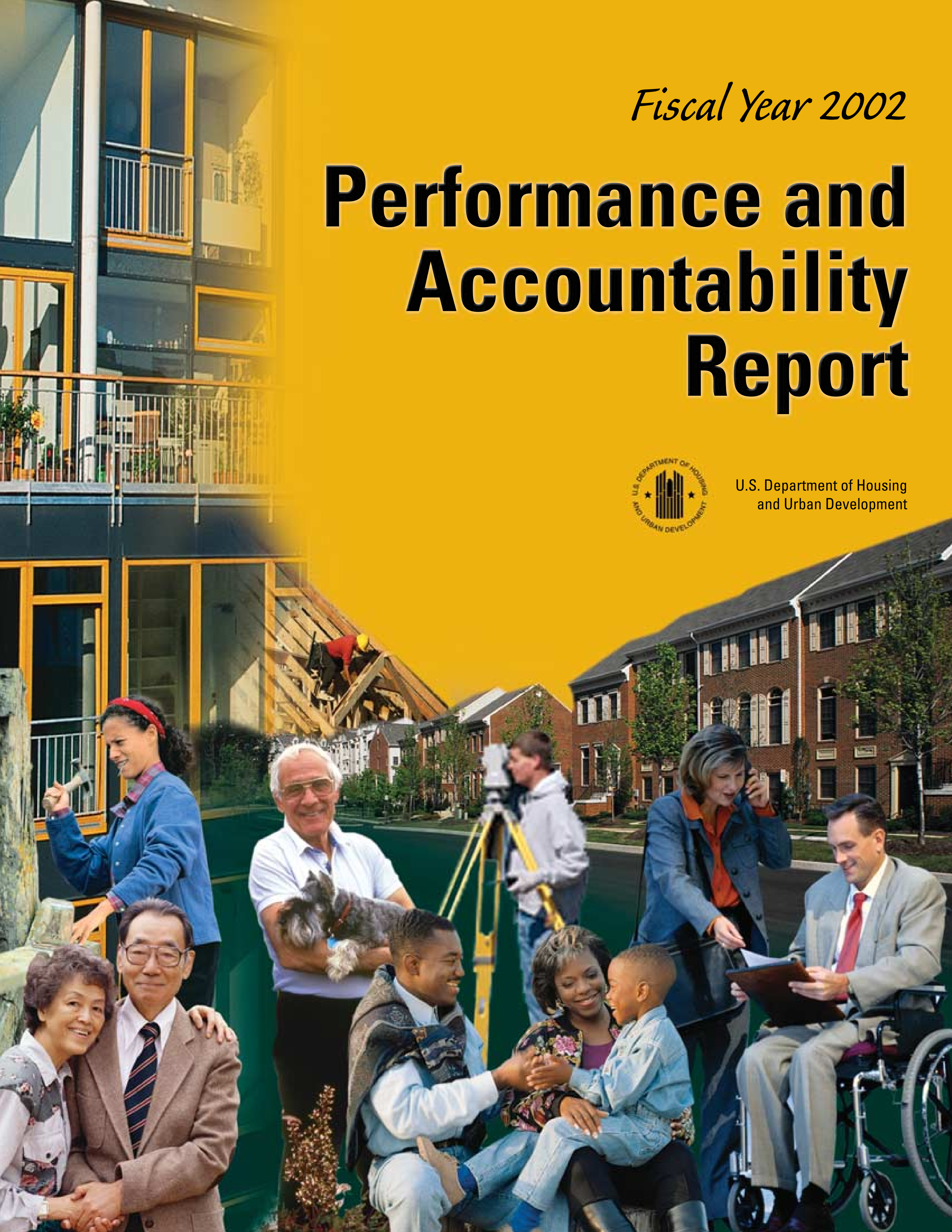
*Fiscal Year 2002*

# Performance and Accountability Report



U.S. Department of Housing and Urban Development

The FY 2002 Performance and Accountability Report consists of three major parts:

- Part 1, Management Discussion and Analysis
- Part 2, Performance Information
- Part 3, Financial Information
- In addition, there are four Appendices.

Each page has a header that indicates which Part (1, 2, or 3) of the Report you are in. The page numbering at the bottom center of each page also corresponds to the Part of the report you are in. The page numbering consists of an Arabic number (which indicates which Major Part of the Report you are in) followed by a dash followed by sequential Arabic numbers starting with 1.

- The Management Discussion and Analysis is numbered 1-1, 1-2, 1-3, etc.
- Performance Information is numbered 2-1, 2-2, 2-3, etc.
- Financial Information is numbered 3-1, 3-2, 3-3, etc.
- The Appendices are numbered A-1, A-2, A-3, etc.

This report and prior year reports are available on the web at

***www.hud.gov/offices/cfo/reports/cforept.cfm***

The following is a list of direct web links to the major HUD program offices:

| | |
|---|---|
| Community Planning and Development | ***www.hud.gov/offices/cpd/about/cpd_programs.cfm*** |
| Fair Housing and Equal Opportunity | ***www.hud.gov/progdesc/fheoindx.cfm*** |
| Federal Housing Administration | ***www.hud.gov/offices/hsg/hsgabout.cfm*** |
| Government National Mortgage Association | ***www.hud.gov/progdesc/gnmaindx.cfm***<br>***www.ginniemae.gov/*** |
| Government Sponsored Enterprises | ***www.hud.gov/offices/hsg/gse/gse.cfm*** |
| Healthy Homes/Lead Hazard Control | ***www.hud.gov/offices/lead/*** |
| Multifamily Housing | ***www.hud.gov/offices/hsg/mfh/progdesc/progdesc.cfm*** |
| Single Family Housing | ***www.hud.gov/funds/singlefamily.cfm*** |
| Public and Indian Housing | ***www.hud.gov/progdesc/pihindx.cfm*** |
| Policy Development and Research | ***www.hud.gov/progdesc/pdrindx.cfm*** |

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# I. Management Discussion and Analysis

## Message from Secretary Martinez

January 31, 2003

I am pleased to report that Fiscal Year 2002 was a year of continued improvement and significant achievement for the U.S. Department of Housing and Urban Development. HUD's FY 2002 ***Performance and Accountability Report*** highlights accomplishments, management stewardship, and financial information for HUD's vital housing and community development programs. It also documents our expanded efforts to integrate the Department's budget and performance and to promote electronic government. In addition, this year's report has been prepared to better meet the public's need for transparency in government. Our performance goals are clearly listed, accompanied by concise statements about how we fared in meeting our goals, with a detailed examination of the results and our performance for each goal.

The Department's mission is to "promote adequate and affordable housing, economic opportunity, and a suitable living environment free from discrimination." This is a complex challenge, but it reflects the responsibility we have to the citizens of the United States. As a key member of the federal government's domestic family, HUD is dedicated to working with our federal, state, and local partners and the United States Congress to efficiently and effectively deliver critically needed programs and services to the American people. To underscore our commitment, I am pleased to highlight some of HUD's accomplishments in the areas of homeownership, consumer protection, predatory lending, affordable housing, fair housing, and chronic homelessness.

