- Same as above but cosmetic repairs only
- Limited to renovation costs at \$35,000 (approximately \$30,000 in renovation bid)

HOMESTYLE (FANNIE MAE)

- Conventional loan
- Conforming limits to \$453,100 (select counties have higher limits)
- Renovation costs limited to 50% of as-completed-value
- Cosmetic/structural AND luxury items allowed
- Owner-occupied/2nd homes/Multi Unit and Investors allowed
- 5% down for owner-occupied 1 unit/10% for 2nd home/15%-25% for investors





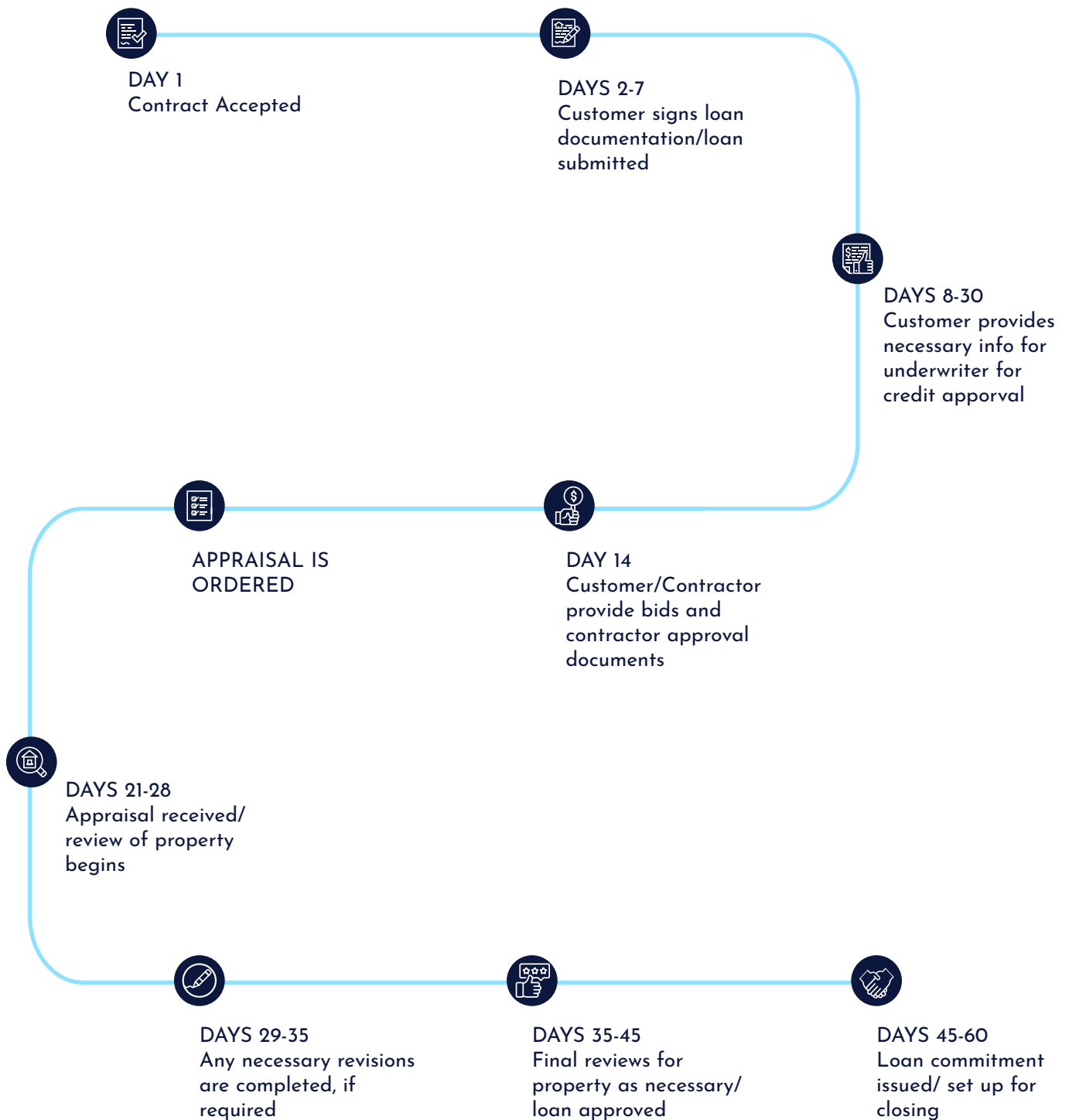
What Renos Are Allowed?

The types of renovations that can be done vary between the program selected, but in a general sense, any type of cosmetic or structural renovation can be included. FHA 203K and 203K Streamline do not allow for luxury items to be included, but the Homestyle does allow luxury items. The bottom line in most cases, is that the renovation can be included if the as-completed value of the home supports it.

