HUD Cash Flow Distributions: *How to Qualify for Monthly Draws*

A Practitioner's Guide to HUD's Requirements on Surplus Cash

For most of HUD's history, cash flow distributions on a HUD-insured apartment property could be taken only twice a year. Mortgagee Letter 2022-16 changed that in September 2022, and eligible borrowers can now distribute cash to their investors monthly. The catch is that the monthly election has to be made at closing and cannot be added afterward, and most properties have to season before distributions change from semi-annual to monthly. This article covers how the election works, how the seasoning clock runs, when seasoning can be waived entirely, and how the cash flow calculation is performed.

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Published July 2026

Current as of July 2026.

Latest version: roachlorenz.com/resources/hud-cash-flow-distributions/

Anyone who has put a HUD execution up against Fannie Mae or Freddie Mac has run into the same question: how often cash can be distributed to investors. Until 2022 the answer was only twice a year. On a conventional execution, cash flow can go to the owner every month. On a HUD deal, an owner distributed in June and December. We have both watched that single rule be the deciding factor against using a HUD-insured loan.

Thankfully, HUD fixed it on September 7, 2022 when it issued Mortgagee Letter 2022-16. It lets eligible borrowers take monthly distributions. It should be known, however, that the rule is narrower than the headline initially suggests, because most projects need to season into eligibility and existing HUD mortgages aren't

grandfathered in.

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BACKGROUND

The Semi-Annual Rule and *Why Borrowers Complained*

The semi-annual distribution rule lived in Section 13 of the Regulatory Agreement where it required that the borrower calculated Surplus Cash as of the last day of its fiscal year, with an optional second calculation on the last day of the sixth month.

> **Surplus Cash, in one line.** Surplus Cash is a point-in-time cash test rather than an income calculation. It is project cash and equivalents, less everything due within the next 30 days — principal, interest, MIP, and reserve and escrow deposits — less funds that must be segregated, including tenant security deposits.

That structure dates to the 1970s, when HUD's insured book was dominated by Section 236 and Section 8 properties operating on constrained subsidized income, and when the bookkeeping behind a surplus cash calculation was done by hand.

Before the change, the practical effect was a genuine disadvantage against every other execution on the table. A sponsor running a portfolio on conventional debt receives cash monthly. A sponsor with one HUD asset in that portfolio has to explain to investors why that one property pays out on a different schedule, why the preferred return accrues against cash the property has already earned but cannot release, and why the December distribution is carrying six months of operations. For sponsors and developers weighing HUD against the agencies, this came up constantly, and it was one of the more common reasons to take a FNMA or Freddie execution. HUD knew these were outdated rules and said that the timing change would align its requirements with industry standards and improve its competitive standing against other lending options.

A broader pattern. Over the last six years HUD has removed or loosened several of the constraints that made the program harder to use than its terms deserved.

- **March 2020** — Mortgagee Letter 2020-03 ended the 223(f) three-year rule, opening the program as a construction takeout.
- **September 2022** — Mortgagee Letter 2022-16 allowed monthly cash flow distributions.
- **January 2025** — Mortgagee Letter 2025-03 lowered minimum DSCR and raised maximum LTV/LTC.
- **October 2025** — HUD cut MIP to 25 basis points across every multifamily program and eliminated the Green, Affordable, and Broadly Affordable rate categories.
- **May 2026** — Mortgagee Letter 2026-04 pared back environmental requirements covering railroad vibration, pressurized pipelines, fall hazards, and noise-sensitive outdoor use.

02

THE ELECTION

How to Get *Monthly Cash Flow Distributions*

While HUD allows for monthly distributions now, it is not automatic, and sponsors need to be aware of the requirements. Mortgagee Letter 2022-16 added one line to the Regulatory Agreement:

ADDED TO THE REGULATORY AGREEMENT BY ML 2022-16
Election for Monthly Surplus Cash Distributions: _____ Yes _____ No

This box must be checked “Yes” at closing. HUD states that if this is not checked “Yes” the project is not eligible for monthly distributions. Further, projects with loans closed before the 2022 effective date are not eligible, and HUD will not consider amendments to executed Regulatory Agreements on existing mortgages.