Over the past two years, the national homeownership rate for all Americans has reached record levels of 68 percent, but minority homeownership rates still lag too far behind. In FY 2002, the President issued a bold challenge to create 5.5 million new minority homeowners by the end of the decade, and HUD is working in unprecedented partnership with representation from throughout the housing industry to answer that challenge. HUD programs will play key roles in helping reach the President's goal, including FHA mortgage insurance, an important source of financing, especially for minority and lower income homebuyers; homeownership vouchers; the HOME program; Community Development Block Grants; housing counseling; and other focused efforts.

During FY 2002, HUD launched a major consumer advocacy initiative: reforming outdated and needlessly complex regulatory requirements under the Real Estate Settlement Procedures Act (RESPA). RESPA reform is intended to make the process of buying and refinancing a home significantly simpler, less expensive, and better able to protect consumers—especially the vulnerable elderly, lower income, and minority Americans—from unscrupulous lending practices. Simplifying and improving the real estate settlement process will be a landmark accomplishment, saving American homebuyers an estimated six to ten billion dollars a year.

To assist citizens who decide against or who may not be prepared for homeownership, HUD also maintains a commitment to increasing quality affordable rental housing. Working with public agencies, nonprofit, faith-based, and community organizations as well as private partners, the Department has helped expand the availability of affordable housing and improve structural and living conditions at HUD-insured and—assisted rental housing projects. Moreover, a variety of HUD program offices offer specially targeted programs to provide housing and other essential support to populations with special needs, including the elderly, persons with disabilities, individuals with HIV/AIDS, and the homeless.

The Department plays a major role in another challenge issued by President Bush: to end chronic homelessness within ten years. Research indicates that approximately ten percent of all homeless persons are chronically homeless and that this population consumes over half of the resources designed to assist all homeless individuals and families. To help meet this ambitious goal, we reactivated the Interagency Council on Homelessness, which had been dormant for the previous six years. The Council consists of 18 federal agencies that assist homeless individuals and families, and as HUD Secretary I serve as chairman. We have shifted the federal emphasis to meeting the needs of the most vulnerable homeless persons, and made more resources available for local homelessness programs. During FY 2002, HUD awarded a record $1.1 billion to fight homelessness, and achieved notable success in expanding the supply of permanent and transitional housing with supportive services.

In FY 2002, the Department also completed the National Housing Discrimination study. The report compares results to a 1989 study and provides up-to-date information to further fight discrimination, expand homeownership, and increase housing opportunities for all Americans. While the report reflects progress in many areas, unacceptable levels of discrimination persist which we continue to address.

Regarding the management of HUD, I certify with reasonable assurance that, except for the one material weakness and the two non-conformance issues specifically identified in the Financial Management Accountability section of this report, the Department is in compliance with the provisions of Section 2 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. While the Department maintains its commitment of full compliance of its internal controls and systems and while most of the Department's financial management systems are substantially compliant, I am unable to certify that HUD fully meets the requirements of Section 4 of the Act. HUD has not been able to certify compliance with Section 4 since FMFIA was enacted in 1982. However, this report evidences the plans and progress HUD is making to establish fully compliant financial management systems that better meet the Department's business needs.

HUD is further committed to providing financial and performance data that are complete and reliable to those who rely on such data for decision-making. This report responds to past reviews and continues our efforts to improve data reporting by replacing estimates with actual data, by improving the quality and extent of reporting, and by establishing baselines where necessary. In general, the financial and performance data in this report are complete and reliable with any exceptions noted in Sections 2 and 3 of this report. Sections 2 and 3, covering Performance Information and Financial Information, discuss the reliability and completeness of the data. Finally, the "President's Management Agenda" and "Financial Management Accountability" sections describe our continuing efforts to provide timely and useful performance and financial data to Congress, OMB, the public, and HUD managers.

I look forward to continued and successful working relationships with our program partners and the Congress. Our goal is to improve both the performance and financial accountability of HUD's vital housing and community development programs, which will enable us to provide better service to the American people.

Mel Martinez
Secretary

# An Overview of the Performance and Accountability Report

HUD's Performance and Accountability Report for Fiscal Year 2002 provides the Congress and the American people with an accounting for the results of the expenditure of public funds towards the mission and strategic goals and objectives of the Department for this year. The Department pursues its mission by specifying in a six-year Strategic Plan and Annual Performance Plans the strategic goals and objectives HUD seeks to achieve through its funded programs.

The ***Management Discussion and Analysis*** section of this report provides summary information on HUD's:

- organization and major programs,
- strategic goals and objectives for FY 2002,
- performance highlights in FY 2002,
- progress in meeting management challenges and correcting material weaknesses, including activity under the President's Management Agenda, and
- analysis of financial conditions and results for FY 2002.

The ***Performance Information*** section of this report provides detailed data and analysis on specific performance indicators under each FY 2002 strategic goal and objective.

HUD's five strategic goals in FY 2002 were to:

1. Increase the availability of decent, safe and affordable housing in American communities,
2. Ensure equal opportunity in housing for all Americans,
3. Promote housing stability, self-sufficiency and asset development of families and individuals,
4. Improve community quality of life and economic vitality, and
5. Ensure public trust in HUD.

The ***Financial Information*** section of the report provides the Department's consolidated financial statements for FY 2002, along with the independent auditor's report on those financial statements. This section also contains the HUD Inspector General's independent assessment of the Department's major management and performance challenges and progress in addressing those challenges.

The FY 2002 Performance and Accountability Report satisfies the reporting requirements of the:

- Federal Managers' Financial Integrity Act of 1982,
- Chief Financial Officers Act of 1990,
- Government Performance and Results Act of 1993,
- Government Management Reform Act of 1994, and
- Reports Consolidation Act of 2000.

# Major Program Areas

HUD's major program areas fall into three categories:

1. The Federal Housing Administration (FHA)

2. The Government National Mortgage Association (Ginnie Mae)

3. HUD's Grant, Subsidy, and Loan Programs

## 1. Federal Housing Administration

FHA programs provide insurance on mortgages originated by private lenders relating to one to four family residences, multifamily rental housing, condominiums, nursing homes, assisted living facilities, hospitals, manufactured housing, property improvement, and "special risk" units.

FHA has been an innovator in housing finance from its introduction of mortgage insurance in the 1930s to reverse annuity mortgages for seniors in the 1980s. For nearly 70 years, FHA has successfully supported the availability of capital for single family and multifamily homeownership and for the development of affordable rental housing, stabilizing the housing markets and providing homeownership opportunities. FHA continues to serve families and markets that are not well served by the conventional mortgage markets.

**FHA Funds.** FHA's activities are financed by the FHA Funds, which are supported through premium and fee income, interest income, congressional appropriations, borrowings from the U.S. Treasury and other sources. There are four FHA Funds:

1. ***The Mutual Mortgage Insurance (MMI) Fund***, a historically self-sustaining fund that supports FHA's basic single family homeownership program. At the end of FY 2002, the MMI Fund comprised 82.95 percent of the FHA Insurance Fund.

2. ***The General Insurance (GI) Fund***, which supports a wide variety of multifamily and single family insured loan programs for rental apartments, cooperatives, condominiums, housing for the elderly, nursing homes, hospitals, property improvement, manufactured housing (Title I) and disaster assistance. At the end of FY 2002, the GI Fund comprised 16.06 percent of the FHA Insurance Fund.

3. ***The Special Risk Insurance (SRI) Fund***, which supports multifamily rental projects and loans to high risk borrowers. At the end of FY 2002, the SRI Fund comprised 0.95 percent of the FHA Insurance Fund.

