Mortgage Partnership Finance

Construction to Permanent Financing

MPF® Traditional Product
MPF Xtra® Product

March 18, 2020

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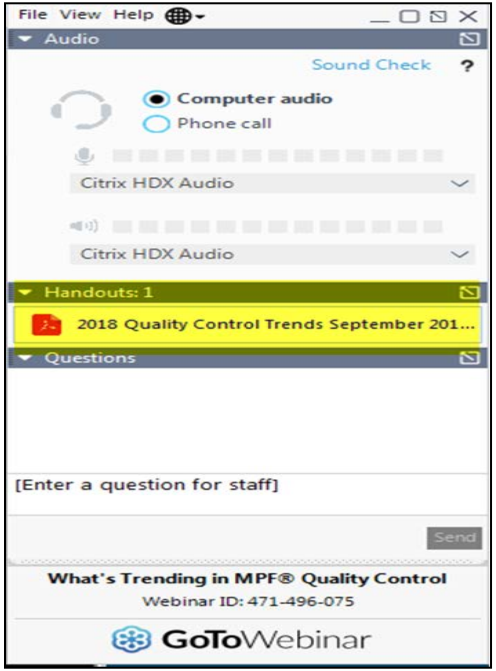

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The official versions of all MPF Guides are available at www.fhlbmpf.com or via AllRegs®.

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Agenda

- Basic Construction Terminology
- General Requirements
- Transaction Types
  - ✓ Single-Close Construction Loans
  - ✓ Dual-Close Construction Loans
- Purchase or Refinance?
- Important Reminders

Basic Construction Terminology

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Basic Construction Terminology

Construction-to-Permanent Loan

Either a single-close or dual-close transaction used to finance and build a residential property.

Construction Phase

The period when the home is being built where typically the borrower pays interest on the disbursed portion of the loan.

Permanent Phase

After the construction phase is completed, the loan either modifies to long term principal and interest payments (single-close) or the loan is replaced by new financing (dual-close) where similar long-term principal and interest payments begin.

Basic Construction Terminology

General Contractor

Employed by the borrower, the general contractor is responsible for the management and overall coordination of the project.

Subcontractor

Specialized tradespeople such as electricians, plumbers, masonry workers who are hired by the general contractor to complete specific jobs during the construction phase.

Soft Costs

Expenses for items such as architect fees, surveys, and permits and engineer inspections.

Basic Construction Terminology

Construction Escrows

Many lenders utilize available construction escrow services for the oversight of the construction payouts to general contractors, subcontractors and material suppliers.

- ✓ Most title insurance companies offer construction escrow services.
- ✓ Ensures that no mechanic's liens are recorded against the property.

Sworn Contractor's Statement

The general contractor submits a *Sworn Statement* that lists all of the subcontractors/material suppliers that are entitled to be paid with each draw.

- ✓ When paid, each subcontractor and/or material supplier must supply a *lien waiver.*
- ✓ Amounts are reviewed by the construction escrow service provider to make sure the loan is in balance.
- ✓ Construction escrow services protect both the lender and the borrower during the construction of the project to make sure that payments are made and there are enough funds to complete the project.

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Basic Construction Terminology

General Contractor's Sworn Statement

Varies from state to state but generally lists the following information:

- ✓ Name and address of the subcontractor/supplier
- ✓ Description of the kind of work performed
- ✓ Cost of the work per the contract
- ✓ Retention amount (usually a percentage held until all work is completed)
- ✓ Amount of any previous payments
- ✓ Amount of the payment for the present draw
- ✓ Balance due to complete the work

GENERAL CONTRACTOR'S SWORN STATEMENT

Name, Address, and Telephone Number	Type of Labor and Materials to be Furnished	Amount of Contract (including extras and credits)	Amount Previously Paid to Date	Amount of Current Request	Accumulative Retainage to Date	Balance Due
Bob's Electric (000) 111-2222	Rough in electric Fixtures and install	$ 6,800.00	$ 3,950.00	$ 1,600.00	$ 500.00	$ 750.00

Basic Construction Terminology

Lien Waiver

A document from a contractor, subcontractor or materials supplier stating they have received payment and waive any future lien rights to the property.

Mechanic's Lien

A legal claim against a property typically used by subcontractors and suppliers who have not been paid by the general contractor or property owner.

- ✓ Each state has specific rules that define when a lien must be filed and who has the right to file the lien.
- ✓ In some states, a mechanic's lien can take priority over the lender's interest.

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General Construction-Perm Requirements

Construction to Permanent Loans

Construction-to-permanent loans are eligible under the MPF® Traditional* and MPF Xtra® products if the construction phase is completed and the permanent financing is in place prior to purchase by the MPF Bank.

