

Construction to Permanent Loans

April 9, 2025



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Construction Financing Types

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- 1. New Construction**
 - 2. Dual-Close**
 - 3. Single-Close**
- a. The borrower takes out a short-term construction loan that is refinanced into permanent financing when the home is ready to occupy
 - b. The borrower closes on the construction funds prior to construction and the loan converts to permanent financing when the home is ready to occupy
 - c. A builder funds the cost to build the home according to the borrower's selected finishes. The transaction closes when the home is ready to occupy

Dual-Close Transactions

Dual-Close Transactions

MPF Traditional Selling Guide:2.6.3
Fannie Mae Selling Guide: B5-3.1-03
Freddie Mac Selling Guide:

Loan #1: A short-term loan finances the construction (and land acquisition, if applicable) when the home is complete, the loan is refinanced

Loan #2: The permanent financing is structured as a limited cash-out or cash-out refinance*

The lender is responsible for managing disbursements to the contractor/builder, subcontractors, and suppliers

***Cash-out refinances:** borrower must own the lot for at least six months prior to closing the permanent loan.

Manufactured homes are not eligible for cash-out.

Pros of Dual-Close

- Can cover construction overruns (if paid directly to the builder)
- Borrower can be reimbursed for self-financed overruns (cash-out only)
- Construction phase may exceed 18 months

Cons of Dual-Close

- Two closings and two sets of closing fees
- Interest rate uncertainty
- Borrower must requalify when refinancing

Dual-Close Transactions

Can a borrower's permanent loan pay off builder overruns and still be a limited cash out refinance (LCOR)?

Yes. Documented construction cost overruns that occur outside of the interim construction loan can be included in the loan amount **if** the overrun costs are paid directly to the builder at closing

Self-financed cost overruns are permitted on cash-out refinance transactions only

Borrowers can also finance a second mortgage taken out for cost overruns if it was used exclusively to pay for the cost of construction

Single-Close Transactions

Single-Close Transactions

Single-close loans are used for both the construction costs (including land acquisition, if applicable) and the permanent financing

The lender is responsible for managing disbursements to the contractor/builder, subcontractors, and suppliers

The loan documents specify the terms of the permanent financing which allows the loan to automatically convert upon completion of the construction

Pros of Single-Close

- One closing, one set of closing fees
- In some cases, the interest rate for the permanent financing may be established prior to closing
- Requalifying may not be required in all cases

Cons of Single-Close

- Construction phase is limited to a maximum of 18 months
- Cash-out is not permitted

Determining Transaction Types and Loan-to-Value Ratio Calculations

Purchase or Refinance?

It's a purchase when...

- The borrower is not the current owner of the property/lot
- The property/lot will be purchased at the same time the construction loan closes (may or may not be included in the construction financing)

How to calculate the LTV ratio for purchases

Base your LTV on the **lesser of:**

The total cost to build + lot acquisition cost (refer to the contract) **or;**

The “as completed” value from the appraisal

Purchase or Refinance?

It's a refinance when...

- The borrower already owns the property/lot
- Dual-close transactions are always refinances (cash-out refinances are permitted)
- Cash-out refinances are not permitted for single-close construction loans

Use the “as completed**” value from the appraisal to calculate the LTV ratio for refinances**

Construction Phase Management

New Construction Considerations




Only loans that have been converted to permanent financing are eligible for delivery to the MPF Program

- Management of the construction phase may vary
- The following information covers information that is common within the industry and should not be taken as MPF Program requirements

Common Responsibilities

Many lenders have a review process for General Contractors

- Are they financially stable?
- What do former clients say?
- Are they properly insured?



**Do you use a
builder
questionnaire?**

Construction loan management has many responsibilities which may include:

- Arranging for periodic inspections of the property (usually prior to funds being disbursed)
- Disbursing funds-payments to contractors and suppliers
- Collection lien waivers
- Being aware of project timelines and costs



**Many lenders
use construction
escrow services
at a title
company**

Typical Documentation

Processing a construction loan application requires additional documentation

- **Signed contract** with the builder/general contractor (GC) outlining the scope and cost of the project
- **Plans and specifications** for what is being built
- **Sworn Contractor's Statement** itemizing the costs associated with the project
- **Draw Schedule** (accepted by builder/GC)
- **Permits and Insurance**



General Contractor's Sworn Statement

GC's Sworn Statements show the itemized costs

- The statement may be used to create and manage the draw schedule
- The statement should be updated throughout the construction process