4. ***The Cooperative Management Housing Insurance (CMHI) Fund***, a historically self-sustaining fund that supports insurance on market-rate cooperative apartment projects. This fund is no longer active, except for refinancing. At the end of FY 2002, the CMHI Fund comprised 0.04 percent of the FHA Insurance Fund.

## 2. Government National Mortgage Association (Ginnie Mae)

Ginnie Mae, through its Mortgage-Backed Securities program, facilitates the financing of residential mortgage loans by guaranteeing the timely payment of principal and interest to investors of privately issued securities backed by pools of mortgages insured or guaranteed by FHA, the Department of Veterans Affairs, and the Rural Housing Service. The Ginnie Mae guarantee gives lenders access to the capital market to originate new loans.

## 3. HUD's Grant, Subsidy, and Loan Programs

The most significant of these in terms of expenses are:

**Grant, Subsidy, and Loan Program Gross Expenses for FY 2002**

| | | |
|---|---|---|
| Section 8 Lower Income Rental Assistance | $18.474 billion | 48.6% |
| Community Development Block Grants (CDBG) | $5.443 billion | 14.3% |
| Public and Indian Housing (PIH) Grants and Loans | $4.252 billion | 11.2% |
| Operating Subsidies for Public Housing Agencies | $3.699 billion | 9.7% |
| HOME Investment Partnerships | $1.551 billion | 4.1% |
| Housing for the Elderly and Disabled | $1.163 billion | 3.1% |
| All Other Programs | $3.437 billion | 9.0% |
| Total | $38.019 billion | 100% |

Expenses during FY 2002 for grant, subsidy, and loan program expenses were $38.019 billion compared to $34.571 billion in FY 2001. The following is a description of these programs.

**The Office of Housing** administers rental subsidy, homeownership subsidy, and grant programs designed to provide housing to low and moderate income persons.

***Section 8 Project-Based Rental Assistance:*** This program encourages owners to develop or rehabilitate rental housing for low and very-low income families with rental assistance tied to specific units under an assistance contract with the project owner.

***Section 202/811 Capital Grants:*** Capital grants are provided for the construction and long-term support of housing for the elderly (Section 202) and persons with disabilities (Section 811). Advances are interest-free and do not have to be repaid providing the housing remains available for low-income persons for at least 40 years. Prior to the Section 202 Capital Grant program, Section 202 loans were made to finance housing for low-income elderly persons.

***Other Housing Programs:*** Housing also maintains manufactured housing construction and safety standards, administers the Real Estate Settlement Procedures Act (RESPA), and regulates interstate land sales.

**The Office of Public and Indian Housing (PIH)** serves low-income families and individuals who live in public housing, Section 8-assisted housing, and Native American housing.

***Section 8 Tenant-based Rental Assistance*** is provided to low-income families to enable them to obtain decent, safe and sanitary housing in privately owned housing units. This tenant-based-rent-subsidies program is administered by State and local Housing Authorities (HAs).

Public Housing Operating Subsidies are financial assistance provided for project operations to approximately 3,160 HAs managing approximately 1.2 million units.

Public Housing Capital Funds are provided for capital improvements (i.e., developing, rehabilitating and demolishing units), for replacement housing, and for management improvements.

***Native American Housing Block Grants and Home Loan Guarantees*** assist Native Americans in building or purchasing homes on Trust Land; obtaining affordable housing; implementing local housing strategies to promote homeownership; and developing communities.

***Supportive Services to Families and Individuals*** are grants to HAs to administer programs that help to stabilize the lives of families living in public housing.

**The Office of Community Planning and Development (CPD)** administers the Department's major economic and community development grant programs, several housing programs, and HUD's homeless assistance programs. The following are the largest:

***Community Development:*** Community Development Block Grants are provided to units of local government and States for the funding of local community development programs that address housing and economic development needs, primarily for low and moderate income persons.

*Affordable Housing Programs:* HOME Investment Partnership Grants provide assistance to renters, existing home-owners, and first-time homebuyers, build state and local capacity to carry out affordable housing programs, and expand the capacity of nonprofit community housing organizations to develop and manage housing. The Housing Opportunities for Persons with AIDS (HOPWA) provides affordable housing and related assistance to persons with HIV/AIDS.

*Homeless Programs:* This consists primarily of grants to public and private entitles to establish comprehensive systems for meeting the needs of homeless people.

**The Office of Fair Housing and Equal Opportunity (FHEO)** enforces the Federal Fair Housing Act and other civil rights laws in its effort to ensure equal housing opportunity. The Federal Fair Housing Act prohibits discrimination based on race, color, religion, sex, national origin, disability, or familial status. FHEO also endeavors to direct jobs, training, and economic opportunities to low-income residents in communities receiving housing and community development assistance.

*Fair Housing Assistance Program (FHAP)* provides grants to State and local agencies that administer fair housing laws which are substantially equivalent to the Federal Fair Housing Act.

*Fair Housing Initiatives Program (FHIP)* provides funds competitively to private and public entities to carry out local, regional and national programs that assist in eliminating discriminatory housing practices and educate the public and housing providers on their fair housing rights and responsibilities.

**The HUD Center for Faith and Community-Based Initiatives** is one of five Cabinet department centers formed by the President to implement his vision of government and faith-based and community-based organizations working together to accomplish the shared objective of more effectively helping the needy. The Center's goal is simple: More organizations providing more services to help more people.

**The Office of Healthy Homes and Lead Hazard Control** provides funds to state and local governments to develop cost effective ways to reduce lead-based paint hazards and other housing related health risks.

**The Office of Federal Housing Enterprise Oversight (OFHEO)** is an independent office within HUD that provides oversight with respect to the financial safety and soundness of the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae).