- The payoff of a short-term construction loan or conversion to permanent financing may be accomplished one of two ways:
  - ✓ Single-Close (one-time close)
  - ✓ Dual-Close

**Includes MPF Original, MPF 125 and MPF 35*

General Requirements

Loans may be underwritten through DU, LPA or manual underwriting.

- Underwriting should be based upon the terms of the permanent financing.
  - ✓ Because in some cases the interest rate is unknown and subject to change over the course of the construction period, it's advised to underwrite loans at a higher interest rate to ensure that the borrower will still qualify if there is an increase in rates.
  - ✓ Real estate taxes should be estimated based upon the completed home.

MPF Xtra: Special Feature Code (SFC) 151 should be used for single-close construction loans.

General Requirements

- Before submitting a loan for purchase, the property must be complete and a certificate of occupancy (CO)* issued.
- The borrower must hold title to the lot (previously acquired or acquired as part of the transaction).
- The existing mortgage must be insured by a valid title policy or title opinion.
  - With no encumbrances as of the date of the permanent mortgage loan.
- The minimum borrower contribution must be met.
  - Borrower contributions vary based upon transaction type and LTV.
- An ***Appraisal Update*** (FNMA 1004D) and/or ***Completion Report*** (FHLMC 442) completed by the appraiser is required for all appraisals made subject to completion per the plans and specifications.

**** If COs are not available in a particular jurisdiction, equivalent documentation may be submitted.***

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Construction Must Be Completed

If the appraisal indicates the property is subject to completion, a ***Completion Report*** indicating the property is complete according to the plans and specifications is required.

The *Appraisal Update and/or Completion Report* is also known as **FNMA Form 1004D** or **Freddie Mac Form 442.**

Single-Close Construction Loans

Single-Close Transactions

The benefits of doing a single-close construction loan:

- There is one set of closing costs.
- The borrower may have the opportunity to lock their rate before construction begins, eliminating worry in a raising rate environment.
- Borrowers may not have to re-qualify or re-apply for permanent financing.*

*May not be applicable in all cases.

Single-Close Transactions

- A single-close construction loan closes before construction begins and consists of two phases:
  1. **Construction phase**
  2. **Permanent phase (after construction is completed)**
- The originating lender is responsible for managing the construction phase, including but not limited to:
  - ✓ Proper disbursement of funds through a series of draws/advances.
  - ✓ Oversight of payments made to the general contractor, subcontractors or any other authorized suppliers.
  - ✓ Collection of required lien waivers.
  - ✓ Periodic inspections
  - ✓ Monitoring the progress of the construction schedule.

LTV Calculations

Transaction Type	Lot Ownership Requirement	LTV Ratio Calculation
Purchase	The borrower **is not the owner** of record of the lot at the time of the first advance of interim construction financing.	Divide the C-P loan amount by the **lesser of:** Cost of construction + price of the lot or, The "as completed" appraised value of the property (the lot and improvements).
Limited Cash-out Refinance	The borrower **is the owner** of record at the time of the first advance of interim construction financing.	Divide the C-P loan amount by the "as completed" appraised value of the property.

Single-close transactions are subject to the maximum LTV/CLTV/ TLTV ratios outlined in the ***MPF Traditional*** *Selling Guide and the* ***MPF Xtra*** *Selling Guide.*

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Transaction Examples

Betty and James are building a new home with ACME Builders

The builder is selling them their desired lot for $35,000 and the cost to build the home is $350,000

Since they will not own the lot until closing, this transaction is a <u>purchase</u>

Lot Price + Cost to Build = **$385,000**

“As-completed” Appraised Value = $395,000

The LTV is based on the lower of the two amounts

The borrowers wish to contribute 10% down (90% LTV)

10% of $385,000 = $38,500

Loan amount = $346,500

Borrowers provide their “down payment” funds at closing, those funds are disbursed before any loan proceeds.

Transaction Examples

Carl bought a lot last year and just finalized plans to build his dream home on the lot.

Carl paid $42,000 for the lot and his contractor has quoted $275,000 to build the home.

Since Carl already owns the land, this is a <u>refinance</u> transaction.

The “as-completed” value of the project = **$325,000**

The LTV is based on the “as-completed” value

90% of $325,000 = **$292,500**

If the lot was financed, that loan is paid off at closing.

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Examples of Construction Phase Terms*

The terms of the construction phase may be set up in a number of different ways and may vary by lender.

