

Understanding New Construction Loans

This guide breaks down the ins and outs of new construction loans, including what they are, how they work, and the steps you'll take from application to completion.

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A Comprehensive Guide by The Housing Assistant



Introduction

Building a home from the ground up is an exciting journey, but the financing process is very different from buying an existing home. This guide breaks down the ins and outs of new construction loans, including what they are, how they work, and the steps you'll take from application to completion. We'll also explain construction-to-permanent loans and what documents you'll need along the way.

What is a New Construction Loan?

A construction loan is a short-term loan that finances the cost of building a new home. Unlike a standard mortgage that provides the full loan amount upfront, construction loans are disbursed in stages, called 'draws,' as work is completed.

Types of Construction Loans

Construction-Only: A short-term loan used during the build. Once construction is done, the borrower must refinance into a permanent mortgage.

Construction-to-Permanent (C2P): A one-time close loan that covers both the construction phase and the permanent mortgage, saving on closing costs.

Builder-Financed: The builder carries the construction costs, and the buyer gets a regular mortgage once the home is finished.

Renovation Loans: For improving existing homes, not building new ones (e.g., FHA 203(k), Fannie Mae HomeStyle).

When Should You Use a Construction Loan?

- You're building a custom or semi-custom home
- You're buying land and building from scratch
- Your builder doesn't offer their own financing
- You want more control over the home design and cost

THA Tip: Make sure your builder is approved by the lender before moving forward!

The Construction Loan Process (Start to Finish)

Here's what the typical journey looks like, from application to completed home:

Phase	Key Steps
Pre-Approval	Get qualified based on income, credit, and assets—before building begins.
Land Purchase	You must own the lot or include it in the loan.
Builder Contract	Submit signed contract with full cost breakdown and construction specs.
Appraisal	Appraiser uses plans and lot info to determine future value.
Underwriting	Lender reviews builder credentials, permits, insurance, and budget.
Closing	Loan closes; funds are escrowed and released through draw requests.
Draws & Inspections	Builder requests funds as work is completed; lender may order inspections.
Conversion (C2P only)	Loan switches to mortgage after final inspection and Certificate of Occupancy.

What is a Construction-to-Permanent (C2P) Loan?

C2P loans offer the convenience of a single closing. You finance the build and permanent mortgage in one transaction. During construction, you usually make interest-only payments on the amount drawn. Once construction is complete, the loan converts to a traditional mortgage with principal and interest payments.

THA Tip: Always ask whether you can lock your interest rate upfront or modify it after construction.

What Documents Are Required?

- Fully executed builder contract
- Construction plans, specs, and budget breakdown
- Land deed or purchase contract
- Appraisal based on 'as-completed' home value
- Builder risk insurance and permits
- Title updates at each draw
- Certificate of Occupancy (CO) before final draw or conversion

THA Tip: Stay organized—construction loans move quickly and often require updated docs at each phase.