

Construction to Permanent Loans

April 2026



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Construction Financing Types

1. **New Construction**
 - a. The borrower takes out a short-term construction loan that is refinanced into permanent financing when the home is ready to occupy
 2. **Two-Close**
 - 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
 3. **Single-Close**
 - 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
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Two-Close Transactions



Two-Close Transactions

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

Freddie Mac restricts cash-out refinances to site-built homes only

Pros of Two-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 Two-Close

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

Two-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

MPF Traditional Selling Guide:2.6.3
Fannie Mae Selling Guide: B5-3.1-02
Freddie Mac Selling Guide: 4602

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

The minimum borrower contribution must be met unless the borrower acquired the lot a year or more prior to application and uses the equity in the lot or land to meet the requirement

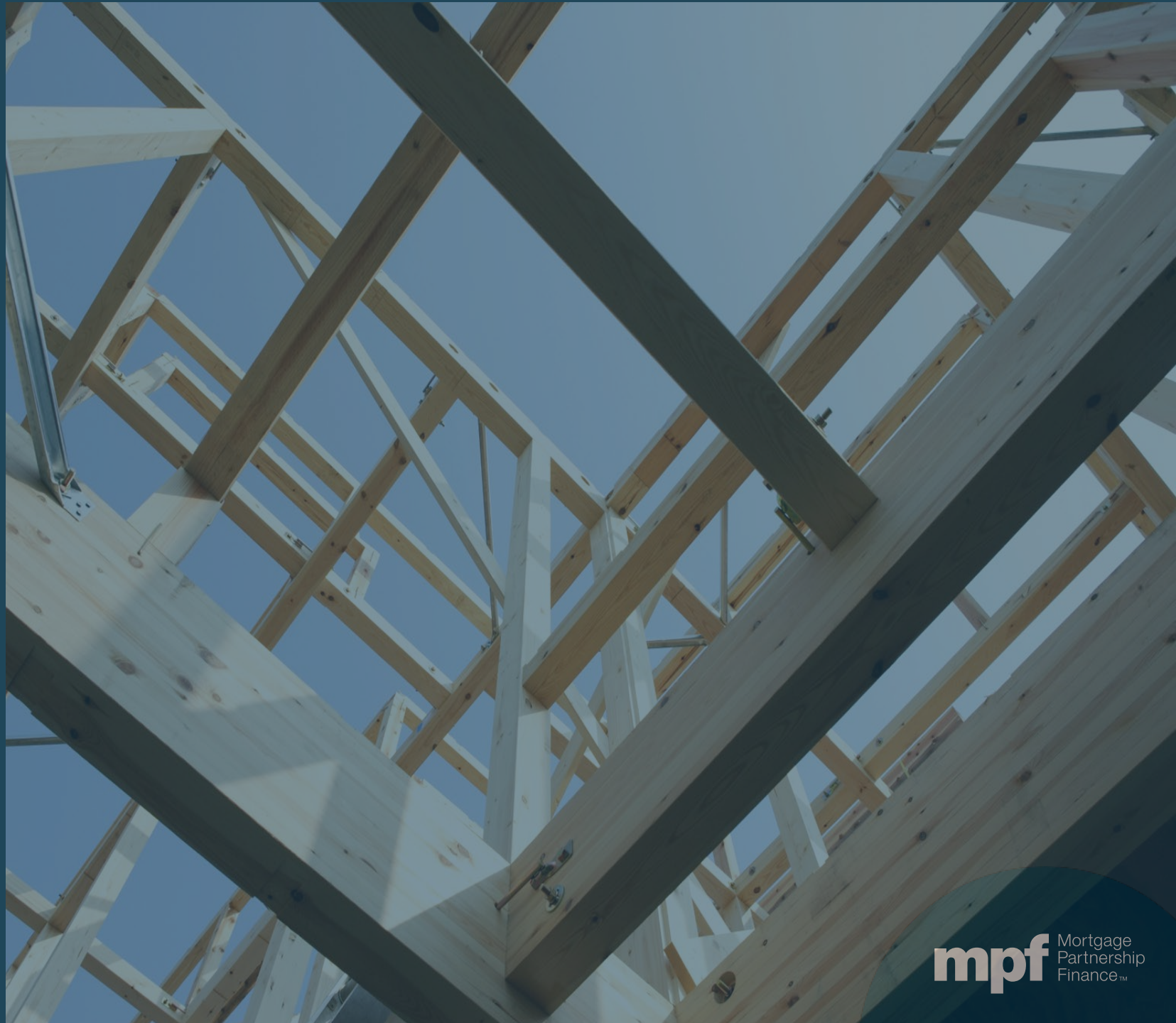
Purchase or Refinance?