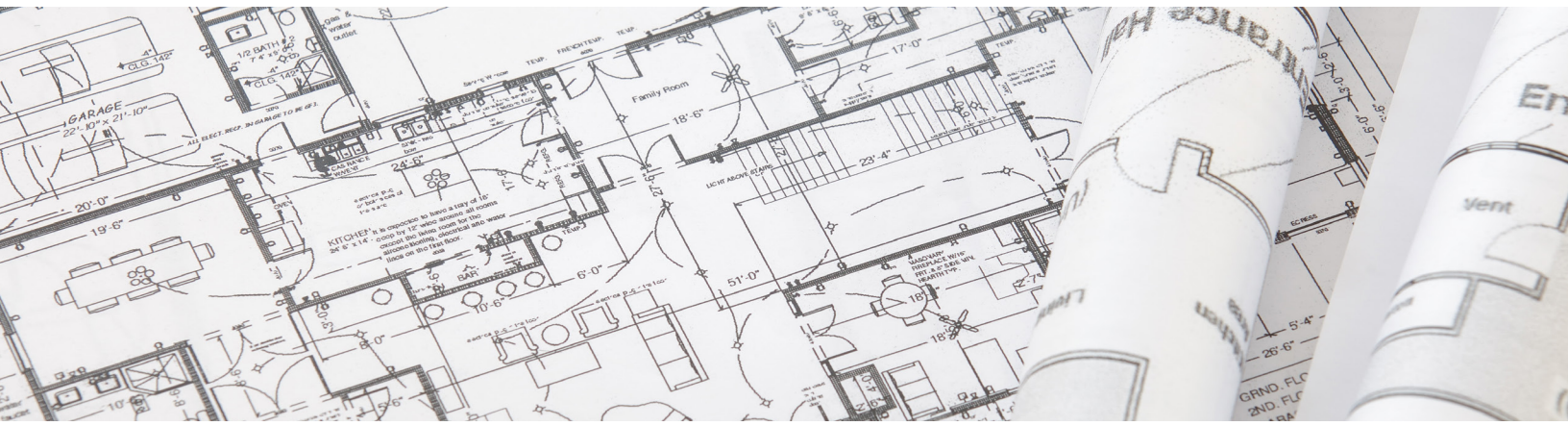
The following list is not all-comprehensive; consult with your renovation specialist for details.

- Remodel a kitchen
- Utility Upgrades - Electric, Plumbing, Gas
- Finish a basement
- Putting on an addition or adding a 2nd story
- Flooring
- Roof repair/replacement
- Painting
- Pools & Hot Tubs
- Decks
- Mold remediation
- Septic and well
- Redesign a floor plan
- Making a home ADA accessible
- Aesthetic Landscaping
- Foundation repair
- Gut rehab
- Historic home preservation/rehab
- Convert a multi-unit property into single family home

Timeline: 60 Day Closing



**any delays to these milestones may be cause to reset closing expectations



The Process

Initial Consultation

It is important in your choice of a lender and loan officer when it comes to pursuing a renovation loan. These loans have particular guidelines and requirements that are crucial to your transaction. Find out how many renovation loan transactions the loan officer has done. An experienced renovation specialist will discuss with you all the different options of loan types, specifics about qualification for you, review the process, and demonstrate a plan of action. A renovation loan is not for everyone, and it's important to be educated to ensure if it's the right fit for you.

Getting Pre-approved

Nothing is worse than getting your hopes up about what your renovated/transformed home could be, and then finding it can't happen. A pre-approval is different than a prequalification. A prequalification is simply you telling a lender how much you make, how much you have in your bank accounts, and a description of debts you owe. The lender will then say, based on what you have told them, you should be able to qualify for \$xxx,xxx amount of a mortgage.

Instead, look to get a rm preapproval. A preapproval is a credit-based decision and review of your actual documentation. You'll complete an application, provide income documents (such as W-2's, pay stubs, bank statements, etc), and the lender will run a credit report. After review of that information, to ensure its accuracy, the lender will run all the information through a decision engine backed by Fannie Mae/Freddie Mac or FHA, and receive actual results that indicate if an approval would be warranted. This type of preapproval substantiates that if an underwriter verifies the information that was entered into the decision engine, and all other circumstances about the property are acceptable, then you would be approved for a loan.