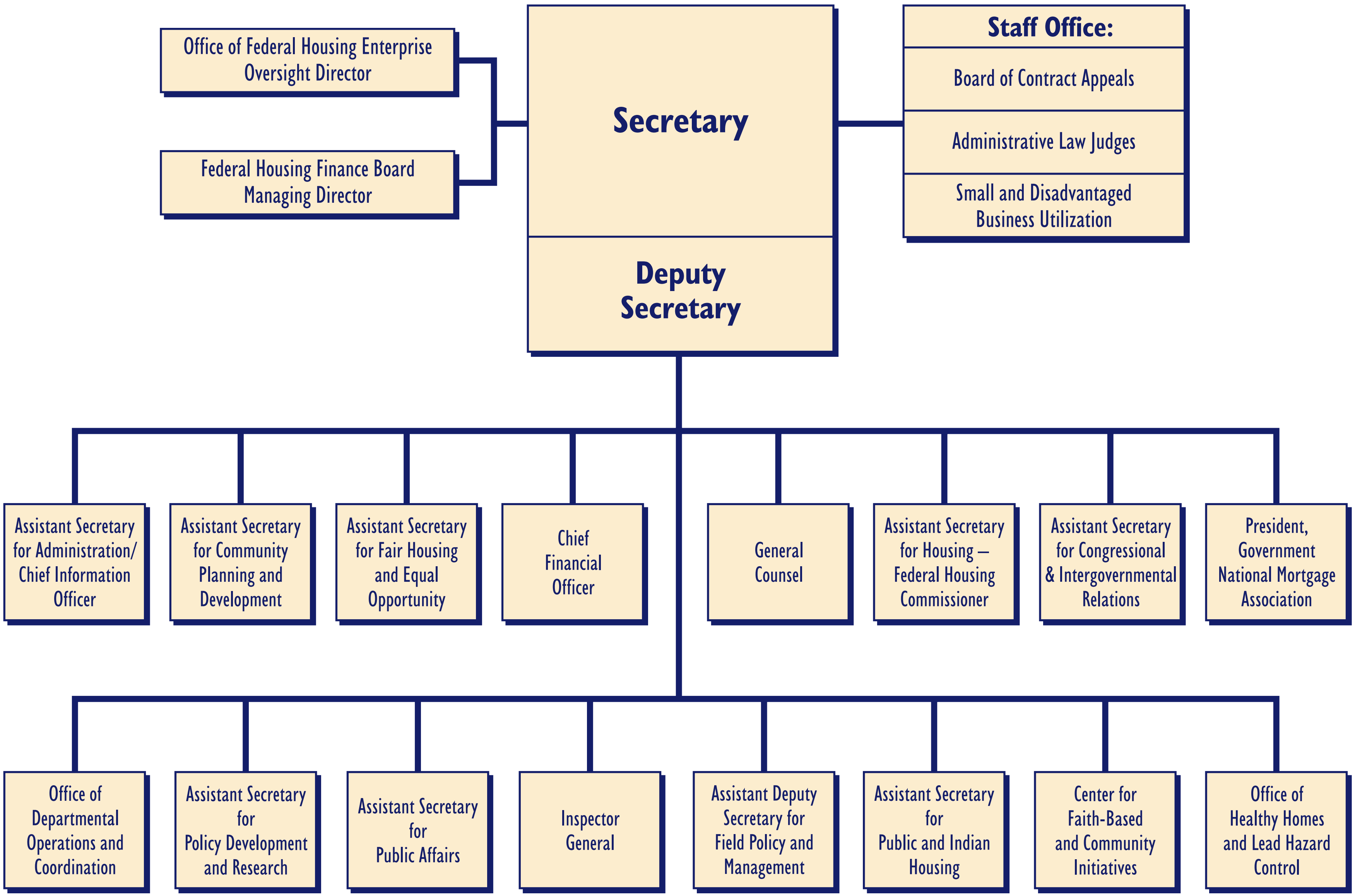
## Support Organizations

In addition to the major program offices, HUD has the following support organizations:

- Administration
- Chief Financial Officer
- Chief Information Officer
- Congressional and Intergovernmental Relation
- Departmental Operations and Coordination
- Field Policy and Management
- General Counsel
- Inspector General
- Policy Development and Research
- Public Affairs

On the following page is overview of the organizational components of the Department.

# HUD Organization



# HUD's FY 2002 Strategic Framework

## HUD's Mission:

***Promote adequate and affordable housing, economic opportunity, and a suitable living environment free from discrimination.***

## Vision:

***To fulfill our mission, HUD will be a high-performing, well-respected, and empowering partner with all levels of government, with the private sector, and with families and individuals.***

| Strategic Goal 1 | Strategic Goal 2 | Strategic Goal 3 | Strategic Goal 4 | Strategic Goal 5 |
|---|---|---|---|---|
| Increase the availability of **decent, safe** and **affordable housing** in American communities. | Ensure **equal opportunity** in housing for all Americans. | Promote **housing stability, self-sufficiency and asset development** of families and individuals. | Improve community **quality of life** and **economic vitality**. | Ensure **public trust** in HUD. |
| **Strategic Objectives** | **Strategic Objectives** | **Strategic Objectives** | **Strategic Objectives** | **Strategic Objectives** |
| 1.1 Homeownership is increased. | 2.1 Housing discrimination is reduced. | 3.1 Homeless families and individuals achieve housing stability. | 4.1 The number, quality, and accessibility of jobs increase in urban and rural communities. | 5.1 HUD and HUD's partners effectively deliver results to customers. |
| 1.2 Affordable rental housing is available for low-income households. | 2.2 Minorities and ow-income people are not isolated geographically in America. | 3.2 Poor and disadvantaged families and individuals become self-sufficient and develop assets. | 4.2 Economic conditions in distressed communities improve. | 5.2 HUD leads housing and urban research and policy development nationwide. |
| 1.3 America's housing is safer, of higher quality, and disaster resistant. | 2.3 Disparities in homeownership rates are reduced among groups defined by race, ethnicity, and disability status. | 3.3 The elderly and persons with disabilities achieve maximum independence. | 4.3 Communities become more livable. | |

*This Strategic Framework reflects what was in place for FY 2002 with the modifications reported in the FY 2003 Annual Performance Plan. HUD is issuing a revised Strategic Plan in 2003. Performance highlights for the FY 2002 strategic goals are discussed on the following pages of the Management Discussion and Analysis. More detailed information on each HUD performance indicator for FY 2002 is presented in Part 2, Performance Information.*

# Strategic Goal 1: Increase the Availability of Decent, Safe, and Affordable Housing in American Communities

## Homeownership

HUD has contributed significantly to raising and sustaining the Nation's homeownership rate to record levels of 68 percent, despite a downturn in the economy. Homeownership is a stabilizing economic force for families, communities and the Nation as a whole. HUD is committed to helping more Americans enjoy the benefits of homeowners, particularly those populations and geographic areas that lag behind.

Through HUD efforts, central cities have gained homeowners and held steady with a homeownership rate of over 52 percent at the end of FY 2002. In addition, the minority homeownership rate has held steady at record levels in excess of 49 percent for the past two years. However, this still lags far behind the national homeownership rate, and HUD continues to expand its efforts to increase minority homeownership in FY 2003 and beyond.

**National and Minority Homeownership Rates in the United States – Last Quarter of Fiscal Year**

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| National | 67.0% | 67.7% | 68.1% | 68.0% |
| Minority | 47.6% | 48.2% | 49.2% | 49.1% |

HUD has a wide variety of programs that support homeownership. The programs with the greatest impact on homeownership are Federal Housing Administration (FHA) mortgage insurance and the Government National Mortgage Association (Ginnie Mae). These organizations cut the costs of homeownership—including financing, production, and transaction costs and fees—to make homeownership more affordable and financing more widely available.

Other programs that contribute to homeownership are the Community Development Block Grants (CDBG) and HOME (Housing Investment Partnerships) programs, the Public Housing Homeownership program, and the homeownership voucher program. Homeownership is further advanced through goals set by HUD for the housing government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.

### FHA Single Family Programs

In FY 2002, FHA endorsed 1.3 million single-family mortgage loans (including re-financings), compared with 1.1 million loans in FY 2001. Seventy-eight percent of all FHA single-family home purchase endorsements, or 683,677 loans, were for first-time homebuyers. This is a 6 percent increase over the 643,748 endorsements made to first-time homebuyers during FY 2001. Thirty-six percent of the homebuyers with FHA mortgage insurance were minorities. These positive results were due in large part to increased FHA marketing and outreach events, with a focus on outreach to minority communities, during a period of low mortgage interest rates.

