The U.S. Department of Housing and Urban Development’s (“HUD”) Federal Housing Administration (“FHA”) Multifamily Mortgage Insurance Program is one of the largest drivers of multifamily housing development in the country. Unfortunately, with rising costs and other factors increasing transactional complexity, it is often necessary to utilize multiple funding sources in order to close transactions, particularly those with an affordable component. Different funding sources bring potential for clashes and conflicts, especially with FHA financing’s maze of statutory, regulatory and administrative requirements. This publication aims to help navigate the process of utilizing FHA multifamily financing and the potential pitfalls of using FHA multifamily financing\(^1\) in conjunction with other financing sources.

**The Basics—Why FHA?**

FHA assistance is a very powerful financing tool, but it is not a direct lending program. FHA insures mortgage loans given by HUD approved lenders in accordance with FHA rules and

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1. This publication focuses on the FHA Multifamily program and Multifamily Accelerated Processing (MAP). This publication does not address the FHA Single Family programs or the FHA healthcare (hospital and nursing home) programs. This publication does not address traditionally processed (TAP) transactions.
regulations. If a lender follows FHA rules and regulations regarding appropriate borrowers, procedures, form documents, etc., FHA will pay the lender’s claim in the event the borrower defaults on the loan. FHA minimizes the lender’s risk and encourages the lender to make loans deemed to be in the public interest that the lender would likely not make otherwise. In addition, the presence of FHA mortgage insurance provides for lower interest rates and longer amortization terms than typically found with conventional loans. In this way, the FHA program expands access to credit and mortgage loan lending for affordable and market rate housing and other urban development purposes. In FY 2017, HUD closed approximately 1,050 FHA-insured multifamily transactions worth over $14 billion. At its peak in 2013, HUD closed over 1,600 transactions worth over $16.5 billion.

Because of the public nature of FHA assistance, it is highly regulated. Here are some helpful citations for FHA Multifamily resources:

- **Statute:** FHA is governed by the National Housing Act (12 USC 1701 et seq.).
- **MAP Guide:** FHA Multifamily transactions are typically processed using the Multifamily Accelerated Processing (“MAP”) rules, governed by the MAP Guide (Housing Handbook 4430.G).
- **HUD Closing Guide:** Procedures for closing and legal closing requirements are governed through HUD’s Office of General Counsel (“OGC”) with the FHA Multifamily Program Closing Guide (“Closing Guide”). OGC maintains the most up-to-date versions of the Closing Guide on

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3. References to FHA statutory provisions in this publication will follow HUD’s convention of referring to the sections of the National Housing Act, rather than to their references in the US Code.

4. As of the printing of this publication, the most recent MAP Guide was REV-2, released in January 2016 and available on HUD’s website: https://www.hud.gov/program_offices/administration/hudclips/guidebooks/hsg-GB4430. As with most pages on HUD’s website, they are more easily located through an external internet search engine (by searching for “HUD MAP Guide”) than through internal HUD website navigations or searches.
the Multifamily Document Reform Implementation website, under the “References” link.5

• FAQs: The Multifamily Document Reform Implementation website referred to in the previous bullet paragraph contains many helpful resources, including Frequently Asked Questions (FAQs) organized by “Categories” corresponding to the form documents.6

It is also important to note that there are actually several FHA Multifamily insurance7 programs. For the purposes of this publication, we will focus on the following:

• **Section 221(d)(4)** transactions pertain to new construction and substantial rehabilitation projects. This program is referred to by its section of the National Housing Act (221(d)(4)) (12 USC 1715l(d)(4)). Regulations for 221(d)(4) projects are found at 24 CFR parts 200 and 207.

• **Section 223(f)** transactions are intended for refinancing of existing multifamily housing with only moderate repairs. The program is authorized by sections 207 and 223(f) of the National Housing Act.8 Regulations for 223(f) transactions are found at 24 CFR part 200 and 207.

• **Section 223(a)(7)** transactions refinance projects that are already receiving FHA insurance or are HUD held.9 Regulations for 223(a)(7) transactions are found at 24 CFR part 200 and 207.

In this publication, we will refer generally to the FHA “Multifamily insurance program” or simply the “Multifamily program” to discuss all of these types of transactions, unless we reference something that applies only to a specific program.

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5. As of the publishing of this publication, the most recent version is the February 2015 version. Notwithstanding the instruction in the previous footnote, performing a search for “HUD FHA Closing Guide” will lead you astray as that search returns a prior version of the Closing Guide. OGC has so far been maintaining the most recent version on the MF Document Reform Implementation webpage, which also lists FAQs and is a good place to search for guidance, https://www.hud.gov/program_offices/general_counsel/mffaq5.


7. Again, this guide does not provide reference to the FHA Office of Healthcare Programs (OHP) transactions relating to hospitals and nursing homes.

8. See 12 USC 1715n(f). Section 223(f) of the National Housing Act was added by Section 311(a) of the Housing and Community Development Act of 1974.

