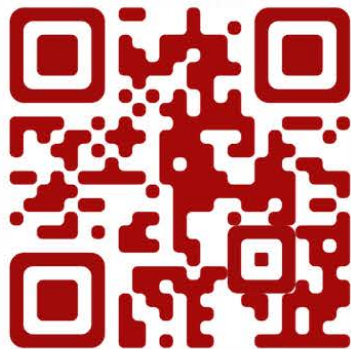


RED OAK

MORTGAGE, INC

Construction & Renovation Lending

A GUIDE TO UNDERSTANDING YOUR LOAN



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INTRODUCTION

The purpose of this *Construction & Renovation Lending* guide (the “Guide”) is to provide you with information about construction and renovation lending along with the construction and renovation products offered by Red Oak Mortgage Inc., contractor and project approval requirements, and information about how to obtain draws to pay for construction or renovation costs. Should you have questions that are not answered by this Guide, please direct them to your loan originator who will be more than happy to assist you.

Building or renovating a home can be a daunting challenge, but for those who have successfully completed a project they’ll tell you the results can be incredibly rewarding. This Guide will take you step-by-step through the process from choosing a contractor to moving into your new or newly renovated home. Our goal is to make the financing process as smooth and straightforward as possible.

CONSTRUCTION LENDING

Construction lending consists of providing financing for the construction of a new residential structure on property either already owned by the borrower or purchased concurrently with the loan closing.

Construction lending takes two primary forms: one closing or two closings.

One Closing

A one-closing construction loan combines the construction financing into the same loan as the permanent mortgage financing. There is a single closing transaction before construction begins where a single set of fees and closing costs are collected from the borrower. During construction, borrowers pay a monthly interest payment based on the amount of construction funds used to-date (construction funds are accessed through “draws” that will be explained later in this Guide) along with an escrow payment for real estate taxes and insurance, if required. Once construction is complete, the loan will convert to the permanent phase and the borrower will begin making a traditional principal and interest payment to include an escrow payment for taxes and insurance, if required.

RENOVATION LENDING

Renovation lending consists of providing financing for the purchase or refinancing of an existing residential structure along with funds for renovation, rehabilitation, repairs, remodeling or energy improvements to the residence to meet the needs of the borrower or to bring the home up to minimum property standards. This is accomplished with a single closing transaction prior to the start of renovation work and involves a single set of fees and closing costs.

A renovation loan is different from construction financing in that the loan is fully disbursed at closing with renovation funds held in a renovation escrow account. The borrower pays a standard principal and interest payment (plus escrows for real estate taxes, hazard insurance and mortgage insurance, if required) beginning with the first payment.

PRODUCTS OFFERED

CONSTRUCTION PRODUCTS

Red Oak Mortgage Inc, offers the following construction products:

One Closing Products

- Conforming One-Close Construction

Offers construction periods of 9 or 12 months, depending on how long it will take the builder to complete construction. The loan will convert to a full 15- or 30-year term upon completion of construction.

The interest rate is locked prior to closing at the rate that will apply for the permanent phase of the loan, for example 5.00%. During the construction phase the interest rate is 0.75% higher than the permanent interest rate, or 5.75% based on the example above.

During the construction phase you are responsible for payment of the interest accrued on the amount disbursed to-date, billed on a monthly basis. If an escrow account is established for taxes and insurance, the monthly billing will include these deposits.

When your home is nearing completion we will ask that you update your credit profile with current income, assets and credit report.

After the completion of construction the loan converts to the permanent phase and you will begin making traditional principal and interest payments based on the locked interest rate, for example 5.00%, and the selected term of 15- or 30-years. If an escrow account is established for taxes and insurance, the monthly billing will include these deposits.

- Jumbo One-Close Construction

Offers construction periods of 12, 18 or 24 months, depending on the size of the project and how long it will take the builder to complete construction. You may qualify for a longer term than you are approved for. Please consult your loan officer. The loan will convert to a full 15- or 30-year term upon completion of construction.

The interest rate is locked prior to closing at the rate that will apply for the permanent phase of the loan, for example 5.00%.