Not every property qualifies. Projects with a project-based Section 8 HAP contract are not eligible for the monthly distribution option. Neither are projects on a HUD-held note, meaning a mortgage HUD holds directly — usually one a lender assigned to HUD in exchange for insurance benefits — rather than an ordinary HUD-insured loan. Those borrowers stay on the annual calculation with the optional semi-annual calculation.

Checking Yes buys the right to qualify rather than the automatic right to distribute. Three conditions apply on an ongoing basis:

- **Compliance and reporting.** The borrower must be in compliance with all applicable Program Obligations, with no outstanding violations relating to financial management or annual financial reporting, and no more than one instance of non-compliance during the preceding three fiscal years. One late annual financial statement does not disqualify a borrower, however, two do.
- **Debt service coverage.** The project must meet the minimum DSCR established in Program Obligations, which is currently 1.15 for market-rate properties and 1.11 for LIHTC properties with a rent advantage to market. The number is the same one used to size the loan, applied here against audited operating results.
- **Physical condition.** The most recent REAC/NSPIRE inspection score must be 80 or above, with no score below 60 during the preceding three fiscal years.

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SEASONING

HUD *Seasoning Rules* for Monthly Distributions

While the HUD rule is a welcome change for qualifying projects, the monthly distributions don't start automatically.

New construction and substantial rehabilitation properties, and properties that have gone through a transfer of physical assets (TPA), require two full fiscal years of seasoning from the date of final endorsement or transfer. Newly endorsed 223(f) properties require one full fiscal year.

The key words that Borrowers (and HUD Originators) often miss are “full fiscal year.” It is not twelve months from endorsement, but rather after a full fiscal year. For example, take a 223(f) that endorsed in March 2026, so the first full fiscal year ends 12/31/2027. This means monthly distributions become available in 2028 — twenty-two months after endorsement.

On new construction and substantial rehabilitation, the two full fiscal years run from final endorsement rather than initial endorsement, so the entire construction period and cost certification sit in front of the clock before it starts. Take a 221(d)(4) with initial endorsement in early 2026 and final endorsement in mid-2028. The two full fiscal years are 2029 and 2030, and monthly distributions become available in 2031.

TWO SEASONING TIMELINES — CALENDAR FISCAL YEAR
223(f), endorsed March 2026: first full fiscal year 2027 → monthly distributions available 2028

221(d)(4), final endorsement mid-2028: full fiscal years 2029 and 2030 → monthly distributions available 2031

But know that seasoning is not a distribution blackout. A borrower working through the seasoning period still operates under Section 13.b of the Regulatory Agreement, which is the annual calculation with the optional semi-annual calculation at the six-month mark. The borrower is on the old rule temporarily rather than locked out of its cash.

Whatever the seasoning timeline looks like, we recommend Borrowers check the Monthly Distribution box at closing, no matter how far out the first monthly distribution is.

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WAIVERS

When You *Don't Have to Season*

HUD does have special rules where some qualifying, HUD-experienced sponsors can skip seasoning entirely on a 223(f). The one full fiscal year does not apply if the Borrower or its Active Principals have owned at least two FHA-insured projects for the prior five full fiscal years with no 2530/APPS flags or regulatory violations during that period. A sponsor who clears that test takes monthly distributions from the first month after endorsement.

There is also a second path. The Regional Director may approve monthly distributions for a newly endorsed property where the Borrower or its Active Principals have owned at least one FHA-insured project for at least three of the prior five full fiscal years with no APPS flags or regulatory violations, and have contracted with an experienced management agent and an independent auditor that HUD, in its sole discretion, deems satisfactory.

Two limits on this are worth knowing before a sponsor plans around it. The waiver language attaches only to the 223(f) sentence, so there is no waiver path for new construction, substantial rehabilitation, or a transfer of physical assets. And a TPA resets the clock to that same two full fiscal years, so an experienced buyer acquiring a stabilized insured property whose Regulatory Agreement already carries the election still starts over.

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ONGOING RULES

Running *Monthly Distributions*

A borrower taking monthly distributions calculates Surplus Cash as of the end of the prior month and may distribute only to the extent the number is positive. The borrower preserves each calculation and makes it available for HUD inspection. Every borrower, monthly or not, still performs and reports the annual calculation with its annual financial statements.

