



Land loans not like home loans

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Land is a finite commodity, especially in the Chicago area. If you are determined to buy a site on which to build your custom house, be ready for a search that could last months.

To be ready to pounce on a property when it becomes available, buyers must first search out their financing options. Loans strictly for land purchase can be as scarce as good residential lots. But there are other available financing methods for buying lots to immediately build on.

While many lending firms around the nation compete to provide mortgages for the purchase of a house on a lot, only local institutions typically will be interested in lending for an empty lot. "In general, the farther it is from the bank, the less they know about the land and the less willing they will be to lend," says Thomas Kelly, a spokesman for Bank One, Chicago. "If you came into a bank in Chicago and ask for a loan for a lot in Idaho, they just wouldn't know enough about it [to lend]."

Lenders consider it riskier to lend on raw land than on a lot with a house on it, which the borrower will be living in and tending day to day. Proximity to property boosts lenders' comfort level because they are often familiar with local land values. But land loans carry higher interest rates and bigger down payments than conventional mortgage loans, to reflect the increased risk. At Bank One, for example, land loans have a maximum 10-year term and interest rates range roughly about 3 to 5 percentage points more than mortgage rates.

Lenders' concerns about increased risk are justified, says John Bates, a real estate broker with Coldwell Banker, Naperville. "Sometimes, for instance, the soil on a particular lot might not be appropriate for building," says Bates.

However, it's only buyers who plan on holding land for months or years before building who need a specialized land loan. If buyers have immediate plans to build a house, lenders say funding is easier to find and rates are more comparable to conventional mortgages.

In a typical arrangement, a buyer makes a down payment to buy the lot, getting a loan for the remainder of the price. Then, he or she is extended a line of credit up to a certain limit, which is then drawn upon to pay construction bills as the new house is built. When the house is complete, the land loan and construction line are wrapped into one new mortgage.

An old rule of thumb dictated that the price of the lot was 20 percent of the total project, explains Joseph Perri, senior vice president of North Federal Savings Bank, Chicago. "You used to contribute the lot as your down payment on the entire project, and then the lender would give you money for the construction," Perri says.

Now, the scarcity of land in many neighborhoods has forced prices up to as much as 50 percent of a total project, experts say. To ensure that they're not lending on a value that's more than a finished house could sell for, lenders expect buyers to present detailed plans for the house they plan to build.

Another complicating factor in the Chicago area is that many lots bought to build on contain houses that must be torn down. "You have to consider what the costs for tearing down are going to be," adds Howard Ackerman, director of mortgage sales for Harris Trust & Savings Bank, Chicago.

Building firms are often intimately involved in helping buyers select an appropriate site to accommodate a particular house design, says Christine Spencer, owner of Vintage Estates, a Glen Ellyn building firm. The builder is also involved in issues such as soil testing and zoning that lenders must have cleared, Spencer says.

In some cases, Spencer adds, a building firm will buy a lot and fund the construction of a house for a buyer. In these instances, builders ask that buyers be pre-approved for the mortgage they'll need to purchase the completed house.

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