Shows amounts due, items paid to date, and balances owed

May reflect retainages (holdbacks) paid at agreed upon completion points

GENERAL CONTRACTOR'S SWORN STATEMENT						
Name, Address, and Telephone Number	Type of Labor and Materials to be Furnished	Amount of Contract (including retainage and credits)	Amount Previously Paid to Date	Amount of Current Request	Accumulative Retainage to Date	Balance Due
	Demolition					\$ 0.00
G and G Services	Excavation	\$ 4,500.00				\$ 4,500.00
G and G Services	Concrete	\$ 5,000.00				\$ 5,000.00
Wellstone Brick and Masonry	Masonry	\$ 12,000.00				\$ 12,000.00
Kennedy Framing and Construction	Carpentry	\$ 45,000.00				\$ 45,000.00
Lumber Supply, Inc.	Rough Material	\$ 20,000.00				\$ 20,000.00
Lumber Supply, Inc.	Finish Material	\$ 20,700.00				\$ 20,700.00
Thompson Drywall	Drywall	\$ 13,000.00				\$ 13,000.00
Parker Building Supply	Insulation	\$ 5,000.00				\$ 5,000.00
Axon Shingle and Siding	Roofing	\$ 7,593.00				\$ 7,593.00
Axon Shingle and Siding	Gutters	\$ 6,800.00				\$ 6,800.00
Perfection Plumbing	Plumbing	\$ 7,400.00				\$ 7,400.00
Perfection Plumbing	Plumbing Fixtures	\$ 8,100.00				\$ 8,100.00
Perfection Plumbing	Water and Sewer	\$ 10,000.00				\$ 10,000.00
Carson Steelworks	Structural Steel	\$ 4,000.00				\$ 4,000.00
T and J Heating and Cooling	HVAC	\$ 18,490.00				\$ 18,490.00

Draw Schedules, Inspections, and Disbursements

Draw schedules should be agreed upon prior to closing the construction loan

- The number of draws may vary due to the scope of the project or other reasons

Inspections typically occur before each draw is made

- Inspections confirm that the work is complete, so the money owed for the work can be released
- If utilizing the appraiser for inspections, be sure to include the inspection fees on the Loan Estimate (LE)

Payments should be paid directly to the sub-contractors and suppliers and should not funnel through the GC

- Lien waivers should be collected to prevent the filing of any mechanic's liens against the property

Single-Close Construction Loans

Products, Rates, and Construction Periods



Lenders can offer a variety of options during the construction phase *however*, once converted to permanent financing, the loan must be fully-amortizing with a fixed interest rate (this is an MPF Program requirement)

Let's look at some examples

Common Single-Close Product Offerings

- During the construction phase, the borrower may have the option between an adjustable-rate (ARM) or fixed-rate product
- Monthly payments during the construction phase are usually based upon the disbursements that have been made (like a line of credit)
- Monthly payments may be interest-only during the construction phase



Common Single-Close Product Offerings



Borrowers may be given the option to lock into a permanent, fixed rate prior to beginning construction

- The locked rate is typically higher than current market rates because the lender needs to protect themselves from rate increases while the home is being built
- Some lenders offer a float-down feature that allows a one-time option to re-lock at a lower rate. This offer is usually available just before the loan is set to convert to permanent financing

Structuring Single-Close Loans: Example



Wendy and Paul have locked in a rate of 8.625% for a 30-year fixed, single-close construction loan

The prevailing 30-year fixed rate is around 6.625%, so why is their rate so high?*

- During construction they'll make interest-only payments based on the amount drawn/disbursed from the construction funds
- Just before the loan converts, they have the option to float down if the 30-year fixed rates are lower than 8.625%
- If rates are higher than 8.625%, they'll keep what they have and begin making principal and interest payments

**Rates are for example purposes only*

Structuring Single-Close Loans: Example

Chris is building a custom home on a lot she purchased 2 years ago

- Her construction phase product is a 5/1 ARM
- During construction she makes interest-only payments based on the amount drawn/disbursed from the construction funds
- When construction is complete, the loan may be **modified** to give Chris a 30-year fixed mortgage at a prevailing rate
- Some lenders may allow Chris to keep the 5/1 ARM with P&I payments beginning after the construction phase is complete (*Reminder-the MPF Program does not purchase ARMs*)



Underwriting Single-Close Transactions

MPF Traditional Selling Guide:2.6.3.1
Fannie Mae Selling Guide: B5-3.1-02
Freddie Mac Selling Guide: 4602.3

- The borrower should be qualified based on an interest rate/term/product that is a realistic estimation of the permanent financing
- Real estate taxes should be estimated based upon the value of the **completed** home
- Minimum borrower contributions must be met
- If the borrower acquired the lot a year or more prior to application, any equity may be used towards the borrower contribution