FHA continued to promote increased use of loss mitigation tools during FY 2002, to keep families in their homes during difficult economic times and to reduce the level and cost of FHA's Real Estate Owned (REO) inventory. The percentage of potential FHA mortgage insurance claims resolved by loss mitigation techniques was 49.7 percent, exceeding the goal of 48.1 percent. The number of cases resolved through loss mitigation techniques during FY 2002 (68,755) exceeded foreclosures during a single fiscal year for the first time.

FHA's focus on increasing the number of its REO property sales to owner occupants has also been a part of its efforts to support homeownership. During FY 2002, there were 39,214 such sales, compared to 38,108 sales during FY 2001.

### RESPA

In June 2002, Secretary Martinez announced a plan to reform the regulatory requirements under the Real Estate Settlement Procedures Act. RESPA was first introduced in 1974 as a consumer protection statute designed to help homebuyers be better shoppers in the home buying process. However, RESPA has not been substantially revised in decades and has not kept pace with changes in the marketplace. The proposed rule change would simplify and improve the process of obtaining home mortgages and reduce settlement costs for consumers.

An economic analysis of HUD's proposed rule finds that the comprehensive regulation changes could potentially save consumers $6.3 to $10.3 billion a year. The major changes to RESPA include clearly disclosing mortgage broker fees, improving the Good Faith Estimate, and removing regulatory barriers to lower costs. Changes to RESPA are anticipated to help boost homeownership beyond 68 percent of the population and further the administration's goal of producing 5.5 million minority homeowners by the end of the decade.

### Ginnie Mae

The Government National Mortgage Association supports the federal government's housing initiatives by attracting capital from the nation's financial markets into the residential mortgage markets. Ginnie Mae guarantees the payment of principal and interest on securities issued by private institutions and backed by pools of federally insured or guaranteed mortgage loans.

Since 1970, Ginnie Mae has guaranteed the issuance of over $2 trillion in securities, providing the capital to purchase or refinance 28.4 million homes for American families. In FY 2002, Ginnie Mae securitized 87.5 percent of eligible FHA and Veterans Administration (VA) loans. FY 2002 production provided the capital to purchase or refinance homes for approximately 1.5 million American families including multifamily units.

Ginnie Mae's Targeted Lending Initiative helps raise homeownership levels in central city areas. The program provides financial incentives for lenders to increase loan volumes in traditionally underserved areas. In six years of operation, the Targeted Lending Initiative has issued $30.1 billion in securities, representing 218,954 targeted loans with a mortgage value of $21.8 billion.

### Government-Sponsored Enterprises

HUD regulates Fannie Mae and Freddie Mac, the two housing government-sponsored enterprises (the GSEs) which were chartered by Congress to create a secondary market for residential mortgage loans. The GSEs purchase mortgage loans from lenders and hold them in portfolio or package them into mortgage securities for sale to investors. HUD sets affordable housing and geographically targeted goals for the GSEs. In general, GSEs must assure that a set percentage of dwelling units financed by their mortgage purchases go to targeted lower income groups or underserved areas, including central cities, and rural areas. In 2001, the GSE's financed 8.3 million housing units that contributed to meeting or exceeding all of their goals for affordable housing and geographic targeting.

## Affordable Rental Housing

HUD has many programs that serve to increase the production and quality of affordable rental housing and to provide rental assistance to households in need.

**FHA Multifamily Housing Programs.** Production of multifamily housing loans increased dramatically in FY 2002 to 1,105 FHA-insured loans, compared with 758 loans in FY 2001 and 574 loans in FY 2000. Total FHA- insured loans for FY 2002 equaled $6.5 billion. These loans financed approximately 147,000 housing units and beds in nursing homes and assisted living facilities. Of the 1,105 FY 2002 loans, FHA shared the risk with state housing finance agencies for 57 of these loans totaling over $437 million and about 7,200 units.

The high level of FHA mortgage insurance in FY 2002 was due largely to low mortgage interest rates and widespread lender use of FHA's Multifamily Accelerated Processing (MAP). MAP places responsibility on the lenders for underwriting the loan. HUD retains responsibility for reviewing the work and for final approval of the mortgage insurance. In FY 2002, the Department created a Lender Qualification and Monitoring Division to review underwriting and regulatory compliance on MAP transactions.

On three occasions from 1994-2001, FHA was forced to temporarily shut down several of its popular construction programs because its appropriation for credit subsidy was exhausted. The last shut down occurred in 2001. To prevent this problem in the future, FHA for FY 2002 raised the mortgage insurance premium for its Section 221(d)(4) program to 80 basis points (eight tenths of one percent) in order to eliminate the requirement for credit subsidy for the program. At the same time, FHA conducted the first systematic analysis of the credit subsidy calculation in a decade. The analysis examined the statistical techniques used to evaluate loan performance; updated and refined FHA's data, considered FHA underwriting changes and incorporated the major tax law changes in the 1980s that affected the profitability of multifamily housing. As a result of the re-analysis of credit subsidy, the Department was able to further reduce the premium for the Section 221(d)(4) program to 57 basis points, thus making the program self-sustaining.

Multifamily Housing also contributed substantially to the supply of affordable housing for special needs populations—the elderly and persons with disabilities. In FY 2002, 307 projects were brought to initial closing under the Section 202 and Section 811 programs, up from 301 in FY 2001.

**Ginnie Mae Multifamily Housing.** Ginnie Mae supported FHA multifamily mortgage insurance by securitizing 100 percent of the eligible FHA-insured multifamily mortgage volume in FY 2002. The outstanding balance of Ginnie Mae's Multi family Mortgage-Backed Securities was $25.4 billion at the end of FY 2002, compared to $21.7 billion at the end of FY 2001.

**HOME.** HOME Investment Partnerships provide funds to State and local governments to address their affordable housing needs. HOME encourages public-private partnerships by providing incentives to for-profit and non-profit developers for production of housing for low-income households. Participating jurisdictions committed 84,054 new units of assisted housing for FY 2002, a 3 percent increase over FY 2001. Of this total, 27,243 units were rental housing, 32,490 units were homebuyer housing, 14,082 units were existing homeowner rehabilitation housing and 10,239 units were tenant-based rental assistance.

**Government-Sponsored Enterprises.** To increase the supply of affordable rental housing, HUD establishes annual targets for purchases, guarantees, or acquisitions of interests in special affordable multifamily mortgages by the GSEs. Special affordable multifamily mortgages are those that serve very low-income families and low-income families living in low-income areas. The most recent available data show that during calendar year 2001, Fannie Mae and Freddie Mac substantially exceeded their HUD-established targets: Fannie Mae funded $7.36 billion qualifying multifamily mortgages, far exceeding its goal of $2.85 billion; and Freddie Mac funded $4.65 billion, also exceeding its goal of $2.11 billion for the year.

**Rental Housing Assistance.** In FY 2002, HUD's various rental housing assistance programs provided housing to over 4.7 million households. HUD's primary rental housing assistance programs are:

- Public housing;
- Housing Choice Vouchers; and
- Project-based assisted housing, including supportive housing for the elderly (Section 202) and for persons with disabilities (Section 811).

Under these programs, assisted households typically pay 30 percent of their income for housing and HUD funding covers the balance of the stipulated rent or remaining operating costs, in accordance with program regulations.

There are an estimated 4,535 housing agencies (HAs) across the nation that manage HUD's Public and Indian Housing and Housing Choice Voucher Programs. These HAs are primarily composed of Public Housing Agencies (PHAs) and Tribally Designated Housing Entities (TDHEs).

