

A stack of light-colored wooden Jenga blocks is positioned in the upper right quadrant of the image. The blocks are stacked in a slightly irregular manner, with some blocks protruding from the sides, creating a sense of depth and balance. The background is a dark blue gradient with subtle, wavy lines.

10 Ways To Reduce Risk In Construction Loans

Unlike most real estate backed loans, construction and renovation loans carry other inherent risks that require constant oversight. At the end of the day, as a lender you want every project completed on time, on budget, and without any misappropriation of funds—which can be easier said than done. Here are some smart ways you can proactively manage risk and avoid surprises.



Pre-Closing Builder and Budget Due Diligence

The best risk management begins long before a project ever starts. No different than making good credit underwriting decisions, smart lenders know that a lot of risk can be mitigated by simple pre-closing due diligence on the builder/contractor and a thorough cost review of the project budget to validate feasibility. Adopt best practices and verify the builder/contractor's financial stability along with their track record before accepting them as eligible to work with. Equally important is to ensure the builder/contractor has the proper licenses, certifications, and insurance for the project - we also recommend calling trade references to ensure they are current on all their bills.

2

Order Regular Draw Inspections

Once construction has begun you should be ordering inspections to validate that all work items and materials included in a draw request are, in fact, in place. These progress inspections also help in determining the appropriate release of funds. Inspections are designed to reduce risk and give you peace of mind that every dollar you lend out is going directly into your collateral. If no draws are requested, it still might be worth ordering an inspection to have a pulse on whether the project is pushing forward.





3

Pay Extra Attention To Inactive Loans

(Run Stale Loans Report)

As we all know, it's extremely important to ensure all projects make it to completion. Once a project starts, as a lender you want it pushing forward on schedule. A project stalling can be an early indicator that something has gone wrong, and having a pulse on this can help you avoid expensive surprises.

With technology, you can now run reports on your construction portfolio looking for any loans with no draw or inspection activity over a set period of time (i.e. 60 days). It is likely well worth your time to pick up the phone and check in on the status of any stale projects.

4

Avoid Overfunding Loans

As a lender you want every dollar to go directly into your collateral, so it's important to be aware of any draw requests for a greater amount than the most recent draw inspection actually released (when loans are being managed on spreadsheets, it's easy for overfunding events to slip through the cracks). However, that's not to say there may not be a reason for a request to be greater than work completed. For instance, a builder having to put a deposit down for cabinets that an inspector would not be aware of. With technology, you can automate overfunding alerts as draws are requested by comparing the request against the inspected progress in real-time. With a proactive alert, you can dive deeper into the request or escalate it up the chain for an approved exception.



Be Aware Of Maturity Milestones

It's estimated that only 5% of construction projects finish on time, so having a pulse on loan maturity and project completion is extremely important - especially for newer builders/contractors. If a loan is approaching maturity and the project isn't at the appropriate completion milestone, you want to know as early as possible so you can remedy the situation. If a project is complete, but the property hasn't sold, you should reach out to the builder/contractor to create a plan as their loan approaches maturity.





Appropriate Insurance Coverage Verification

Construction loans are short-term, high-risk, and often high-margin. To help mitigate the construction risk, you should be following strict procedures to ensure active builders have the appropriate documents and insurance policies involved with every construction project. If a project does not have the proper insurance coverage you are exposing yourself to unnecessary exposure. With technology, you can automate manual processes currently used to capture and track documents and insurance policies by creating notifications, making you aware in real-time if there is a lapse in coverage or when a critical document is missing. It's easy for things to fall through the cracks when you're trying to track manually and push draw requests forward in a timely manner, but this should not be overlooked.



7

Stay In First Position With Lien Waivers and Releases

Depending on the state(s) your lending in, you may have more stringent statutory mechanic's lien laws to navigate that impact the draw process. If that's the case, you want to maintain first position by collecting the appropriate lien releases and potentially getting a title date down endorsement with every draw. Most lenders put the onus on the builder/contractor to collect the appropriate documentation from their subs and vendors before disbursing funds. Collecting lien releases can be made easier if you provide an easy way for the builder/contractor to upload lien releases when they request draws.



8

Make Project Budgets Transparent and Flexible

Historically lenders have tracked construction budgets and inspection progress on spreadsheets because there hasn't been a better way. As a result, there's very little standardization or transparency to where things sit across all key stakeholders. With advancements in construction loan management technology, there are now ways to dramatically simplify the management of construction budgets from a central web-based hub. This makes all parties aware of project completion in real-time and simplifies things like change orders, tracking retainage, or drawing from contingency.



Follow Your Policies & Procedures and Document Exceptions

Examiners and auditors want to know that you have policies and procedures for oversight in place, but more importantly, that you are actually following them. Some examiners will ask to be shown any loans with exceptions as a quick test to see how closely a lender is managing to their policies and procedures. Implementing an internal system for fast escalation of any irregular issues can be a great way to easily document exceptions. For example, if a draw request comes in for more than what is actually available, you might automate an escalation to a more senior manager for their review and approval. With technology, you can set automatic triggers based on the type of exception that map directly to the appropriate elevated user.



10

Business Intelligence

Having a pulse on your construction portfolio means measuring what's happening so that you can effectively manage and improve. In the past that meant man hours, paper files, emails and spreadsheets. Today, you can proactively control risk with a clear understanding of your portfolio exposure and the status of all active construction projects in real-time. Using an online, web-based tool will simplify this process and provide full transparency ensuring every project is completed on time, on budget, and without any misappropriation of funds.

Visit getbuilt.com to schedule a demonstration.



Changing the way the world gets built.
BUILT TECHNOLOGIES, INC.

getbuilt.com • 800-655-8138 • info@getbuilt.com