During the construction phase you are responsible for payment of the interest accrued on the amount disbursed to-date, billed on a monthly basis. If an escrow account is established for taxes and insurance, the monthly billing will include these deposits.

When your home is nearing completion we will ask that you update your credit profile with current income and asset documentation, and an updated credit report and appraisal will be ordered.

After the completion of construction the loan converts to the permanent phase and you will begin making traditional principal and interest payments based on the locked interest rate, for example 5.00%, and the selected term of 15- or 30-years. If an escrow account is established for taxes and insurance, the monthly billing will include these deposits.

RENOVATION PRODUCTS

Red Oak Mortgage offers the following renovation products:

- Fannie Mae HomeStyle Renovation

Offers renovation and permanent financing as part of a standard 15- or 30-year fixed-rate conventional loan with renovation costs allowed up to 75% of the as-completed appraised value of the home. Funds for renovations, repairs, remodeling or energy improvement can be included as part of a new purchase transaction, or with the refinance of the applicant's current mortgage loan. Renovation work must be completed within the first 12 months after closing.

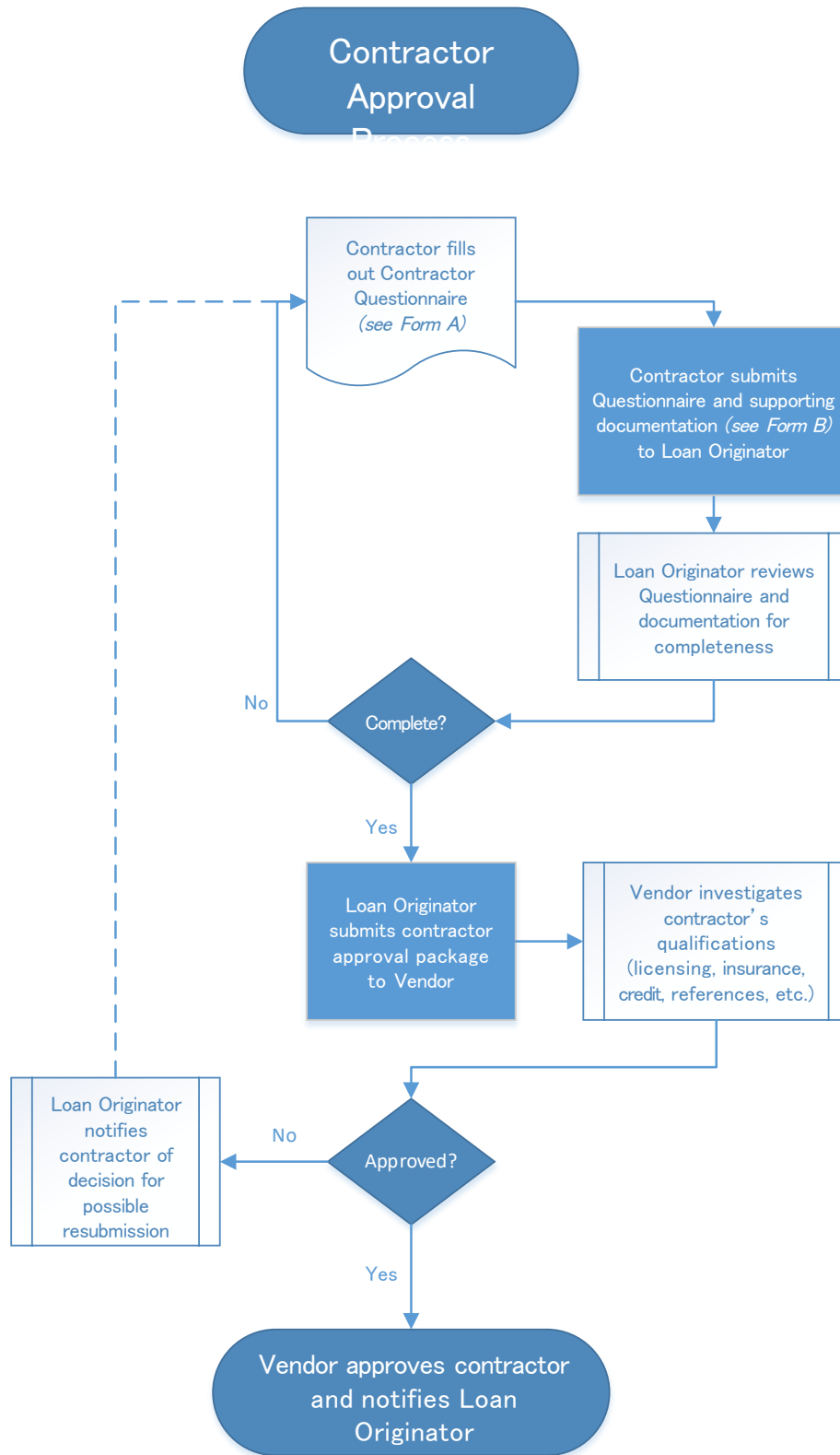
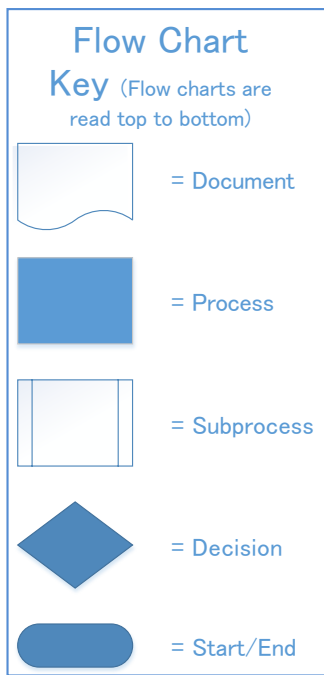
THE LENDING PROCESS