Submitting an Offer (for purchase)

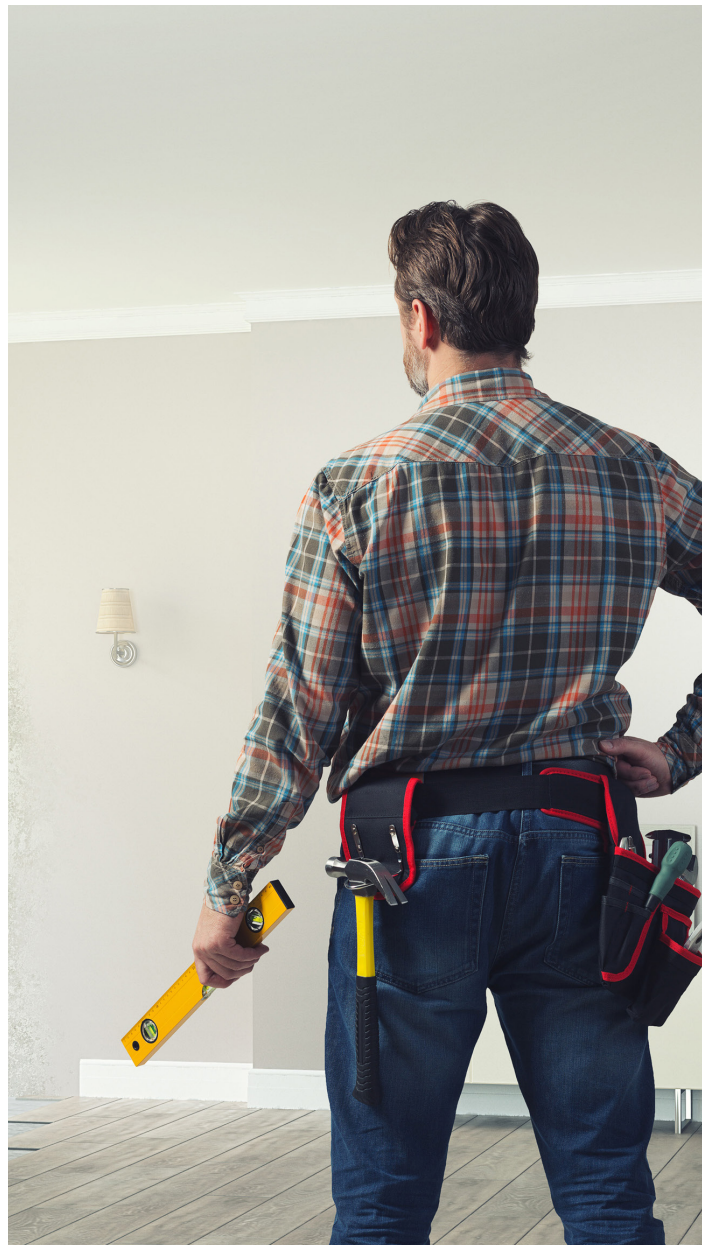
Negotiating a sales price for the property on what you're willing to pay the seller. In your contract, you will indicate to the seller that you are obtaining renovation financing, but will not indicate the estimated amounts of repairs. You may also negotiate with the seller if they will pay for any of your closing costs and prepaid expenses (consult with your realtor and loan officer about this). In your offer, you should request 60 days for closing on a renovation transaction (see the section on Timeline) and discuss with your renovation specialist how that timeline can be affected for shorter or longer times.

Selecting a Contractor

The choice of a contractor is up to you. Some lenders may have preferred contractors or networks, as it is very important for a contractor to understand the renovation loan program, the timelines necessary for a purchase contract, having the proper credentials, and know how they will be paid through the renovation escrow account. It is important that when you choose a contractor, that the contractor is in agreement to the requirements of the loan and lender, that some paperwork about them is required, and that credentials are checked. It can cause issues if you are well into your loan process, only then to find the contractor cannot comply, and putting you in a delayed position to find another contractor. For most programs, it is a requirement to have a General Contractor. The FHA 203K Limited/Streamline may allow a few different contractors, but additional costs may apply. It is strongly urged even with the FHA 203K Streamline that a General Contractor is used.

Tips for Selection

- Timeliness for returning bids and approval documentation
- Appraisal cannot be ordered until bids have been received
- License requirements (where required by state, city/county based on subject property location)
- Registered company in good standing with the Secretary of State
- General liability insurance (and workman's comp if employees)
- If FHA 203(K) - No family/relationship allowed, it is okay for HomeStyle
- Customer must choose their own contractor, customer to do their due diligence in selection





The Process

Third Party Inspector

- Is required on all transactions except FHA 203(k) Limited/Streamline or HomeStyle when cosmetic repairs only.
- Is typically a HUD consultant
- Identifies upfront any necessary repairs for the home to meet standards
- Reviews initial bid and works with contractor to develop a work write-up
- Post-Closing: Will perform draw inspections to certify work has been done
- Authorizes payment from renovation escrow

Lenders and the investors that back these loans are assuming some additional risk in the transaction in that they are making and insuring a loan that is based on work that has not yet been completed and won't be completed until after the loan has closed. To protect their interest in doing the loan, it can be a requirement, depending on the type of work and loan product being used, that a third party inspector provide oversight and authorization of the release of escrowed renovation funds. Typically, renovation projects that are cosmetic work only and less than \$35,000 in total costs do not require a third party inspector, but may vary depending on lender.