The annual true-up. A borrower taking monthly distributions has to demonstrate positive Surplus Cash on the annual calculation. If the annual number comes out negative, distributions taken during that fiscal year must be repaid to project-related accounts within sixty days of fiscal year end, or a longer period if HUD approves one. Distributions authorized based on the prior fiscal year's annual computation are not subject to repayment.

Monthly distributions are therefore provisional until the fiscal year closes, and twelve months of positive monthly calculations can still produce a repayment obligation if the audited year-end number goes the other way. That argues for leaving cushion rather than distributing to the last dollar every month.

Distributions are broader than owner draws. Under the Regulatory Agreement, a Distribution is not limited to a check written to the sponsor. It reaches payments to affiliates and principals and cash outlays that are not properly project expenses. Paying a non-project expense out of the project operating account is a distribution whether anyone intended it as one, and unauthorized distributions are an example of a compliance failure that costs a borrower the monthly election under the first eligibility condition.

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IN PRACTICE

What to *Settle Before Closing*

Because the election is only available at closing, monthly distributions are an application-stage conversation rather than something asset management sorts out later. Three items are worth resolving early:

- That the Regulatory Agreement will carry the election marked **Yes**. This is the item with no second chance.
- Where the seasoning clock lands given the program, the expected endorsement date, and the borrower's fiscal year end — and whether closing timing within the fiscal year is worth adjusting.
- Whether the sponsor's Active Principals clear the two-project, five-year test that waives 223(f) seasoning, and whether APPS is clean.

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FREQUENTLY ASKED

Common Questions About *Monthly HUD Distributions*

Can I switch my existing HUD loan to monthly draws?

Not on the existing loan. The election is made in the Regulatory Agreement at closing, and HUD will not amend an executed Regulatory Agreement to add it. A refinance executes a new Regulatory Agreement, which carries a new election, so a 223(a)(7) or 223(f) is the route for a loan endorsed on or before September 7, 2022.

What counts as a full fiscal year for seasoning?

A complete fiscal year of the borrower's, not twelve months measured from endorsement. The partial year between endorsement and the borrower's fiscal year end does not count. A calendar-year borrower endorsing a 223(f) in March 2026 and one endorsing in November 2026 both become eligible in 2028.

My property has a Section 8 HAP contract. Am I eligible?

No. Mortgagee Letter 2022-16 applies to non-assisted properties. A property subject to a project-based Section 8 Housing Assistance Payments contract, or subject to a HUD-held note, remains on the annual calculation with the optional semi-annual calculation.

Does NSPIRE change the REAC score requirement?

The thresholds still apply as written. REAC continues to administer the inspections, NSPIRE kept the 0 to 100 scale, a score below 60 is still failing, and a score of 30 or below still draws an automatic referral to the Departmental Enforcement Center. What changed in October 2023 is how the score is built - NSPIRE reorganized the inspectable areas, weighted deductions by defect severity, and shifted emphasis from appearance to resident health and safety. Because the eligibility test looks back three fiscal years, it now straddles that transition, and a pre-2024 score and a post-2024 score for the same property are not measuring the same thing.

Do surplus cash notes still get paid before I take a distribution?

Yes. Mortgagee Letter 2022-16 states directly that the additional distribution opportunities do not obviate the borrower's obligations on any outstanding Surplus Cash notes. Where a deal carries soft debt, a deferred developer fee, or seller financing documented on a Surplus Cash Note, payments on that subordinate debt run cumulatively from up to 75% of available Surplus Cash, leaving 25% as the owner's incentive. Electing monthly distributions changes the timing of the calculation, not the split.

What happens if year-end surplus cash comes out negative?

Distributions taken during that fiscal year have to be repaid to project-related accounts within sixty days of fiscal year end, unless HUD approves a longer period. Distributions authorized off the prior fiscal year's annual computation are not affected.

Does electing monthly distributions affect loan sizing?

No. The election governs how often the borrower can take money out after closing. It has no effect on the four sizing tests, on the underwritten DSCR, or on proceeds.

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HUD/FHA Multifamily Origination

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