It's a refinance when...

- The borrower already owns the property/lot
- Two-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 considered 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?

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, sub-contractors, and suppliers
- Collection lien waivers
- Monitoring project timelines, disbursements, and costs



Do you use a
builder
questionnaire?



Many lenders use
construction escrow
services at a title
company

Typical Documentation

Processing a construction loan application requires additional documentation such as:

- **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**

Examples only, not intended to be all-inclusive



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 extras 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	\$ 8,900.00				\$ 8,900.00
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	\$ 28,800.00				\$ 28,800.00
Lumber Supply, Inc.	Finish Material	\$ 29,700.00				\$ 29,700.00
Thompson Drywall	Drywall	\$ 13,000.00				\$ 13,000.00
Parker Building Supply	Insulation	\$ 5,800.00				\$ 5,800.00
Avon Shingle and Siding	Roofing	\$ 7,680.00				\$ 7,680.00
Avon Shingle and Siding	Gutters	\$ 8,800.00				\$ 8,800.00
Perfection Plumbing	Plumbing	\$ 7,400.00				\$ 7,400.00
Perfection Plumbing	Plumbing Fixtures	\$ 8,100.00				\$ 8,100.00
Perfection Plumbing	Water and Sewer	\$ 10,800.00				\$ 10,800.00
Canon Steelworks	Structural Steel	\$ 4,800.00				\$ 4,800.00
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

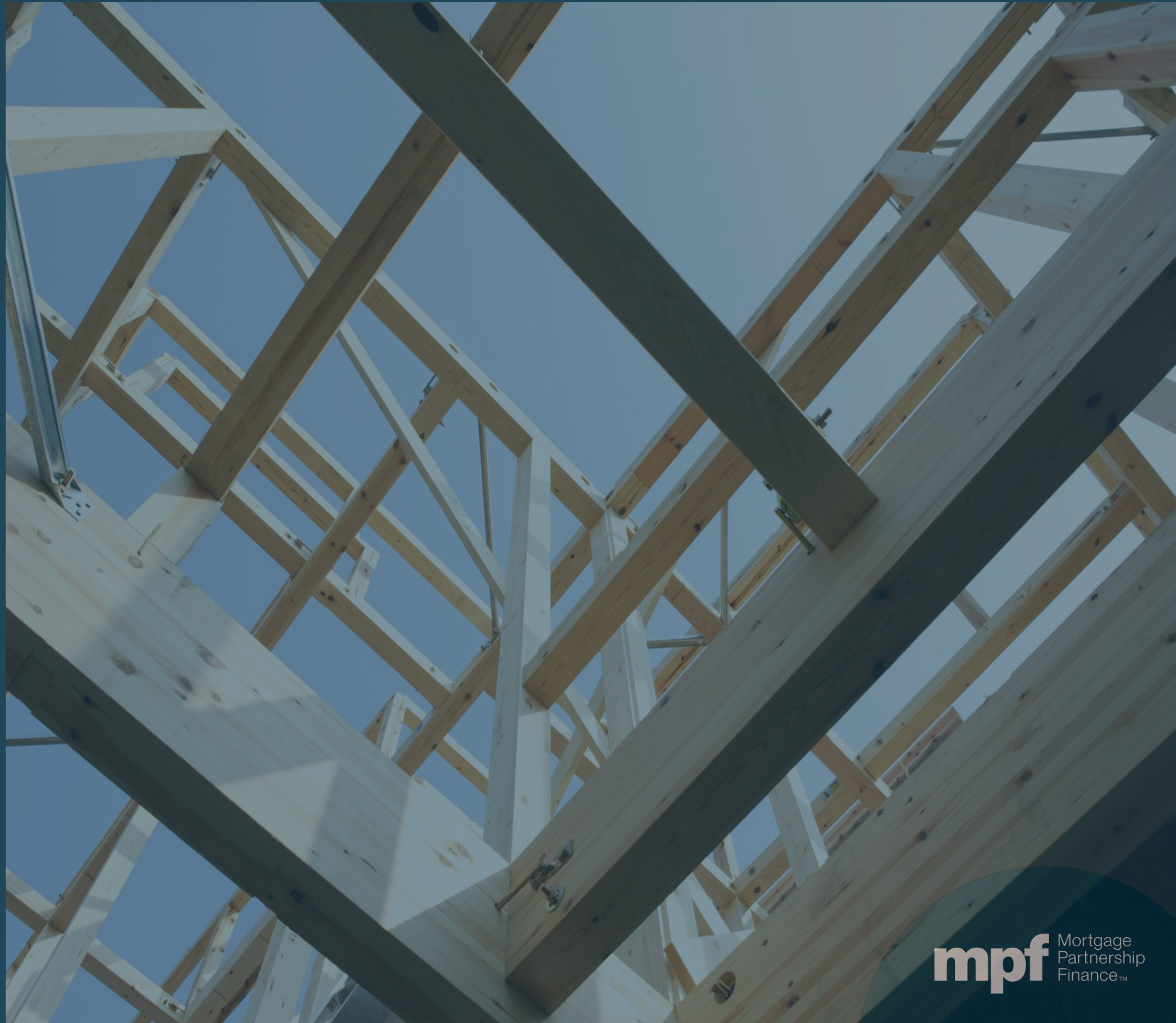
Inspections typically occur before each draw is made