- Similar to a line of credit, borrowers usually make payments that are based upon the amount that has been disbursed.
- The construction phase may be set up as an adjustable rate mortgage but must modify to a fixed-rate at completion.
- Payments may be interest-only during the construction phase.
- Some lenders lock the borrower into a fixed rate with an option to float down if rates are lower at the time the loan converts to the permanent phase.*
  - ✓ The initial locked rate is usually higher than market rates to protect the lender.
  - ✓ If rates are higher when construction is completed, the borrower is able to keep their initial locked rate.

*These are just a couple of examples and other structures may be available.

Documentation for Single-Close Construction Loans

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Terms of the Construction Loan Period

MPF Xtra/MPF Traditional with DU/LPA

The Fannie Mae Selling Guide provides specific guidelines for structuring the construction phase

The construction loan period for a single-close transaction may have no single period of more than 12 months and the total construction period may not exceed 18 months.

- When needed to complete construction, an extension to the original period may be permitted.
  - ✓ The loan documents may not indicate an initial construction period or subsequent extension of more than 12 months.
  - ✓ If extended, the entire construction period may not exceed 18 months.

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Options for Conversion

Fannie Mae states that a constructions loan may be converted to a permanent loans by using one of two methods:

1. A **construction loan rider** used to modify Fannie Mae’s uniform instrument that will be used for the permanent mortgage.

2. Through the use of a **Modification** (FNMA Form 3179)

Conversion to Permanent

Construction Loan Riders

- The rider must state the construction loan terms and state that they become null and void at the end of the construction period (before the mortgage is delivered for purchase).
- If the construction is completed sooner or later than originally anticipated, the rider must be amended along with any applicable uniform instruments.
  - ✓ The amendment should provide the new dates on which amortization for the permanent mortgage will begin and end.
  - ✓ The amended documents must be recorded before the loan is delivered for purchase.
  - ✓ When amended documents are recorded in connection with a construction loan rider, the lender also must include a copy of the original documentation that the borrower signed.

Modifications

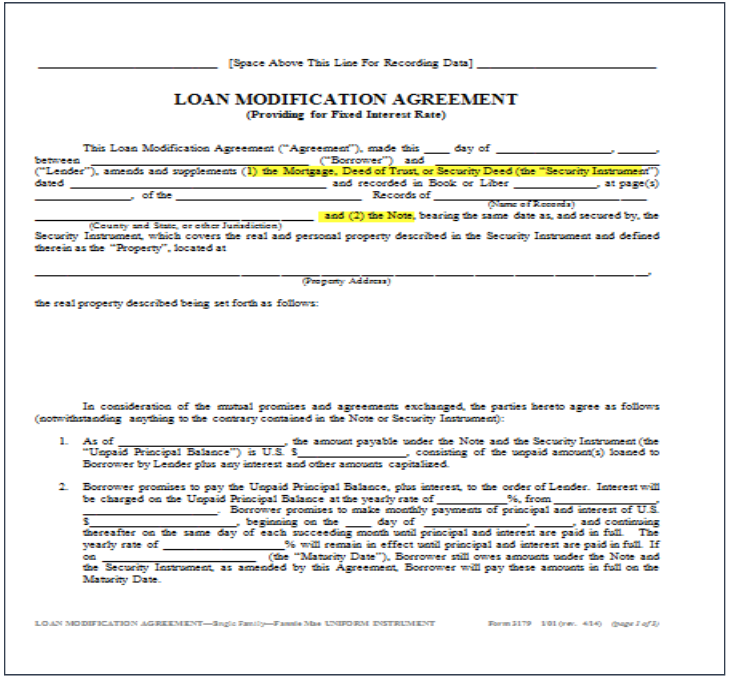
If the terms of the permanent financing change after the original closing date of the construction loan, the loan may be modified if it meets all of the following criteria:

- The modification must take place prior to or at the time of conversion.
- The modification must be recorded prior to delivering the loan.
- Only the following loan terms may be modified:
  - ✓ Interest rate
  - ✓ Loan amount
  - ✓ Loan term
  - ✓ Amortization type (only an adjustable rate to a fixed is permitted)

Loan Modification

The *Loan Modification Agreement* amends and supplements the Mortgage (or Deed of Trust) and the Note.

Must be executed and recorded before the loan may be delivered for purchase.



______ [Space Above This Line For Recording Data] ______

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) ______ (County and State, or other Jurisdiction) and (2) the Note, bearing the same date as, and secured by, the 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)

The example shown is FNMA Form 3179

MPF Xtra (or Traditional with DU/LPA)

The loan must be underwritten based on the terms of the loan *as modified.*

- The final terms of the loan must match the last submission to Desktop Underwriter® (DU®).
  - ✓ If not, the loan must be re-submitted and subject to re-submission tolerances outlined in *Fannie Mae's Selling Guide* (B3-2-10).
- The loan must be re-underwritten if the new modified interest rate causes the DTI ratio:
  - ✓ To exceed 45%
  - ✓ To increase by 3 percentage points or more (if the recalculated DTI ratio is less than 45%).
- If the loan amount changes, follow the re-underwriting tolerances also found in *Fannie Mae's Selling Guide* (B3-2-10).