The Construction Phase

MPF Traditional Selling Guide:2.6.3.2
Fannie Mae Selling Guide: B5-3.1-02
Freddie Mac Selling Guide: 4602.3

The construction period for a single-close transaction may not exceed 18 months

- At conversion, the loan must have a fixed rate with a term of no longer than 360 months
- Loans underwritten using DU* cannot have a single construction period of more than 12 months and a total construction period of more than 18 months. **Examples include:**

**Three
6-month
periods**

**One 12-
month
period and
one 6-month
period**

**Six
3-month
periods**



* Freddie Mac/LPA guidelines may vary

Single-Close Re-Underwriting

Single-Close Transactions: Using DU

True or False

If the borrower's credit documents are more than 12 months old at the time the loan is being converted to permanent financing, you must always update the following:

- Credit report
- Income documentation
- Employment verification
- Bank statements

False. Bank statements are not required **unless** the borrower needs more reserves to qualify and/or they are bringing additional funds to the transaction

Loan documents can be up to 12 months old at conversion if all the following attributes are met

- Credit score is ≥ 700
- LTV/CLTV/HCLTV $\leq 95\%$
- Loan has received an Approve/Eligible DU recommendation

If any of the items above do not apply, loan documents that are older than 120 days at the time of conversion must be updated and the borrower requalified on the updated information

Borrower Requalification

If the **loan amount** or **interest rate** is modified at conversion, follow Fannie Mae's re-underwriting tolerances to determine if the loan requires re-underwriting

The following modifications require re-underwriting:

- Amortization change (ARM to fixed)
- Term change
- LTV increase due to a decline in the property value
- Credit, income, and employment documentation is older than 12 months

Applicable to loans
underwritten with
DU

*Refer to Fannie Mae's Selling Guide for more specifics about manual underwriting requirements

DU Tolerances

Which of the following would require re-underwriting (re-submit to DU)

- a. When an interest rate increase causes the DTI ratio to increase more than 3% (when the DTI is less than 50%)
- b. When the interest rate increases causing the DTI to exceed 43%
- c. When an interest rate increase causes the DTI to exceed 45%
- d. When the loan amount increases by the lower of \$500 or 1% of the loan amount

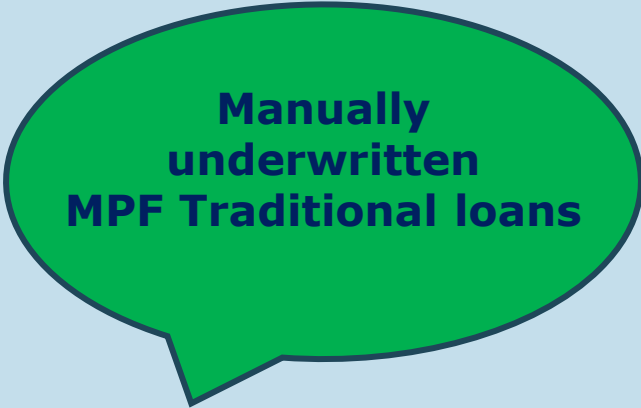
All but b.

DTI Tolerances

Original DTI	New DTI	Resubmission?
35	40	YES
44	46	YES
46	48	NO
46	50	YES

Borrower Requalification

- The MPF Traditional Selling Guide (manual underwriting) does not mention the need to requalify at conversion
- Documents should be no older than 120 days on the date the note is signed
- The underwriting analysis (pre-closing) must be based on the terms of the permanent loan and must meet MPF Program requirements in effect at the time the loan is converted to permanent financing
- Loans must qualify based on guidelines in effect at the time of delivery
- Your organization may have specific requirements related to underwriting and re-qualifying borrowers



**Manually
underwritten
MPF Traditional loans**

Property Completion

Certificate of Occupancy

A certificate of occupancy is required to confirm the property is complete and suitable for occupancy

- In jurisdictions where a certificate of occupancy or an equivalent is not available, a certification that is customary for the area may be submitted



Property Completion

Single-close transactions: the property must be 100% complete and all work paid in full

Dual-close transactions: the property should be complete but some postponed work (cannot be outside the contract with the builder) may be permitted

- Weather-related or supply chain delays
- Items must not impact the ability to obtain an occupancy permit
- Cost cannot be more than 10% of the as-completed value
- A completion escrow must be established*
- Work must be completed within 180 days of the note date

*See the associated selling guide for more details on postponed improvements and completion escrows