- 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

Loan Structuring Examples



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 8.250% for a 30-year fixed, single-close construction loan

The prevailing 30-year fixed rate is around 6.250%, 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 8.250%
- If rates are higher than 8.250%, 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 two 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 is **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

- 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
- Fannie Mae guidelines prohibit 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

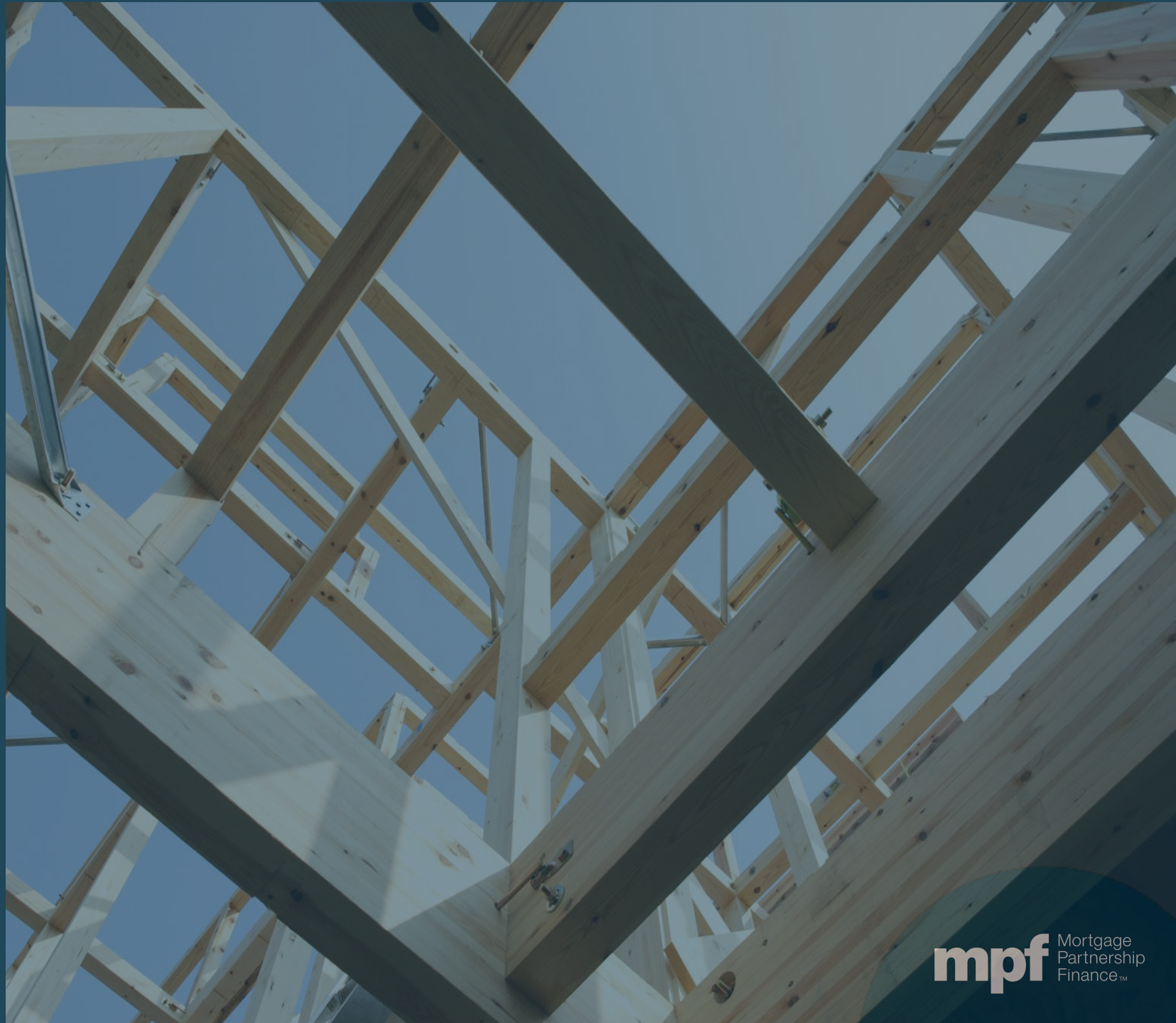
One 12-month
period and one
6-month period

