

# SAN LUIS TRUST BANK

## CONSTRUCTION DRAW PROCESS

When a construction loan is obtained from the Bank, the Bank must closely monitor the funds being disbursed on the loan. To do this a cost breakdown is utilized to track the progress of the project. The only costs listed on the cost-breakdown not included in either the soft or hard costs would be the interest reserve and the contingency. All hard costs are advanced after they have been inspected for, and all soft costs must be faxed to the bank for advances to be made. A typical sequence of events for a draw is as follows:

1. **The REQUEST.** The Draw request can be made by any one of the following methods:
  - A phone call from the Borrower or Contractor.
  - A fax from either of the above, outlining various cost-items.
  - A check clearing the account, bringing the construction checking account negative. This is caused by the borrower writing a check prior to requesting a draw. If this occurs, the borrower will be assessed a NSF fee of \$12.00. The Bank will discourage this practice.
2. **The INSPECTION.** A Bank employee goes to the construction site and takes photos of the work completed. An advance can be made prior to the inspection, if the draw request is under the loan's current "Over/Under" amount. For example, if the previous inspection indicated that the Borrower was \$20,000 under budget, and the Borrower then asked for a \$10,000 draw, the Bank could make the advance, knowing that the project was still at least \$10,000 under budget. This is why the Bank will closely follow the current loan-to-value (LTV), and monitor the progress of the project.
3. **The ANALYSIS.** After the inspection, the cost-breakdown and the current loan history are analyzed.
4. **The ADVANCE.** The Bank will only advance funds for work that has been completed. The disbursement of funds must match the cost-breakdown sheet, and funds will only be released when prior prelim notices have been signed off. The actual funds advanced can be broken out in several different ways. These include the following:
  - **Entire Draws.** Let's assume that draw one is for \$40,000, with grading for \$10,000, the lumber drop for \$15,000 and the concrete slab for \$15,000. The Borrower could wait until the slab is complete and the first lumber drop is on site before making a \$40,000 draw request.
  - **Partial Draws.** Under the above scenario, the Borrower could ask for a \$10,000 advance for the grading. This would result in 20 to 30 draws over the life of the loan, but the Bank is willing to give the contractor and Borrower as much flexibility as possible.
  - **Pre-Draws.** Any cost breakdown item that requires a deposit can receive an advance for that amount, as long as the deposit invoice is faxed to the Bank.
5. **COST OVERRUNS.** If there is a cost overrun, the Bank can process the difference two ways. First, the extra amount can be allocated to the contingency. That way, the cost-breakdown items will always be at or below the original projections. The second method is to input the actual costs next to the projection, with any overage being applied to the contingency. The only difference between the two methods is the timing for the reduction of the contingency. The reverse occurs with any cost shortage. The Bank does

require confirmation of who is responsible for cost overruns. If the General Contractor is the builder, then the contractor is responsible. If the Borrower has a hired contractor, then the Construction Contract must specify who will take responsibility for any overages, for all situations.

6. **MODIFICATION.** If the overages are significant, the Borrowers will have to come in with additional cash or modify the loan. However, in order to modify the loan, a new appraisal must be obtained, and the resulting loan to value must be sufficient to secure the new loan amount. The Bank will also modify, or extend the loan if construction is behind schedule. However, the extension will generally cost ½ point plus documentation fees for a three-month extension.
7. **ADDITIONAL FUNDS/COLLATERAL.** If, after several draws the overages are becoming a problem, the borrower must pay for these overages out of pocket, or the loan must be modified. The modification would only occur if there is sufficient equity, or when another property is used as cross collateral.
8. **DISBURSEMENT ACCESS.** The advanced funds are transferred from the loan to the attached checking account. From there, the Borrower writes the necessary checks to either the general contractor or directly to the various sub-contractors. For control purposes, the contractor should not have direct access to the disbursed funds. The cash should flow from the Bank to the Borrower then to the contractor.

Bottom line in the entire construction process is at no time can the disbursed amount be greater than the actual work completed. All construction draws are for work that has been finished. The only exception would be to pre-purchase certain items, such as the windows or bathtub. The Bank will work with the borrowers and have flexibility in disbursing the funds.

The current draw system should be appropriate for both residential and simple commercial buildings. Since the 5-draw system is often the 25-draw system, it should translate smoothly over for commercial loans.

I have read the above Draw Process and understand I must comply with its contents.

X  
Borrower

X  
Borrower