Public Housing is the oldest federal low-income housing program. Approximately 3,160 PHAs manage approximately 1.2 million public housing units that are homes for some 2.58 million persons. The rental income collected from public housing residents is supplemented by federal funding to support the operating and capital funding needs of these public housing entities. Many of these PHAs also administer Housing Choice Voucher program activity. Another 1,020 HAs manage voucher programs but no public housing. In addition, approximately 355 TDHEs manage an estimated 70,000 to 80,000 housing units, but under the Native American Housing Assistance and Self Determination Act (NAHASDA), TDHEs are not required to report to HUD.

HUD's project-based assistance is administered through over 22,000 contracts with private for-profit and non-profit multifamily housing project owners. Other HUD programs also contribute to rental housing assistance or production. Low-income households are helped by the rental assistance component of the Housing Opportunities for Persons With AIDS (HOPWA) program and the tenant-based rental assistance component of the HOME program. A variety of programs, including HOME, HOPWA and the Low-Income Housing Tax Credit (LIHTC, regulated by the U.S. Department of Treasury), provide subsidies that lower the costs of producing new rental housing or rehabilitating existing housing. Finally, the Rural Housing and Economic Development program provides grants for a variety of housing and capacity building activities, with a focus on the severe needs in reservations, colonias, and small towns.

**Utilization of Vouchers.** HUD and Congress have taken a number of steps to improve utilization of Housing Choice Vouchers. HUD's Section 8 Management Assessment Program (SEMAP) measures a HA's utilization rate as the higher of the share of budget authority spent or the share of units utilized during the HA's fiscal year, excluding units under contract for less than one year or reserved for litigation. For this assessment period, the HA utilization rate was increased to 94 percent[1].

**Preserving Affordable Rental Housing.** In 1998, HUD implemented the "Mark-to-Market" program as a means to preserve HUD's assisted affordable housing stock. Many Section 8 properties with HUD-insured mortgages have assisted rents that are much higher than comparable market rate rental properties. Rather than renew these Section 8 contracts at above-market rents with above-market subsidies, HUD reduces rents to market levels and, where needed, reduces the existing mortgage debt to levels supportable by the lower rents. In FY 2002, the Office of Multifamily Housing Assistance Restructuring (OMHAR) completed 50 rent reduction agreements, 294 full debt restructuring agreements, and an additional 166 restructuring plans were resolved or completed in an action other than a full debt restructuring, for a total of 510 project actions.

The table on the following page shows how many units of housing assistance are available under the major HUD rental assistance programs and certain other HUD housing assistance programs.

[1] *The utilization data for 2001 and 2002 is based on year-end statements for HAs with fiscal years ending September 30 through June 30, each year.*

### Units Eligible for Payment

| | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| **Section 8 Low Income Rental Assistance Program:** | | | | |
| Tenant-based Assistance | *1,681,774 | 1,837,428 | 1,966,171 | 1,997,733 |
| Project-based Assistance | *1,386,533 | 1,358,797 | 1,343,574 | 1,328,532 |
| **Total Section 8** | *3,068,307 | 3,196,225 | 3,309,745 | 3,326,265 |
| **Public Housing Program** | 1,273,500 | 1,266,980 | 1,219,238 | 1,208,730 |
| **Sub-total** | *4,341,807 | 4,463,205 | 4,528,983 | 4,534,995 |
| **Other Assistance Programs** | | | | |
| Homeownership Assistance Program (Section 235) | 43,116 | 26,477 | 17,746 | 13,043 |
| Rental Housing Assistance Program (Section 236) | 464,020 | 446,300 | 414,576 | 392,233 |
| Rent Supplement | 20,860 | 20,261 | 20,161 | 18,600 |
| **Sub-total** | 527,996 | 493,038 | 452,483 | 423,876 |
| Less estimated number of households receiving more than one form of assistance (double count) | (190,140) | (190,140) | (190,140) | (190,140) |
| **Total, Public and Assisted Housing** | *4,679,663 | 4,766,103 | 4,791,326 | 4,768,731 |
| **CDBG Households Assisted** | 158,280 | 187,500 | 172,445 | 187,380 |
| HOME Tenant-Based Assistance | 8,246 | 6,899 | 11,756 | 10,239 |
| HOME Rental Units Committed | 25,114 | 33,487 | 27,456 | 27,243 |
| HOME New Homebuyers Committed | 30,695 | 30,748 | 29,690 | 32,490 |
| HOME Existing Homeowners Committed | 13,952 | 14,731 | 12,566 | 14,082 |
| **HOME Total Households** | 78,007 | 85,865 | 81,468 | 84,054 |
| **HOPWA Households** | 41,670 | 43,902 | **72,117 | 91,065 (est) |
| **Total of CDBG, HOME and HOPWA** | 277,957 | 317,267 | **326,030 | 362,499 |

**These numbers differ from those reported in the FY 1999 Accountability Report because of a prior period adjustment to Tenant-based Assistance units and to Moderate Rehabilitation units in the Project-based Assistance number.*

*** These two numbers differ from those reported in the FY 2001 Performance and Accountability Report because HOPWA used a more accurate system (IDIS) to generate data. See Indicator 1.2.d in Part 2, Performance Information, for more details.*

## America's Housing is Safer, of Higher Quality, and Disaster Resistant

The Nation's housing quality has improved markedly over the past five decades. The most recent data from the American Housing Survey (AHS) show that the share of low-income households who live in units with threats to health and safety declined from 6.2 percent in 1997 to 5.8 percent in 1999 to 4.9 percent in 2001. The most recent data from the AHS show that the share of very-low-income renters living in units with moderate or severe physical problems declined from 14.8 percent in 1999 to 13.9 percent in 2001. Very-low-income homeowners experienced even greater improvements in housing quality, as the proportion with similar problems decreased from 8.1 percent in 1999 to 7.4 percent in 2001.

Working with its program partners at privately owned and public housing, HUD continued to improve the quality of housing supported by its multifamily housing mortgage insurance, project-based assistance, and public housing programs in FY 2002.

## Multifamily Insured and Assisted Housing

The results of the most recent physical inspections conducted on the MF housing portfolio provide the following profile on 28,898 insured and assisted properties with approximately 2.6 million housing units. Currently, over 94 percent of projects meet or exceed HUD's physical condition standards, compared to a baseline of 87 percent.

### Multifamily Housing Inspection Profiles

| Project Conditions | Baseline Profile (28,038 projects) | Cycle II Profile (28,647 projects) | Current Profile (28,898 projects) |
|---|---|---|---|
| Exemplary | 37% | 55% | 54% |
| Above Standard | 24% | 25% | 25% |
| Standard | 26% | 14% | 15% |
| Sub-Standard | 11% | 5% | 5% |
| Troubled | 2% | 1% | 1% |

*(Current profile [FY 2002] represents inspections conducted between 10/1/2001 and 9/30/2002. For comparable unit-weighted data, see Performance Indicator 1.3.3).*

Based on the baseline project inspections conducted over the period 1999-2000, HUD instituted a "3-2-1" inspection policy, where projects in exemplary condition get inspected every 3 years, projects in above standard condition every 2 years, and projects at or below standard condition every year.

