 Office of Credit Unions Policies and Procedures	POLICY NUMBER
	10320
LENDING	EFFECTIVE DATE
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I. PURPOSE


Construction loans constitute higher-risk loans and require sophisticated underwriting and administration. Management must be knowledgeable about the requirements of construction lending and establish acceptable limits to mitigate credit and concentration risks. Examiners must evaluate a credit union's construction lending program through a review of policies and procedures, management of the portfolio, and individual construction loan files.

II. PRIMARY REFERENCES/ REGULATIONS

1. Michigan Credit Union Act:
 - a. [Section 342\(3\)\(b\)](#)
 - b. [Section 401\(2\)\(i\)](#)
 - c. [Section 421](#)
 - d. [Section 423](#)
2. [NCUA Letters to Credit Unions 124](#)
3. [OCC Commercial Real Estate and Construction Lending Handbook](#)
4. [NCUA Part 723](#), Commercial Construction (if applicable).

III. MINIMUM PROCEDURES:

1. Review the policies and procedures pertaining to construction lending to ensure that they address the following:
 - a. Require a risk assessment and establish appropriate management systems for the construction lending program.
 - b. Establish loan limits for the amount of assets and net worth that will be committed to construction lending. Loan limitations must comply with regulatory limitations and sound business practices.
 - c. Require detailed cost estimates and building plans to be obtained from the borrower prior to loan approval to evaluate the accuracy and reasonableness of the estimates. The policy should also include a requirement for prior approval of any changes in the plans and specifications.
 - d. Require the evaluation of all builders' financial stability, experience, and track record.
 - e. Require builder's risk insurance.
 - f. Require building permits to be acquired prior to disbursement of loan proceeds.

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- g. Establish loan to value limitations (70% maximum suggested) to ensure the borrower has sufficient equity in the project.
 - h. Require an initial appraisal to be obtained prior to approval, based on an “as is” condition and “as if completed to specified plans.”
 - i. Require ongoing on-site inspections by qualified individuals, such as the original appraiser, independent of the underwriting function.
 - j. Establish procedures for obtaining initial and subsequent “draws” through the use of a draw schedule.
 - k. Require title insurance. Updated title searches should be performed prior to disbursing draws to ensure the title remains clear. A final title policy should also be obtained to ensure no liens encumbered the property during construction.
 - l. Require due diligence reviews of all third parties assisting in any capacity with the construction lending program.
 - m. Require procedures for the use of interest reserves, if applicable.
 - n. Require reporting to the Board of Directors.
2. Evaluate the construction loan portfolio management, including the following:
- a. Ensure the portfolio complies with policy limitations as well as any applicable regulatory limitations.
 - b. Review management’s procedures for monitoring individual on-going construction projects.
 - c. Review collection procedures for any troubled construction loans.
 - d. Ensure segregation of duties is in place and adhered to.
 - e. Ensure all reporting to the Board of Directors is timely.
3. Review a sample of construction loans, including:
- a. Review files to ensure loans comply with the construction loan policies and procedures and exhibit characteristics conducive to safe and sound lending.
 - b. Ensure files document the following:
 - i. Cost estimates are reasonable and supported;
 - ii. Loan covenants exist which address periodic progress inspections and how subsequent draws will be disbursed;
 - iii. Notice of Commencement was received;
 - iv. Builder’s risk insurance is in effect;
 - v. Title search(s) and title insurance;
 - vi. Lien waivers are received when contractors are paid;
 - vii. Mortgage loan commitment has been received ensuring financing is available after the project is completed.