Six
3-month
periods



* Freddie Mac/LPA guidelines may vary

Single-Close Re-Underwriting



Single-Close Construction to Perm Loans

According to Fannie Mae guidelines when certain conditions apply, what is the maximum allowable age of income, employment, and credit documentation at the time of conversion?

- a. No older than 4 months
 - b. No older than 12 months
 - c. No older than 18 months
- c. 18 months (with conditions)



Age of Credit Documents

Fannie Mae B5-3.1-02

Freddie Mac 4602.2 (e) (ii)

Very similar guidelines but instead of 18 months, it states 540 calendar days

Provides more details about pre-closing age of documentation (employment verifications, etc.)


- At closing (note date), all credit documents must be less than 120 days old (also applies for Freddie Mac and manually underwritten MPF Traditional loans)
- Documents may be older than 4 months but less than 18 months at the time of conversion if all the following conditions were met at the time of the original closing of the construction loan:
 - **LTV/CLTV/HCLTV \leq 95%**
 - **Loan has received an Approve/Eligible DU recommendation**
- If either of the above items don't apply or the loan term was modified after the last DU submission, updated income, employment, and credit report documents must be obtained and the borrower requalified
- Updated asset documentation is not required unless more reserves are required or the borrower chooses to bring in extra funds to the transaction

Borrower Requalification: Fannie Mae

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 18 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)

- When an interest rate increase causes the DTI ratio to increase more than 3% (when the DTI is less than 50%)
- When the interest rate increases causing the DTI to exceed 43%
- When an interest rate increase causes the DTI to exceed 45%
- 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