The lending process for your construction or renovation loan application approved involves essentially the following steps:

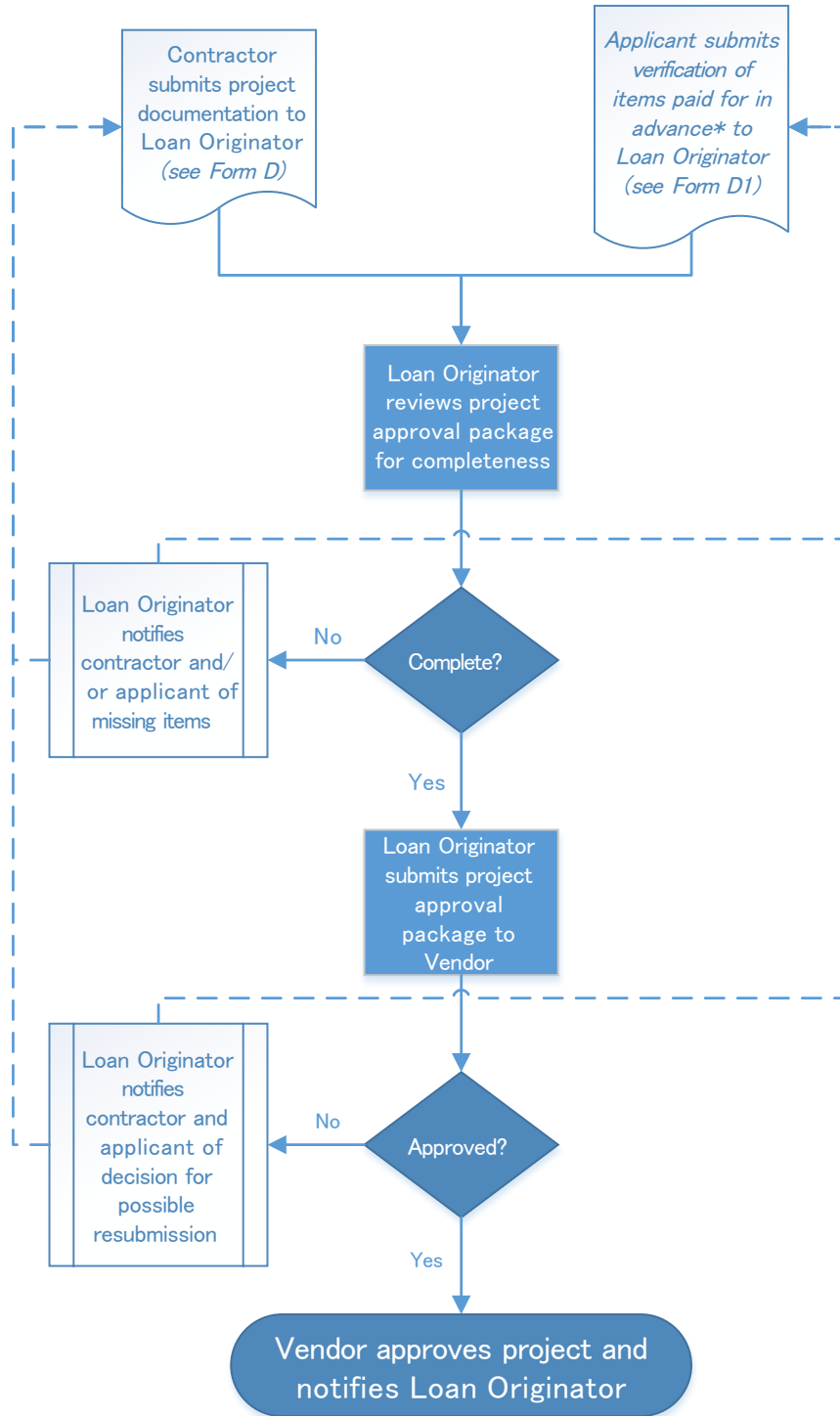
1. Contractor approval
2. Project approval
3. Credit underwriting and loan approval
4. Loan closing
5. Drawing funds during construction/renovation to reimburse the builder for work as it is completed
6. When your home is nearing completion we will ask that you update your credit profile with current income, assets and credit report (One-Close Construction loans only)
7. Completion of construction/renovation (this is the last step for renovation loans)
8. Convert to permanent loan financing (One-Close Construction loans