Age of Documents and Re-Qualifying

MPF Xtra or MPF Traditional with DU or LPA

Credit and appraisal documents dated more than four months but not exceeding 18 months old at the time of the conversion to permanent financing are eligible for delivery if all of the following conditions are met:

- The documents were dated within 120 days of the original closing date of the construction loan.
- The LTV, CLTV and HCLTV ratios do not exceed 70%.
- The borrower has a minimum credit score of 700.
- The casefile was underwritten through DU and received an *Approve/Eligible* (manual underwriting is not permitted).

If any one of the above conditions was not met or an eligible loan term was modified subsequent to the last DU submission:

- Obtain updated credit documents and an appraisal update (1004D).
- Re-qualify the borrowers before delivering the loan for purchase.

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Age of Documents and Re-Qualifying

MPF Xtra and MPF Traditional Manual Underwriting

- If the recalculated DTI (based on the change in rate or loan amount) does not exceed 45%, the loan must be re-underwritten with the updated information to determine if the loan is still eligible for delivery.
  - ✓ If the DTI exceeds 45%, it is not eligible for delivery.
- **Note**: If the increase in the DTI ratio moves the DTI ratio above the 36% threshold, the loan must meet the credit score and reserve requirements in the Fannie Mae Eligibility Matrix that apply to DTI ratios greater than 36% up to 45%.
- *The MPF Traditional guidelines (manual underwriting) do not specify any requirements for re-underwriting loans at conversion. However, the loan should meet the underwriting guidelines in effect at the time the loan is delivered.*

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Dual-Close Construction Loans

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Dual-Close Construction Loans

Benefits of a dual-close construction loan

- Greater flexibility to modify the plans and increase the loan amount during the project.
- Ability to shop around for permanent financing.
- Rate may be lower (depending upon the rate environment) than a single-close loan.

Dual-Close Transactions

Dual-close transactions have two separate loans.

1. An interim construction loan to finance the project.
   - ✓ Loans allow for periodic disbursements during the construction period with interest- only payments on the disbursed amounts.
   - ✓ The loan becomes due upon completion of the home.
   - ✓ The loan cannot be modified and requires a new permanent loan to pay-off the construction loan.
   - ✓ The originating lender is responsible for managing all requirements during construction.
2. A permanent loan that pays off the construction loan.
   - ✓ Loan files should include both sets of closing documents.

- A dual-close loan may be closed as a **limited cash-out** or **cash-out transaction.**
- Manually underwritten MPF Traditional loans for manufactured homes must be completed using a dual closing only.

Quality Control Reminders and Resources

Quality Control Review Reminders

- As-improved property taxes must be considered in the debt to income (DTI) ratio.
- The *certificate of occupancy* must be included in the loan file.
- The appraisal date for the 1004D (*Appraisal Update*) must be included in the loan file.
- If the original appraisal was dated more than 120 days before the Note date, the 1004D should indicate if the value has declined since the original appraisal date.

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Quality Control Review Reminders

- Title policies must reflect the permanent financing and/or a *Date Down Endorsement.*
  - ✓ *Date Down Endorsements* are permitted for **single-close** transactions.
    - The initial policy must be dated concurrently with the date of the mortgage and include a pending disbursements clause.
    - The *Date Down Endorsement* must extend the effective date of the coverage to the date of the recording of the modification agreement and state that the lien as modified, continues to be a first lien.
  - ✓ **Dual-close** transactions require a new lender's title insurance policy to insure the permanent financing.

MPF Contacts and Resources

MPF Service Center

Email - MPF-Help@FHLBC.com
Hours - 8:30 am to 4:30 pm CST
Phone: (877) 463-6673

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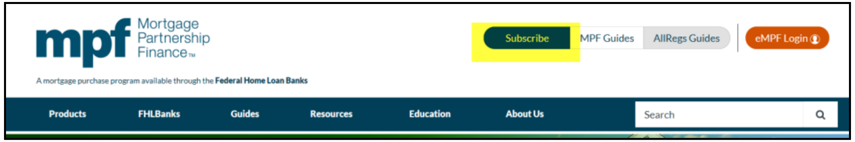

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https://www.fhlbmpf.com/education/upcoming-webinars

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mpftraining@fhlbc.com

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