For most larger projects, or those that involve structural work, a third party inspector will be required. They will perform an inspection early in the process to help identify any necessary work that would be required to be completed. They will then work with you and your contractor in developing an itemized report that categorizes the work that will be completed (both needs and wants). Once everyone (you, the contractor, and consultant) is in agreement, the detailed Work Write Up (WWU) will be signed and forwarded to the lender, so that the appraisal can be ordered. The appraiser will use the WWU to indicate what the home's condition and value will be, based on the assumption of that work being completed.

Post-closing, during the renovation phase. The third party inspector will inspect the work completed by the contractor when a draw is requested. He will certify to what percentage each category of work has been done, and authorize a draw payment be made for that portion of work.

There are fees for this service. An upfront fee, ranging from \$400-\$1100 on average (dependent upon the size of the renovation project), is collected at the time of their initial inspection. Fees for each draw inspection will be incurred (on average between \$200-\$300 per draw inspection, depending on distance). The draw inspection fees are allowed to be financed into your loan.

The Process

Closing & Renovations

You've cleared all your conditions with underwriting, the appraisal has been completed and the value supports your renovations, and the contractor has been approved. This will take us to our closing. Usually taking place at a title company, you will sign all your mortgage paperwork and title paperwork, and the loan will go into effect (in the case of a refinance, you will have a three day right of rescission before it goes into effect). Ownership of the home transfers to you!

With closing, the renovation loan proceeds are provided to the title company. They will disburse those funds to pay the seller, and will send the renovation funds out to be set up into an escrow account (Renovation Escrow). The process may take between a week to thirty (30) days for the renovation escrow account to be fully set up and ready to draw from.

Anytime after your closing, preferably immediately, your contractor may begin the renovations. If your loan is a FHA 203K Limited/Streamline, there will be two payouts from your renovation escrow. A payment up to 50% of the bid amount will be paid out, usually at closing. The contractor would then complete all the work, and once finished, a final inspection is ordered (usually completed by the appraiser) to certify work is all done, and the remaining 50% is paid out. All checks issued are paid out as a two-party check made payable to you and the contractor. The check is mailed to you, to endorse and provide to the contractor.

For all other renovation loan projects (FHA 203K, Homestyle), there is no upfront money for the contractor. The contractor will begin work, and once he has completed a portion, he may request a draw. The third party inspector will come out to certify what has been completed, and will authorize a draw for that portion of work. The check is sent to you, and the contractor then begins his next portion of work. It will continue in that cycle until all work has been completed. Important to note for the contractor, that each draw payment will have a 10% holdback. This is to help ensure timeliness for completion of the work, and is standard in the industry. All holdbacks are paid on the final draw once all work is completed and the final inspection performed.

Once your renovations are complete, an analysis of your renovation escrow account will be done, and any remaining funds in the account will be applied to the principal balance of your mortgage. You will have regular monthly mortgage payments, like any other mortgage, and you just continue making those. There is nothing else you need to do but enjoy your home.



FAQs

Can I do work myself?

Simply, no. Even if you work in that trade.

Can I act as my own general contractor and hire a sub-contractor?

No. The exception is the FHA 203(k) Streamline. You may choose up to 3-4 subcontractors, but each one will require separate approval, and additional costs for escrow disbursement may apply. It is strongly recommended to utilize a general.

How long do I have to complete renovations?

6 months from the date of closing. Larger renovation projects, in excess of \$50,000 may be granted additional time to 9 months, prior approval required.

Can I finance payments if I can't move in right away?

Yes. If the home will not be habitable to move in within 30 days, you can finance up to 6 months PITI payments into your renovation account. The number of months will be determined by approval of the 3rd party inspector. Subject to value of as-completed home supporting increase to loan amount. Not allowed on FHA 203(k) Streamline.

How do I find a contractor?

Some guidance can be provided, but the choice of a contractor is ultimately up to you. Do your due diligence: word of mouth referrals, contact your local Homebuilder's Associations (HBA), check the BBB, ask for references, ensure they are licensed/registered as necessary, ask if they have worked with these programs before. Any guidance by the lender provided are for contractors that are familiar with this loan process and that have received positive feedback from previous customers.

What happens if additional expenses for more work happen?

For the cost of overruns, or if the contractor comes across unforeseen items that need repaired, a contingency is recommended, and generally required. 10% of the renovation amount is usually a minimum, but by customer request, can be increased.



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