only) The flow charts on pages 6–9 should help to illustrate the process.

ILLUSTRATED PROCESS FLOWS

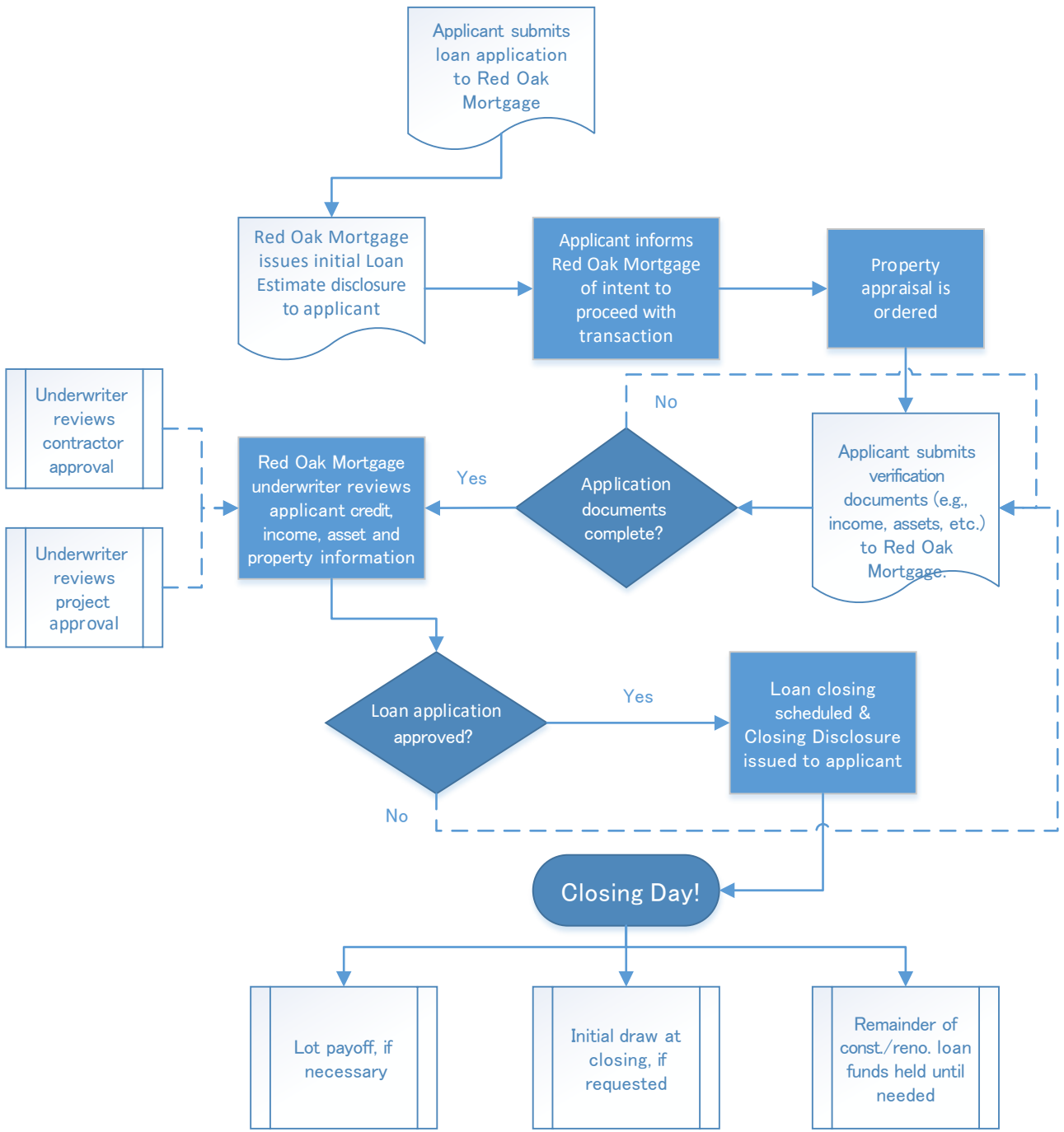


Project Approval Process

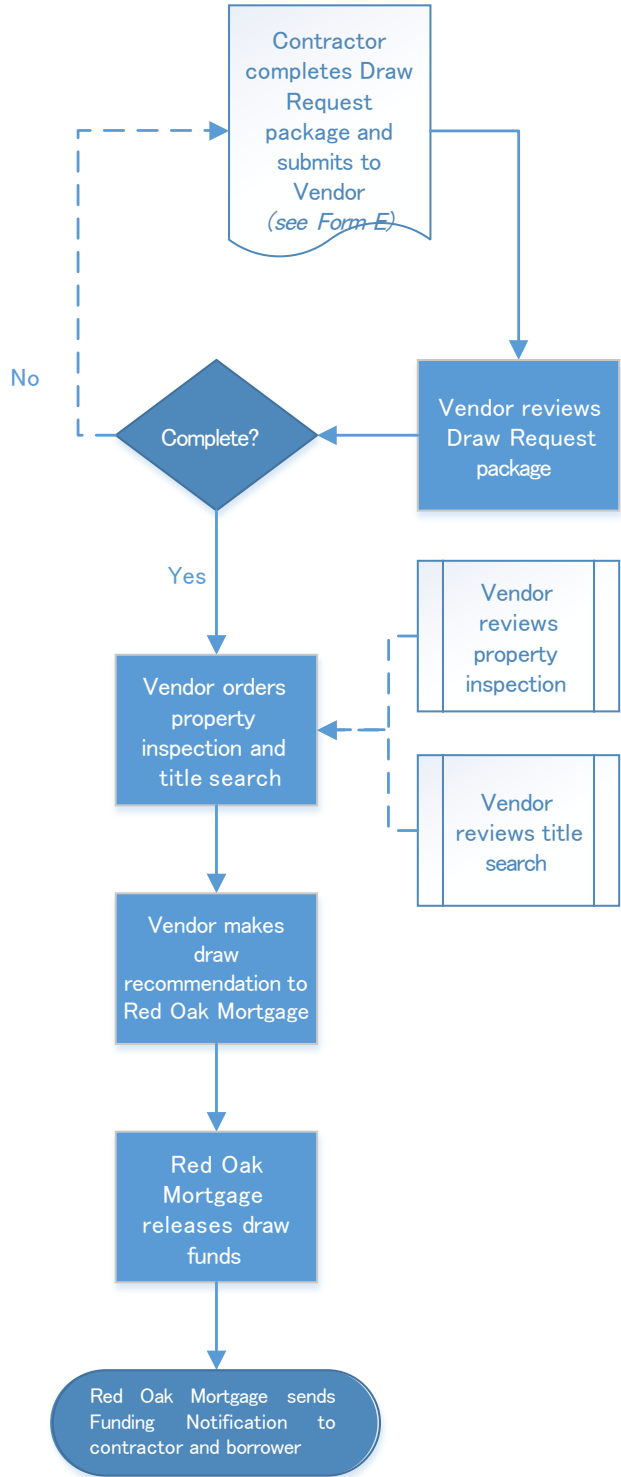


* Verification documentation (invoices, paid receipts, etc.) should be submitted for items that are included as part of the construction contract as well as those items paid for outside of the contract for which the applicant would like to be reimbursed from loan funds.

Loan Approval & Closing Process



Draw Process



CONTRACTOR APPROVAL

We will review a contractor's qualifications by obtaining personal and business credit reports, building history and reference check on all projects. This review is accomplished by requesting the contractor complete the *Contractor Questionnaire* (Form A). Contractors must complete this form in its entirety as missing information will delay the processing of your package. Forward the completed *Contractor Questionnaire*, along with all other required documentation as detailed on the *Contractor Acceptance Checklist* (Form B), to your Loan Originator. Our loan administration Vendor will continuously monitor the contractor's licenses and appropriate insurance information. Should either expire during construction, the Vendor will require a renewal certificate prior to us funding any additional draws.

IMPORTANT