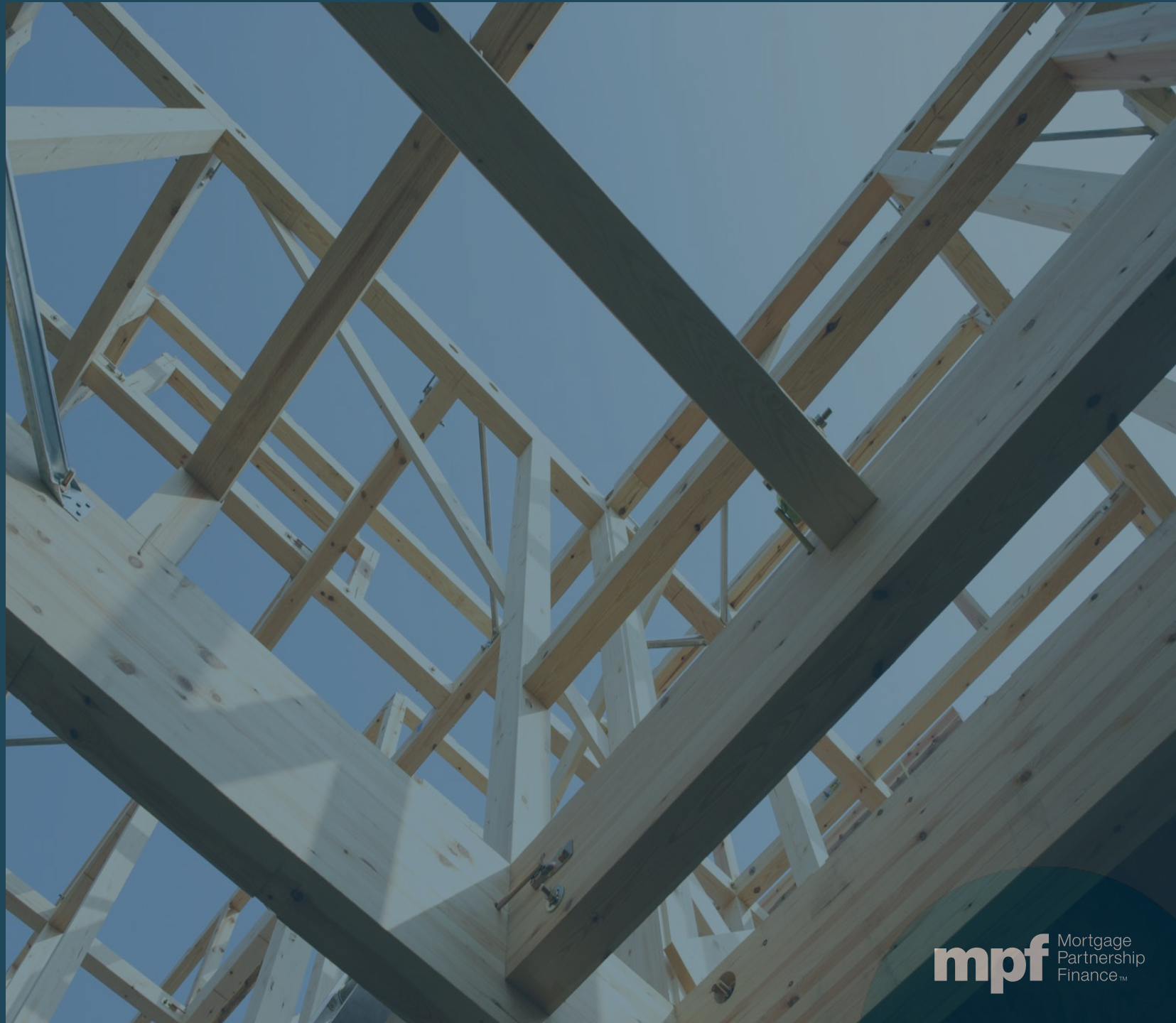
Borrower Requalification

- 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

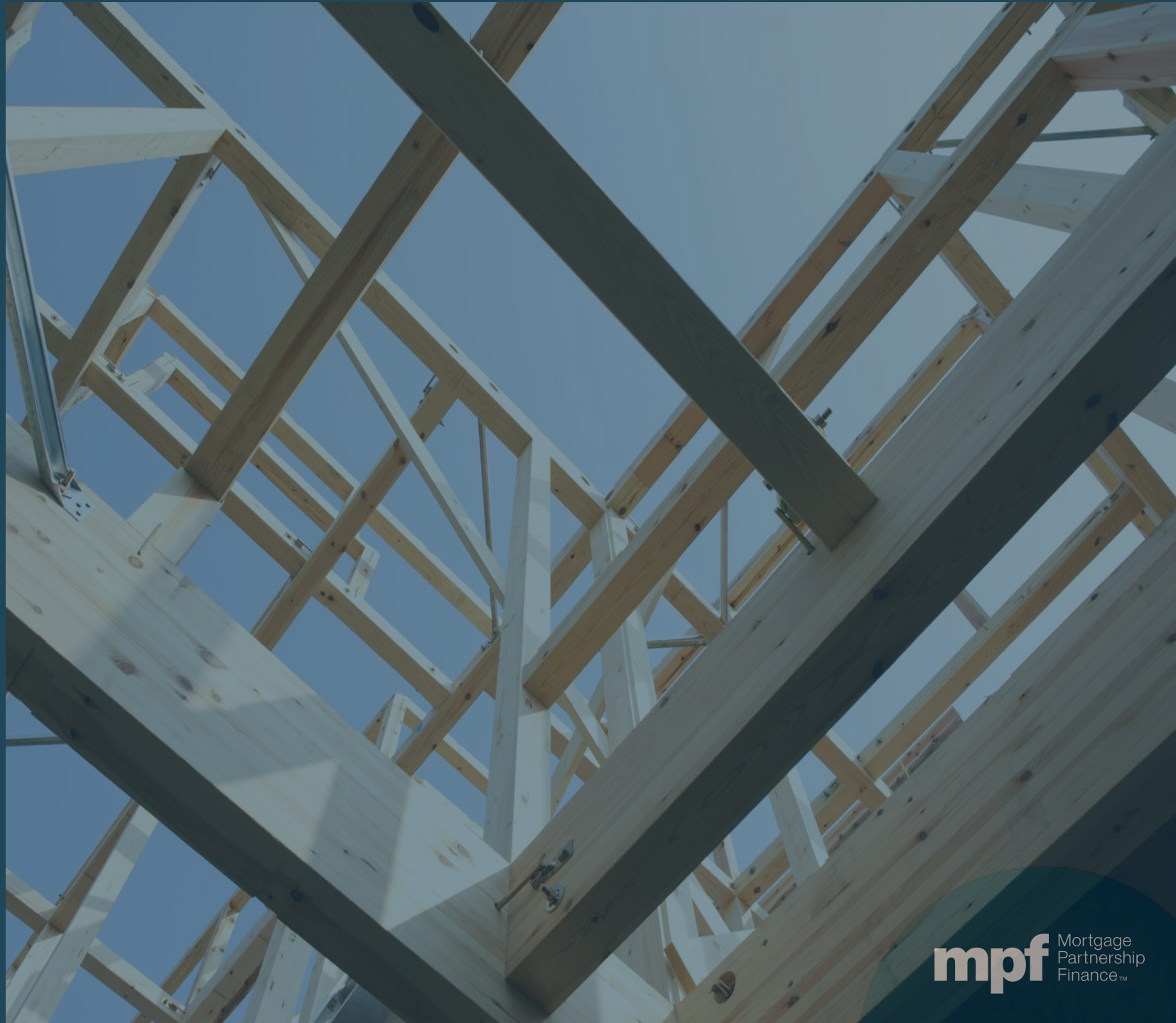
Two-close transactions: the property should be complete but some postponed work (cannot be outside the contract with the builder) may be permitted

- 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: Automatic Conversion

- In single-close transactions, the terms of the interim construction financing are incorporated into security instrument using a rider
- The rider outlines the terms of the construction financing phase and becomes null and void at the completion of the construction phase and prior to delivery to the MPF Program
- The interim construction financing automatically converts to permanent financing upon completion of the construction