Conversion of Single-Close Transactions

Options for Conversion



There are two ways to convert a single-close construction loan to permanent financing

- Construction Loan Rider
- Separate Loan Modification

Fannie Mae/Freddie Mac uniform mortgage instruments must be utilized for the permanent mortgage

Construction Loan Riders

A construction loan rider is typically attached to the security instrument

- Outlines the construction loan terms and states that the construction terms become null and void at the end of the construction period and before the loan can be sold
- If construction is completed sooner or later than what is reflected on the accompanying security instrument, the construction loan rider and the accompanying uniform instrument must be amended
- The amendment must include new dates for when the permanent loan payments will begin and end
- The amended document(s) must be executed and recorded before the loan can be sold

THIS IS A MODEL DOCUMENT FOR USE IN FANNIE MAE CONSTRUCTION LOAN TRANSACTIONS. **THIS FORM IS PROVIDED AS AN EXAMPLE** AND HAS NOT BEEN EVALUATED FOR VALIDITY AND ENFORCEABILITY IN ANY JURISDICTION. LENDERS SHOULD CONSULT WITH LEGAL COUNSEL TO ENSURE THAT ALL FORMS USED TO ORIGINATE LOANS ARE APPROPRIATE, AND THAT ALL LEGAL INSTRUMENTS ARE COMPLETED CORRECTLY AND IN COMPLIANCE WITH APPLICABLE LAW.

CONSTRUCTION LOAN RIDER TO SECURITY INSTRUMENT
(To Be Recorded With The Security Instrument)

LENDER: _____

BORROWER: _____

PROPERTY: _____

THIS CONSTRUCTION LOAN RIDER TO SECURITY INSTRUMENT (the "Rider") will be deemed to amend and supplement the Mortgage or Deed of Trust, and any and all riders or amendments thereto (the "Security Instrument") of the same date, to which this Rider is attached, given by the undersigned (the "Borrower") to secure Borrower's Promissory Note to Lender of the same date (the "Note") and covering the property (the "Property") described in this Security Instrument. All terms defined in the Note and elsewhere in this Security Instrument will have the same meaning in this Rider.

AMENDED AND ADDITIONAL COVENANTS. In addition to the covenants and agreements made in this Security Instrument, Borrower and Lender further covenant and agree as follows:

- 1. Construction Loan Agreement.** Borrower's Note evidences Borrower's promise to pay Lender the aggregate amount of all disbursements made and distributed by Lender under the terms and conditions of a Construction Loan Agreement between Lender and Borrower dated the same date as the Note (the "Loan Agreement"). The Loan Agreement provides for certain improvements (the "Improvements") on the Property. Borrower agrees to comply with the covenants and conditions of the Loan Agreement. This Security Instrument secures to Lender: (a) the repayment of the debt evidenced by the Note, including the aggregate amount of all disbursements made by Lender from time to time under the terms of the Loan Agreement, with interest at the Construction Phase Note Rate, and all renewals, extensions, and modifications of the Note; (b) the performance of all of Borrower's covenants and agreements under the Note, this Security Instrument, and the Loan Agreement (the "Loan Documents"); and (c) the payment of all other sums, with interest at the rate set forth in the Note, advanced by Lender to protect the security of this Security Instrument, or to perform any of Borrower's obligations under the Loan Documents. Upon the failure of Borrower to keep and perform all the covenants, conditions, and agreements of the Loan Agreement, the Principal, all interest, and other charges provided for in the Loan Documents and secured hereby will, at the option of the Lender, become immediately due and payable in full.
- 2. Future Advances.** During the construction of the Improvements (the "Construction Phase"), interest will accrue on the outstanding Principal according to the terms set forth in the Note and the Construction Loan Addendum To Note. Provided there has been no default as defined in the Note, the Loan Agreement, or this Security Instrument, Lender is legally obligated to make disbursements of principal upon application therefor by the Borrower in accordance with the provisions of the Note and Loan Agreement up to a maximum Principal amount (including present and future obligations), which is equal to the amount of the Note as set forth in the Security Instrument. Such disbursements will be evidenced by the Note, made under the terms of the Loan Agreement and secured by this Security Instrument and may occur for a period up to the end of the Construction Phase, but in no

MULTISTATE CONSTRUCTION LOAN RIDER TO SECURITY INSTRUMENT
-Single-Family - Fannie Mae MODEL DOCUMENT

Form 3737 07/2021
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Fannie Mae Form 3737

Modifications

A separate **modification agreement** can be used to convert the construction loan into permanent financing

- The modification must be recorded before the loan can be delivered for sale
- Can be used to modify the rate, loan product type, loan amount, and term

