HUD Opens FHA Financing to Build-to-Rent Communities, Adding Underwriting Burdens to Access HUD Insurance

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The U.S. Department of Housing and Urban Development's (HUD) recent issuance of Mortgagee Letter 2026-12 marks a significant expansion of the Federal Housing Administration's (FHA) multifamily platform. It opens the door to FHA-insured financing for qualifying build-to-rent (BTR) communities consisting of detached homes, duplexes, and triplexes.

While the guidance formally recognizes BTR as an eligible multifamily housing product, it also reflects HUD's view that rental-home communities should not be underwritten the same way as conventional apartment buildings with four or more units.

The result is a framework that offers BTR developers access to FHA financing while imposing underwriting standards tailored to the realities of operating rental-home communities.

HUD Creates a BTR Financing Path

Historically, HUD's multifamily programs focused on traditional apartment properties. According to the Mortgagee Letter, BTR communities were generally excluded due to concerns regarding accessibility requirements, valuation methodology, and underwriting challenges associated with subdivision-style developments. HUD now acknowledges the growing role professionally managed BTR communities play in the housing market and has responded by making qualifying projects eligible for FHA-insured financing.

Under the new guidance, qualifying BTR projects are eligible for:

- Section 221(d)(4) financing for new construction; and
- Section 223(f) financing for acquisition or refinancing of recently developed projects with certificates of occupancy issued less than three years before application.

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To qualify, projects generally must operate as a single, cohesive rental community under common ownership and management and may not permit parcel sales or partial collateral releases during the insured loan term. Common use areas and amenities of BTR projects must satisfy accessibility standards common for traditional apartment complexes.

Lease-Up Risk Receives Special Attention

One of the most notable aspects of the guidance is HUD's treatment of lease-up risk.

Unlike conventional apartment communities, BTR developments are often delivered in phases, may continue construction while portions of the project are occupied, and frequently target households seeking longer-term housing solutions. HUD specifically acknowledges that these characteristics can produce a slower and more complex absorption pattern than is typical for traditional multifamily developments.

To account for those differences, HUD permits absorption periods of up to 24 months for new construction BTR communities. The Mortgagee Letter also requires lenders to support lease-up assumptions through detailed analysis of comparable BTR properties and mandates a minimum Initial Operating Deficit escrow equal to the greater of 3% of the loan amount or four months of debt service.

At first glance, these requirements may appear unfavorable to developers. Larger escrows tie up capital, and longer lease-up assumptions can reduce supportable loan proceeds.

Yet the significance of the policy is not that it provides more aggressive underwriting. Rather, it acknowledges economic reality. By recognizing that rental-home communities often stabilize differently than apartment properties, HUD is creating a financing pathway tailored to the asset class rather than forcing sponsors into assumptions designed for a fundamentally different product.

HUD Expects Higher Operating Expenses

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HUD also recognizes that BTR communities may have higher operating expenses than apartment projects. Low-density layouts often require additional spending on roads, landscaping, grounds maintenance, and dispersed building systems. Accordingly, HUD encourages lenders to rely on BTR operating data and industry benchmarks rather than traditional apartment comparables.

Similarly, the agency anticipates higher Reserve for Replacement deposits because detached-home communities contain significantly more roofs, windows, and exterior building components than a conventional apartment project of similar size.

HUD Requires Conservative Vacancy Estimates

HUD requires market-rate BTR projects to estimate vacancy at the higher of 7% or a market-based rate of comparable projects, and affordable BTR projects must estimate at least 5% vacancy. Smaller BTR projects may need to estimate higher rates of vacancy because each vacant unit has a greater impact on the overall project. HUD indicates these conservative estimates are currently required because of the relative newness of BTRs and HUD's lack of information on BTR projects, so estimated vacancy rates may be reduced in the future as the BTR market matures.

Additional Underwriting Burdens for HUD Access

The practical impact of these requirements is straightforward: Developers may encounter lower proceeds, larger escrows, and higher reserve deposits than they would prefer. In that sense, the new guidance does not make underwriting easier. However, by establishing underwriting standards specifically designed for rental-home communities, HUD has created a pathway for BTR developers to access the FHA platform and its long-term, fixed-rate financing options. In many cases, that access may outweigh the burden of the additional underwriting requirements.

Where Do Rental Townhomes Fit?

The Mortgagee Letter references detached homes, duplexes, and triplexes as qualifying BTR product types but does not specifically

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address attached townhome communities.

Importantly, that omission does not mean townhomes are excluded from FHA financing. Townhome projects have long been eligible under HUD's traditional multifamily programs, where buildings contain four or more dwelling units.

Key Takeaways

The significance of Mortgagee Letter 2026-12 is not that HUD has relaxed its underwriting standards. Rather, HUD has acknowledged that BTR communities are a legitimate multifamily asset class and created an FHA financing framework tailored to their unique operating characteristics.

For developers, the trade-off is clear: accept more conservative underwriting assumptions in exchange for access to one of the most attractive long-term financing platforms in the multifamily market. A developer does not benefit from being forced to escrow more cash. However, a developer may benefit from an underwriter that recognizes the actual business plan rather than insisting on apartment-style absorption assumptions that are unrealistic. Similarly, the operating expense adjustments may reduce proceeds initially, but they may also produce more durable underwriting that is less likely to require future capital support.

The Mortgagee Letter does not create underwriting advantages for BTR projects. Rather, it creates underwriting credibility. HUD is effectively acknowledging that BTR communities operate differently than traditional apartment projects and providing a framework through which those differences can be financed rather than ignored. The remaining question is where rental townhome communities fit within that framework, and whether future HUD guidance will expand the definition of BTR housing.

How We Can Help

FBT Gibbons routinely counsels developers, sponsors, lenders, investors, and other stakeholders on FHA-insured multifamily financing and HUD programs nationwide. We can help structure build-to-rent transactions, evaluate project eligibility, and navigate

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HUD's underwriting requirements. For further guidance, contact the author or any member of our Multifamily Housing team.

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