

1301:9-2-22

Real estate construction loans.

(A) "Construction loans" are loans made for the purpose of building on vacant land or construction additions to existing structures. Because the incomplete structure and the land represent the security for the loan, funds are disbursed in installments as work progresses. One of three methods, or variants thereof, are used to ensure a lien free, and an adequately collateralized loan throughout construction. These three basic methods are:

(1) Progress payment, also referred to as a draw plan. Under this method, portions of the loan proceeds are disbursed to the borrower or general contractor when construction reaches certain stages of completion. These stages must be stipulated in the construction loan agreement. This method provides the least protection to the credit union since frequently no information is obtained as to whether the borrower or general contractor is compensating the subcontractors and materialmen;

(2) Voucher method, under which construction fund payments are usually made directly to the subcontractors and materialmen by the credit union. Payments are made on the basis of vouchers signed by the borrower, general contractor or other persons authorized in the construction loan agreement. Vouchers should be supported by lien waivers, appropriate to the requirements for the area in which the property is located. Under this method some credit unions hold back a percentage of the payments and disburse these funds at some predetermined time following completion of construction; and

(3) Title insurance method, under which a title company assumes responsibility for making construction disbursements and for obtaining the necessary assurance of an unencumbered first lien position for the lender. An updated title insurance policy is issued with each disbursement, insuring the lender to the full amount of the construction disbursements to date. It remains the credit union's responsibility to ensure, through construction inspections, that work is progressing in accordance with plans and specifications.

(B) Credit unions must establish standard procedures for the review and approval of construction loans. These procedures should be designed to provide the credit union with adequate safeguards to ensure lien-free construction of the improvements in accordance with approved plans and specifications. Records shall be available that include the following:

(1) Construction loan agreements that include:

- (a) Allocation of loan proceeds and methods of disbursement; and
 - (b) Descriptions of documents required to support requests for reimbursement.
- (2) Risk analysis work sheets;
 - (3) Copies of feasibility studies;
 - (4) Construction plans and specifications and the builder's cost estimates;
 - (5) Appraisal reports issued by a certified independent appraiser who has satisfied the requirements of Chapter 4763. of the Revised Code and applicable rules or other comparable statutes;
 - (6) Inspection reports;
 - (7) General ledger accounts for construction loans in process, and individual subsidiary ledger accounts for each loan;
 - (8) Construction progress and disbursement records;
 - (9) Reimbursement requests, supporting vouchers, lien waivers, affidavits, releases and receipted bills; and
 - (10) Surveys, soil tests, and data disclosing the availability of water, sewers and utilities.
- (C) The following safeguards must be implemented to assure that construction loans are issued and serviced on a safe and sound basis:
- (1) No disbursement of funds in advance of construction progress. As a result, the credit union will have sufficient undisbursed loan funds to ensure project completion;
 - (2) Loan agreements must include precautionary measures to avoid the filing of mechanics' liens or stop notices;
 - (3) Due consideration must be given to builder's past performance on similar projects including cost estimates to determine their accuracy and reasonableness;
 - (4) Loan agreements must provide for progress inspection to ensure that construction has been performed in accordance with approved plans and specifications, and that labor and material for which reimbursement is requested is evidenced by the construction progress prior to disbursement;

- (5) Disbursement of construction funds that are properly supported by inspection reports;
- (6) Loan agreements must provide that changes in plans and specifications can be made only with prior approval of the credit union; and
- (7) Segregation of construction loan appraisal, inspection and disbursement functions. The disbursement function shall be separate and apart from appraisal and inspection, with all procedures documented as part of the policy.

Replaces: 1301:9-2-22

Five Year Review (FYR) Dates:

Certification

Date

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