LOAN MODIFICATION AGREEMENT
(Providing for Fixed Interest Rate)

This Loan Modification Agreement ("Agreement"), made this ____ day of _____, _____, between _____ ("Borrower") and _____ ("Lender"), amends and supplements (1) the Mortgage, Deed of Trust, or Security Deed (the "Security Instrument") dated _____ and recorded in Book or Liber _____, at page(s) _____, of the _____ Records of _____ (Name of Records) _____ and (2) the Note, bearing the same date as, and secured by, the _____ (County and State, or other Jurisdiction) Security Instrument, which covers the real and personal property described in the Security Instrument and defined therein as the "Property", located at _____ (Property Address) _____

the real property described being set forth as follows:

In consideration of the mutual promises and agreements exchanged, the parties hereto agree as follows (notwithstanding anything to the contrary contained in the Note or Security Instrument):

1. As of _____, the amount payable under the Note and the Security Instrument (the "Unpaid Principal Balance") is U.S. \$ _____, consisting of the unpaid amount(s) loaned to Borrower by Lender plus any interest and other amounts capitalized.
2. Borrower promises to pay the Unpaid Principal Balance, plus interest, to the order of Lender. Interest will be charged on the Unpaid Principal Balance at the yearly rate of _____%, from _____, _____, Borrower promises to make monthly payments of principal and interest of U.S. \$ _____, beginning on the _____ day of _____, and continuing thereafter on the same day of each succeeding month until principal and interest are paid in full. The yearly rate of _____% will remain in effect until principal and interest are paid in full. If on _____ (the "Maturity Date"), Borrower still owes amounts under the Note and the Security Instrument, as amended by this Agreement, Borrower will pay these amounts in full on the Maturity Date.

LOAN MODIFICATION AGREEMENT—Single Family—Fannie Mae UNIFORM INSTRUMENT Form 3179 1/01 (rev. 4/14) (page 1 of 3)

Fannie Mae Form 3179

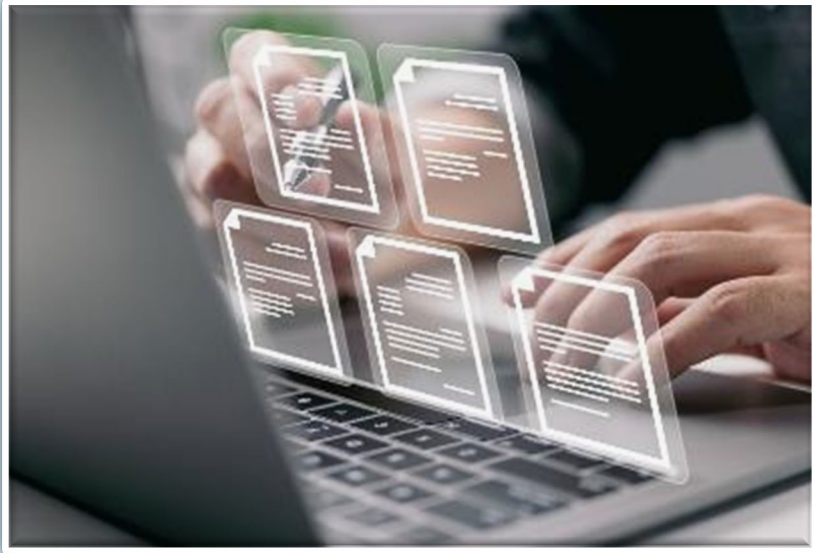
Title Insurance Requirements: Single-Close

A lender's title insurance policy or title opinion/certificate must be obtained

- During construction, date down endorsements are requested with each draw to ensure no mechanic's liens have been filed against the property and to move the policy date forward
- Once the funds are fully disbursed and the property is complete, a final date down endorsement is issued to bring the policy date forward
- If the policy coverage amount has changed (due to the loan amount changing), an endorsement reflecting the new coverage must be obtained



Title Insurance Requirements: Dual Close



A lender's title insurance policy or title opinion/certificate must be obtained for the permanent financing

- Because mechanic's liens aren't always filed immediately, the settlement agent/issuing insurer will request lien waivers and other possible documentation prior to closing the permanent loan
- Organized construction management is the key to closing the permanent loan on time!

Summary

Summary



- The MPF Program purchases construction to perm loans only after construction is complete and the loan has moved into the permanent phase
- Knowledge of the construction management process is essential for a successful construction lending program
- Setting expectations with the borrower and builder will help keep the entire process on track
- Checklists can help keep the borrower and builder accountable for all documentation and required tasks

MPF National Education

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