- If the construction is completed sooner or later than originally outlined in the rider, you must amend and re-record the construction loan rider to reflect the new dates for when the amortization will begin and end
- Loans may not be delivered for purchase before the loan is set to begin the permanent phase



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
- both the original documentation that the borrower signed and any amended documents recorded in

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 _____, 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 2)

Fannie Mae Form 3179
Freddie Mac's equivalent is Form 5166

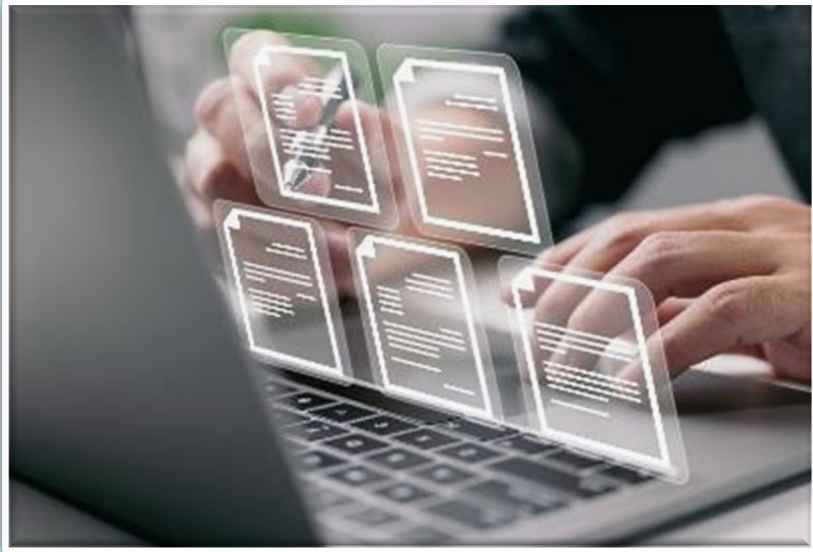
Title Insurance Requirements: Single-Close