The less than 1 percent of projects that fell in the "troubled condition" category were referred to HUD's Enforcement Center to better assure these more egregious conditions are appropriately addressed. For the other 5 percent of sub-standard performers representing 6 percent of units, Office of Housing field staff follow-up to assure that Management Improvement Operating (MIO) Plans are negotiated and adhered to by project owners.

The percentage of projects with "life-threatening" health and safety deficiencies increased from 37 to 39 percent from Cycle II to the current Cycle III profile. A key driver of this increase was the recent change in the inspection protocol that added 16 specific violations to the list of potential violations. When such life threatening health and safety deficiencies are detected during HUD's on-site physical inspections, citations are issued to project owners and agents requiring corrective action and response to HUD within three business days. In FY 2002, 98 percent of these deficiencies were so corrected or mitigated.

These results apply to projects without regard to the size of the project. The results are considerably different when they are weighted by the number of units in the project. The percentage of total units located at projects with identified life threatening deficiencies fell from 16.4 percent in FY 2001 to 16.2 percent in FY 2002.

## Public Housing

While the physical condition standards and on-site physical inspection requirements are the same for both public housing and MF housing, there are differences in how the information is used and acted upon, due to differences in the statutory, regulatory and contractual relationships between HUD and its respective PHA and MF project owner partners. Inspections at PHAs are conducted and scored at the project level, but the results of project inspections are aggregated at the PHA level into an interim Public Housing Assessment System (PHAS) Physical Indicator score and reported as one of four components of the PHAS rule scoring process.

Nevertheless, individual PHA project inspection results indicate a PHA's compliance with HUD's physical condition standards. The results of project inspections associated with the current (third) cycle of PHAS scores (scores for PHAs with fiscal years ending June 30, 2001 – March 31, 2002) were as follows:

### Public Housing Inspection Profiles

| Project Conditions | Cycle I Profile (13,569 projects) | Cycle II Profile (14,011 projects) | Cycle III Profile (14,021 projects) |
|---|---|---|---|
| Above Standard | 22% | 33% | 38% |
| Standard | 61% | 58% | 55% |
| Sub-Standard | 17% | 9% | 7% |

During Cycle II, HUD converted to a "2-1" inspection policy, wherein projects in PHAs with a PHAS Physical Indicator score of at least 80 percent are inspected every 2 years, while "standard" and "sub-standard" projects are inspected annually. Therefore, the Cycle III profile is a mix of new inspection scores on projects in PHAs with lower PHAS Physical Indicator scores (below 80 percent) from Cycle II, plus carry-over scores on projects in high scoring PHAs from Cycle II.

Overall, the percentage of public housing projects that meet or exceed HUD's physical condition standards is approximately 93 percent, an increase of 2 percent since last year. Many of the PHA projects failing to meet HUD's physical condition standards are larger projects, as the 7 percent of projects with sub-standard conditions represented 13 percent of the total public housing units. The percentage of inspected projects with "life threatening" health and safety deficiencies was 46 percent for public housing.

Office of Public and Indian Housing staff use physical inspection results to evaluate annual PHA plans to assure available resources are used to address problem projects and significant housing quality standards deficiencies. HUD's independent physical inspection process is having the desired effect of improving living conditions for residents of HUD-supported public housing.

### Lead Paint and Other Hazards

HUD is playing a central role in the interagency initiative to eliminate lead poisoning of the Nation's children by 2010. HUD intends to eliminate lead hazards in housing by expanding the Lead Hazard Control Program and leveraging other resources. The Centers for Disease Control and Prevention report that nearly 1 million children ages 1 to 5 have elevated blood lead levels—amounting to about 5 percent of all children in that age group. The majority of cases involve low-income children. Exposure to lead can cause permanent damage to the nervous system and a variety of health problems, including reduced intelligence and attention span, hearing loss, stunted growth, reading and learning problems, and behavior difficulties.

HUD's Lead Hazard Control Grant Program has consistently exceeded its goals in all years since the Annual Performance Plan was initiated. In FY 2002, the program completed 8,040 lead-safe units (homes), 12 percent more than its goal of 7,200. This performance level and increase in funding levels is a reflection of the maturation and success of the program, both in terms of a growing infrastructure of trained and certified contractors and the capacity of state and local governments to manage the program more effectively as a result of their increased experience and knowledge.

**Homes Made Lead-Safe by the Lead Hazard Control Program**

| 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|
| 7,471 | 7,969 | 8,212 | 8,040 |

The cumulative total of homes made lead-safe at the end of FY 2002 was 44,244. A recent HUD study showed that the number of housing units with lead-based paint declined from 64 million units in 1990 to 38 million in 2000, further evidence of the program's success.

## Risks, Trends and Factors Affecting this Goal

National and regional economic conditions, as well as the actions of many private and public players, exert a critical influence on increasing homeownership or achieving any of HUD's specific performance targets that measure progress toward that objective. Higher interest rates can reduce the number of first-time homebuyers, thus reducing the number of homes insured by FHA. But lower interest rates do not necessarily mean that the number of first-time homebuyers will increase, because lower interest rates can also signal a weakening of the economy. One interesting point is that lower interest rates usually increase the number of refinancings, thus reducing the *share* of new loans going to first-time buyers, even if their numbers rise. However, during FY 2002, low mortgage interest rates contributed to FHA greatly exceeding its goals for total single-family endorsements and for increasing the endorsements made to first-time homebuyers and minorities over the previous fiscal year. Increases in the number of new endorsements made to first-time homebuyers and minorities were especially influenced by the continued emphasis that FHA placed on marketing and outreach events to reach un-served and under-served housing markets.

Economic weakness and rising unemployment traditionally lead to fewer persons applying for FHA loans, and higher loan default rates. During FY 2002, FHA was able to help increasing numbers of homeowners experiencing financial difficulties to resolve their mortgage defaults instead of foreclosing. Through loss mitigation techniques, such as home retention tools, pre-foreclosure sales, and deeds-in-lieu (DIL) more defaults were resolved and fewer homeowners lost their homes. While greatly influenced by external factors, both FHA and the housing industry overall have maintained a high level of performance, even during weakened economic conditions.

Many external factors also affect the supply of affordable rental housing, including tax policy, local rental markets, building codes and land use regulations, State and local program decisions, and the actions of HUD's many other partners. Although rental vacancy rates nationally have been unusually high for at least 5 years, local rental markets vary in the availability of housing with rents below local fair market rents (FMRs). Some large metropolitan areas have relatively few units that would be affordable to extremely-low-income renters without Section 8 vouchers.

The availability of Federal resources for subsidy payments also affects HUD's ability to provide access to affordable housing. Changes in unemployment rates, in the cost of developing and maintaining housing or in personal income—factors over which HUD has little control—all affect housing affordability. Since tenant-paid rents are established as a percent of income in HUD's rental assistance programs, lower incomes necessitate greater subsidies. With the number of renters with worst case housing needs far exceeding the available funds, and with the pressure of welfare reform, the success of HUD's efforts in this area will be highly dependent on the ability of the economy to continue to generate jobs with decent wages.

A wide array of local factors, such as building codes and other regulations, affect the choices that builders make in constructing and rehabilitating American homes. While HUD can encourage local communities to improve and enforce building codes and regulations, and can encourage private builders and owners to improve their properties, the Department cannot mandate these changes. Increasing building density and other land use factors also have major impacts on the vulnerability to natural disasters and the magnitude of associated risk. Public awareness of hazards and of ways of reducing them is also important but often lacking.