Our approval of a contractor is not an endorsement of that contractor, but rather an acknowledgement at the time of our review they met our standards for participation in our construction/renovation programs in terms of licensing, insurance coverage, timely payments to subcontractors and suppliers, etc. The choice of contractor is solely yours. You should make independent inquiries into their reputation by asking friends and neighbors for recommendations, by asking for and contacting references of past clients, by reviewing a contractor's record with the local Better Business Bureau, etc.

PROJECT APPROVAL

Project approval involves a review of the details of the construction/renovation project to determine if it meets our loan standards and to ensure there are enough funds in the proposed budget to complete the project. In order to complete the project review we require several documents, some of which you may provide but most will come from the contractor or from your loan originator.

DOCUMENTATION REQUIRED FOR PROJECT APPROVAL

The following documents comprise the project review package (see Form D):

From the Applicant

- ¹⁴/₇ Verification of items paid for in advance

Items paid for in advance are costs incurred by the applicant prior to the loan closing for items that either are or are not included as part of the construction contract and budget and for which the applicant has requested reimbursement, meaning that the amounts are requested to be financed into the loan.

Items that ARE included in the construction contract might include deposits for custom or specialty items, while items that ARE NOT part of the construction contract and budget may include architectural costs, permits, and similar items.

For items paid for in advance, please provide the following:

- Complete the *Prepaid Accounting Worksheet* (Form D1).
- Obtain and submit the appropriate support documentation as detailed under *Type of Verification, Prepays Applied to Contract* (Form D1).

From the Loan Originator

- Appraisal

The appraisal must be prepared based on the plans and specifications for the project and the construction contract.

From the Contractor

- Plans and specifications
- Construction contract (fully executed by all parties)
- Memorandum of Understanding with Red Oak Mortgage, Inc.
- Permits (if available)
- Budget (this must be the FINAL budget)

The budget is one of the more important documents in the project approval package. (We provide a Construction Budget (Form C) but the contractor may choose to use his/her own line-item budget.) As construction proceeds, draw requests received are matched to the line item amounts in the budget to ensure each line item is properly accounted for in the disbursement of funds. Therefore, it is critical the contractor submit the final budget for project approval. When requesting a draw the contractor will need to refer to the specific line items from the approved budget in order to be reimbursed for work performed.

IMPORTANT

Once approved, the budget may not be changed without Red Oak Mortgage's written approval. Any changes to the budget without our approval may significantly delay the draw process.