9. The program is authorized by sections 207 and 223(a)(7) of the National Housing Act (12 USC 1715n(a)(7)).
The FHA Multifamily program comes with several benefits and challenges. A major benefit of using the FHA Multifamily program is the interest rate. FHA-insured financing is generally able to provide lower interest rates than conventional financing or other government-sponsored enterprises (GSE’s) (Fannie Mae / Freddie Mac), in large part due to the ability to securitize FHA-insured mortgage loans through issuance of a Ginnie Mae mortgage-backed security. Additionally, FHA-insured financing may be provided as one loan for both construction and permanent financing, while many conventional loans require two separate loans. It is also worth noting that the program offers long-term (up to 40-year), stable financing options and allows for loan-to-value ratios and equity withdrawals that many borrowers find favorable. The main drawbacks to FHA financing are the strict government statutory, regulatory and administrative requirements and the time necessary to process and close the loans. These drawbacks are present for straight FHA-insured transactions; when additional financing sources are added, the potential for pitfalls and delays increases exponentially. Not only must you harmonize the individual requirements of all the sources of financing as you would with any combination of financing sources, but FHA has specific requirements relating to the use of any additional financing proposed. This publication aims at helping to navigate those FHA requirements.

Overview of FHA Requirements for Additional Financing

Although the later chapters of this publication will go into additional detail on specific FHA requirements that have caused obstacles or delays in the past, it may be helpful to provide here a brief overview of the MAP Guide’s and Closing Guide’s rules relating to additional financing. A full discussion of all FHA Multifamily rules is obviously beyond the scope of this publication and the reader is encouraged to review and refer to the National Housing Act, its accompanying regulations, the MAP Guide, the Closing Guide and other HUD guidance, as applicable.

MAP Guide Section 8.7—Secondary Financing

FHA rules require the FHA-insured loan to be in first lien position, but allow for subordinate financing. MAP Guide Section 8.7 discusses the majority of the FHA requirements relating to subordinate loans.
• **First Position as Commonly Given.** It is a statutory requirement that the FHA-insured loan be in the first lien position, as commonly given in that jurisdiction. Because this is a statutory requirement, it is not subject to regulatory or administrative waivers. It is important that any encumbrances recorded prior to the FHA security instrument do not create liens.

• **Repayment from Surplus Cash.** Generally, FHA prohibits hard repayments of subordinate financing, limiting repayments on subordinate financing to no more than 75% of “surplus cash,” as defined by FHA rules and documented in the FHA-required regulatory agreement, which must be memorialized in the subordinate loan documents. In addition, the subordinate loan may not mature before the FHA-insured loan unless a waiver is granted by HUD.

• **Public vs. Private Sources.** The MAP Guide distinguishes governmental or public sources of subordinate financing from private sources and treats public sources more flexibly. Public sources can be used to offset FHA equity requirements (but not tax credit equity requirements) and may exceed 100% of the project’s fair market value. Privately sourced secondary financing, except for seller financing, is generally not permitted on 221(d)(4) transactions.

• **Subordinating Documentation.** FHA requires the subordinate position of the additional financing to be documented in one of two HUD-approved forms: the Subordination Agreement (Form HUD-92420M) for publicly sourced financing or the Secondary Financing Rider (Attachment 5.1 to the Closing Guide) for privately sourced financing. The documents basically prohibit repayments to the junior debt (except from surplus cash) while the FHA-insured loan is outstanding and require the junior debt to be assumed by (and only by) a HUD-approved transferee of the project. The subordinate financing documents must terminate if HUD acquires title to the project. HUD tends to be more flexible on negotiating terms of the Subordination Agreement.

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MAP Guide Chapter 14—LIHTC Rules
Although there are rules that apply to Low-Income Housing Tax Credit (LIHTC) transactions throughout the MAP Guide, Chapter 14 is the main collection of the rules applicable to LIHTC transactions.

- Acknowledgement of Common Investor Concerns. In order to step in quickly to preserve a project and tax credits, LIHTC investors commonly seek notice of defaults, cure rights, rights to transfer investor interests in a project and the ability to remove defaulting general partners. In the past, these requests have created the potential for conflict, as FHA rules generally require HUD to approve the owners and controlling interests in an FHA-insured project. Much work has been done by HUD and LIHTC-interested stakeholders in recent years to find mutually agreeable paths forward. See the HUD “Rider to Security Instrument—LIHTC Properties” (Section 5.4 of the Closing Guide) and the “Identification and Certification of Eligible Limited Liability Investor Entities,” (also colloquially referred to as the “LLCI Certificate”).

- Limits on Developer Fees. FHA rules may limit the amount of developer fees that can be paid, depending on the loan to value ratio of the project. Deferred developer fees may be subject to secondary financing requirements, depending on how they are structured.

- Equity Pay-in. HUD requires 20% of total equity to be paid in at closing, with additional requirements for construction completion and final endorsement of the FHA-insured note. These requirements can create challenges in maximizing tax credit pricing.

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12. Although an LLCI certificate is attached to the Closing Guide, the certificate was updated through the 2016 revisions of the Previous Participation Clearance regulations (24 CFR 200, subpart H) (sometimes colloquially referred to as the “2530 requirements”) and the most up to date form is attached to Housing Notice 2016-15, titled the Processing Guide to Previous Participation Reviews of Perspective Multifamily and Healthcare Participants (Processing Guide): https://www.hud.gov/sites/documents/16-1SHSGN.PDF.
13. The Previous Participation regulatory revisions also updated the clearance requirements for tax credit investors. For a helpful review of the revised requirements, see Soroka and Friedgut, User Guide to HUD’s Previous Participation Review Process (aka “2530 approval”), ABA Publishing (2017).
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