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



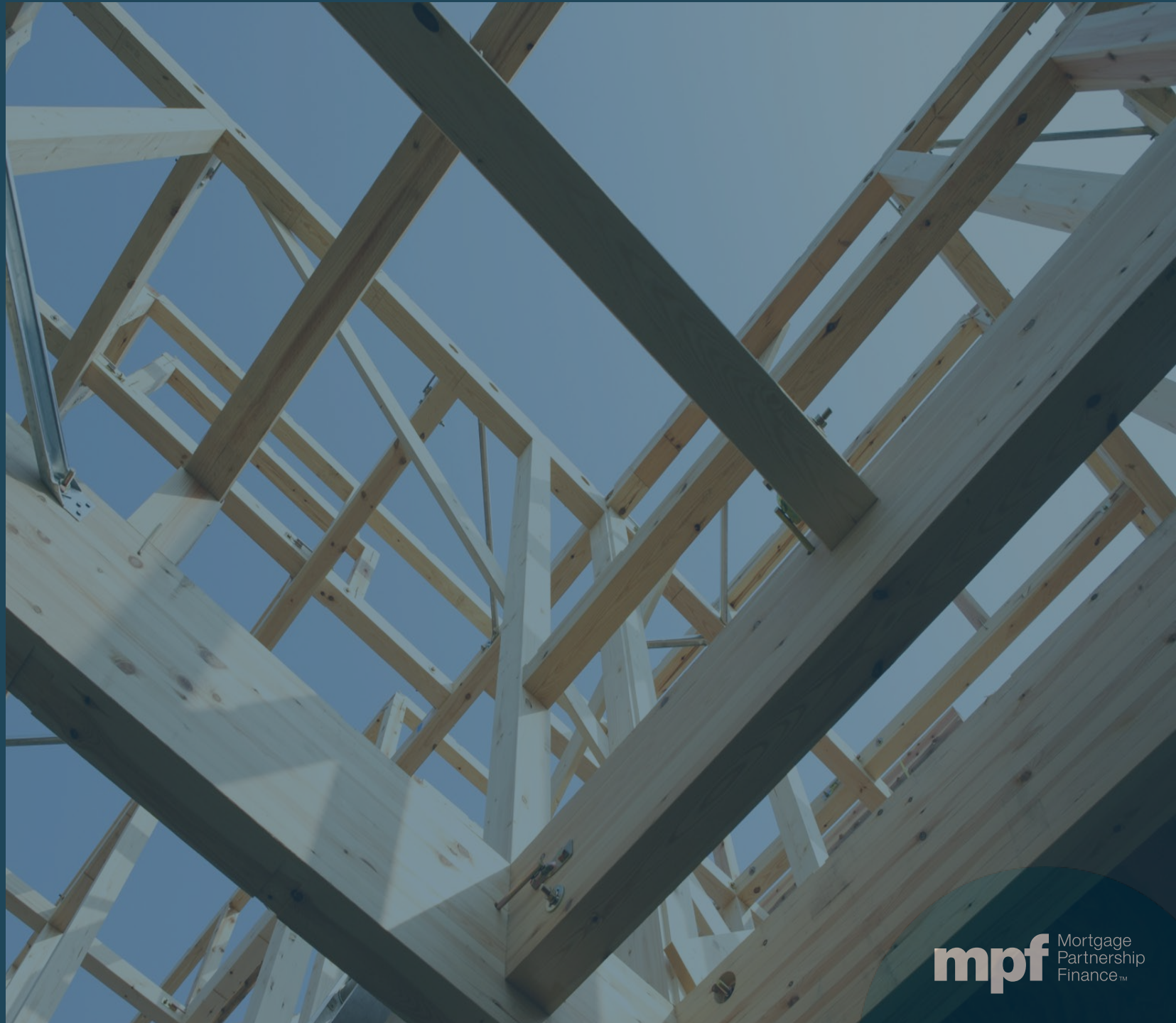
Title Insurance Requirements: Two-Close



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 converting 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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