LOAN APPROVAL

After the contractor and project have been approved, or possibly simultaneously, an underwriter will review your loan application, income and asset documentation, credit report, property appraisal, etc., for approval of the loan itself (or both loans, if you are using the two-closing process). Other than the additional information regarding the contractor and construction/renovation project, this process is the same as any other home purchase or refinance credit decision we make. Your loan will be reviewed by an impartial underwriter with an eye toward ensuring the criteria for approval are met of the loan program under which your application was received. Of course, not every loan application will be approved, and sometimes additional documents are requested by the underwriter to aid in their decision making. We realize the anxiety inherent in this part of the approval process and we will make every effort to make a final decision as quickly as possible.

The end result of the loan approval process, we all hope, will be an approval notice outlining the conditions that must be met either prior to or at loan closing.

LOAN CLOSING

Loan closing is the point at which the final loan documents are signed. This appointment often takes place at a title or escrow company, but can also take place elsewhere. You, the loan applicant(s), will attend as will a settlement agent. The settlement agent is the person responsible for ensuring all construction and loan documents, real estate transfer documents and other documents and disclosures are correctly completed and signed, and that any funds being disbursed at closing are appropriately handled. The settlement agent is also responsible for sending certain documents to the county recorder's office for filing in the public land records after the loan closing.

For a construction loan, if you purchased the lot separately and not from the builder as part of the construction transaction, and if you obtained lot financing when you purchased the lot, we will pay off any outstanding amount at closing. The disbursement of funds at closing for this purpose is not considered a draw. There may also be funds disbursed at closing for certain construction costs that will be considered a draw, discussed later in this document.

Title updates are needed for each draw to ensure that no additional liens were filed on the property by anyone who completed work. The fee for the title updates will be based on the number of draws. Title update costs will be included in the Construction Draw Updates fee line. This fee is not refundable.

A final title update fee is included on all construction and renovation loans in order to ensure no additional liens were filed on the property by anyone who completed work. Any unused portion of this fee will be refunded after the construction has been completed. Refer to Exhibit A, Fees, for specific fee information.

DRAW AT CLOSING

A contractor may wish to request a draw at the loan closing to provide funds for initial materials purchases or for special order items that require payment at the time the order is placed (e.g., custom cabinetry). It can also be used to reimburse you for items you paid for in advance or deposits that may have been needed to start the project. A draw at closing is the **only opportunity** to access construction funds for 10 business days following the loan closing. A limit of 10% of the budget or \$50,000 (10% or \$100,000 for Jumbo One-Close), whichever is less, is placed on this draw.

All draws, including a draw at closing, requires the completion of a *Construction Loan Disbursement Request/Authorization* (Form E). This form must list the line items of the budget from which the funds are to be drawn. The request for a draw at closing should be given to the Loan Originator. This is the only draw that should be submitted in this manner. All other draw requests will be submitted directly to the Vendor for your loan.

In most jurisdictions permits must be obtained for the project and certain forms filed with the county or state. Before you can access construction funds, we (or the Vendor if there is no draw at closing requested) will confirm these have been completed by requesting copies of the permits and/or filings as part of the draw-at-closing request documentation.

Disbursement of Draw Funds

When a draw request is approved, funds may be issued by wire directly to the builder or by two party check payable to you and the builder. If the funds will be disbursed to the contractor by wire, you will need to complete the *Amendment to Construction Loan Agreement /Indemnification Agreement* (Form G) authorizing the direct disbursement of funds to the contractor. In addition, the contractor must complete an IRS Form W-9 and a *Bank Account Authorization* (Form F). The W-9 is required for federal tax filing purposes, while the *Bank Account Authorization* provides the necessary authorization for us to wire funds to a specified account.

HOW YOUR DOWN PAYMENT IS APPLIED

Any cash down payment you bring to closing will be used to acquire or pay off the lot, or may be disbursed to the contractor as a draw at closing. Any excess down payment funds not needed at closing, will be held in a Loan in Process Account and disbursed as work is completed. When these funds are depleted the disbursements will be drawn on the principal of the loan. Red Oak Mortgage, Inc. refers to this as a Restricted Escrow. This is an interest bearing account.

CONTRACTOR CHANGES

On a renovation loan, sometimes it becomes necessary to change contractors before the renovation work is completed. Please be aware that Red Oak Mortgage Inc. must be notified *before a new contractor does any work on the project*. The new contractor is subject to approval by us (through our Vendor), and there will be a contractor replacement fee assessed by the Vendor (refer to Exhibit A, *Fees*, for specific fee information). If the new contractor has their own budget the budget is subject to approval by us (through our Vendor), and there will be an additional project review fee assessed by the Vendor (refer to Exhibit A, *Fees*, for specific fee information). Contractor changes on a new construction loan should be required only in exceptionally rare circumstances. If a change to the contractor is needed on a construction project the new contractor is subject to approval by us (through our Vendor), and there will be a contractor replacement fee assessed by the Vendor (refer to Exhibit A, *Fees*, for specific fee information). If the new contractor has their own budget the budget is subject to approval by us (through our Vendor), and there will be an additional project review fee assessed by the Vendor (refer to Exhibit A, *Fees*, for specific fee information). Anytime, you believe a change in contractor is necessary, either on a renovation or new construction project, please reach out to us to discuss the situation at (732)–410–4141 or by email to info@redoakmortgage.com.

END OF CONSTRUCTION/RENOVATION

WHAT HAPPENS WHEN CONSTRUCTION/RENOVATION IS COMPLETED?

At the end of the construction or renovation phase, final draw funds are disbursed and any construction/renovation funds remaining (e.g., unused contingency funds, but not including any unused fees which will be refunded to you) will be applied to the outstanding principal of the loan.

One-closing construction loans will convert to the fully-amortized permanent phase and payments will include both principal and interest (as well as taxes and insurance, if applicable). For two-closing construction loans, the closing of the permanent loan will be scheduled to pay off the construction financing.

Renovation loans will continue with the standard payment amount and schedule, which also applied during the renovation phase.

What Happens if Construction/Renovation is Not Completed on Time?

Extension paperwork will be sent to you 15 days prior to the maturity of the construction/renovation period. You must complete the paperwork and return it to us with the extension fee.

Refer to Exhibit A, *Fees*, for the specific extension fee and the extension time period allowed. No refund is provided if the work is completed sooner. No additional draws will be processed if your loan has exceeded the

pre-determined construction/renovation period until we have received the extension paperwork and appropriate extension fee.

For One-Close Construction loans, when work is finally completed you will be required to sign loan modification documents to change the beginning date of the permanent phase of your loan and the maturity date. The total construction time including extensions must not exceed 15 months unless the term exceeds 15 months on the Construction Addendum to the Note.

For renovation loans, no modification agreement is necessary. The total renovation time including extensions must not exceed 14 months.

What if Construction/Renovation is Completed Early?

If construction/renovation is completed prior to the end of the predetermined construction/renovation phase, the same process will take place as outlined in the paragraph, “What Happens When Construction/Renovation is Completed?” However, for construction loans, you also will be required to sign loan modification documents to change the beginning date of the permanent phase of your loan, and for one-closing construction loans, also the maturity date of the loan.

FOREGOING COMPLETION OF A RENOVATION PROJECT

On occasion, we have experienced situations where a homeowner who has taken out a Fannie Mae HomeStyle Renovation loan with us decides not to have the renovation work completed after all. They ask us to apply the renovation funds to reduce the outstanding balance of the loan and to treat the loan as if it were not a renovation loan.

These are tough situations because we have to explain that is simply not possible; the loan was made with the understanding that renovation work would be completed. A property appraisal was conducted to determine the value of the property on an as-completed basis meaning that the appraiser arrived at their opinion of value by assuming all of the proposed work was already done. If the work is not actually completed then the valuation assigned by the appraiser is no longer valid, and the loan is no longer eligible under the Fannie Mae HomeStyle Renovation program. This is a breach of the terms of the loan, which results in a default under the loan agreement and can result in the initiation of foreclosure action. We know you don't want that to happen, and neither do we. We want to work together with you to ensure the renovation work gets completed in a timely manner.