Internal factors such as improving management practices and business process streamlining also made an impact on HUD's ability to provide access to affordable housing and FHA's ability to increase homeownership. Through improved management of its portfolio, insurance premiums, and more stringent measures to ensure data integrity, FHA increased the capital ratio of its Mutual Mortgage Insurance (MMI) Fund during FY 2002, a direct influence on its ability to provide insurance coverage to homeowners. The emphasis that HUD has placed on automating its business processes and procedures has been manifested in FHA's current business practices and initiatives.

# Strategic Goal 2: Ensure Equal Opportunity in Housing for All Americans

HUD's strategic goal of ensuring equal opportunity in housing for all Americans has three objectives:

- Housing discrimination is reduced.
- Minorities and low-income people are not isolated geographically in America.
- Disparities in homeownership rates are reduced among groups defined by race, ethnicity and disability status.

HUD achieves these objectives in the private housing market by enforcing the Fair Housing Act (Title VIII) and within HUD-administered programs by enforcing Title VI of the Civil Rights Act and Section 504 of the Rehabilitation Act.

## Fair Housing Enforcement Under Title VIII

Despite the long-standing protections of the Fair Housing Act, studies on the incidence of housing discrimination conducted in 1978 and 1989 showed that alarming levels of illegal discrimination persisted in the housing market. In 2002, HUD released "Discrimination in Metropolitan Housing Markets: Phase I," the first of a three-part study that examines the extent of housing discrimination in America. The Housing Discrimination Study, also known as HDS 2000, provides the most rigorous estimates of housing discrimination since HUD's housing discrimination study in 1989. Between 1989 and 2000, African-Americans and Hispanics benefited from significant reductions in unfair treatment in the housing market. HUD's performance goal was substantially achieved, based on a 2 percentage point decrease in discrimination for three of four measures.

A recent HUD awareness study entitled ***"How Much Do We Know?"*** measured the general public awareness of the nation's fair housing laws. The study revealed that there is a widespread basic knowledge of fair housing law, but many Americans fail to recognize some types of unlawful discrimination when it occurs. For example, 46 percent of respondents were not aware that it is illegal for real estate agents to limit a home search to geographical areas based on racial composition. An alarming 62 percent were not aware that it is illegal to discriminate against families and children. The study also found that almost one in five persons who felt they had experienced housing discrimination did not report it.

The findings of these and other recent fair housing studies will be a valuable tool in increasing public awareness about housing discrimination and will help HUD and its partners assess how best to use fair housing enforcement education and technical assistance resources.

**Enforcement Activities.** In FY 2002, HUD's Office of Fair Housing and Equal Opportunity (FHEO) completed 1,010 enforcement actions, an increase from the FY 2001 level of 600. State and local government agencies become HUD partners when they administer fair housing laws that HUD determines to be substantially equivalent to the Federal Fair Housing Act and receive funding under the Fair Housing Assistance Program (FHAP). During FY 2002, 7,263 cases were received, compared with 7,872 cases in FY 2001. FHEO and its FHAP partners closed 8,164 cases, compared with 9,082 closed in FY 2001, reflecting the fewer cases received in FY 2002. Closures included administrative closures, conciliation/agreements, cause and no-cause determinations, and referrals to the Department of Justice

**Reducing Aged Cases.** In FY 2002, FHEO continued to place a major emphasis on reducing the number of aged cases within its inventory, employing strict controls and more aggressive targeting. As a result, the percentage of HUD closed cases that had been open longer than 100 days continued its marked decline, falling from 37.1 percent in FY 2001 to 29.0 percent in FY 2002.

**Accessibility.** Amendments to the Fair Housing Act (the Act) require that certain multifamily dwellings first occupied after March 13, 1991, must be accessible to persons with disabilities. Nevertheless, across the country multifamily dwellings are being constructed that do not meet the design and construction requirements of the Act. A significant effort is needed to educate the building industry—including architects, builders and owners—as well as State and local governments and others about the accessibility requirements to improve compliance with the Act. In FY 2001 and FY 2002, a total of $2.5 million was committed to carry out a training and technical guidance program for this purpose.

## Fair Housing Enforcement Under Title VI and Other Laws

**Compliance Reviews and Voluntary Compliance Agreements (VCA)**. HUD is required to conduct compliance reviews of grant recipients by Title VI of the Civil Rights Act of 1964 (for discrimination based on race, color or national origin) and Section 504 of the Rehabilitation Act of 1973 (for discrimination based on disability). Section 504 reviews increased to 108 in FY 2002 from 68 in FY 2001. FHEO started 143 compliance reviews in FY 2002 under Title VI, an increase of 37 reviews over the 106 started in FY 2001.

**Complaints Investigated.** FHEO received 778 complaints under Title VI and Section 504 in FY 2002, a 20 percent increase over the 645 complaints received in FY 2001. FHEO completed 99 Title VI investigations compared to 65 in 2001. FHEO continues to work with recipients of HUD funds to ensure to the greatest extent possible compliance with the civil rights laws.

**Fair Lending.** One of HUD's primary means for increasing the homeownership rates of minorities is to ensure equal access to mortgage lending. The most recent data collected from lenders under the Home Mortgage Disclosure Act show that in 2002, minority applicants (excluding Asian-Americans, whose denial rates differ little from non-minorities) were denied mortgages at a rate 92.6 percent higher than the denial rate for non-minority applicants. This is a greater disparity than the 76.4 percent difference in 2001, but denial rates for non-Asian minorities actually declined to the lowest rate in over six years, from 17.8 in 2000 to 15.1 in 2001. To improve results in this area, HUD will promote the Technology Open To All Lenders (TOTAL) scorecard. When used in an automated underwriting system, the TOTAL scoring system will ensure that mortgage applications are evaluated fairly and uniformly.

In addition to enforcing fair lending laws through FHEO, HUD regulates the Government-Sponsored Enterprises (GSEs)—Fannie Mae and Freddie Mac—and continually monitors their programs and practices to ensure consistency with fair lending requirements. Beginning in 2001, HUD increased the share of mortgage purchases each GSE must acquire from underserved areas from 24 percent to 31 percent. During calendar year 2001 (the latest year for which data is available), 32.6 percent of Fannie Mae mortgage purchases and 31.7 percent of Freddie Mac mortgage purchases were for properties in underserved neighborhoods.

**Targeted Efforts.** HUD aims to increase the share of FHA single-family mortgage endorsements that go to minority homebuyers. Along with comparable goals for first-time homebuyers and central-city homebuyers—both disproportionately minority groups—this focus ensures that minority homebuyers have access to the lower interest rates of FHA-insured mortgages.

In FY 2002, due to the Department's continued efforts and increased emphasis on appropriately targeted marketing, 36 percent of the home purchase mortgages endorsed for FHA insurance were to minorities, a modest decrease from the FY 2001 figure of 36.5 percent given the difficult economic conditions.

## Risks, Trends and Factors Affecting this Goal

Social, cultural and economic conditions influence the acceptance of minorities, persons with disabilities and other protected classes. In addition, disparities in wealth and income levels among groups contribute to the inability of some persons to purchase a home, obtain affordable and/or accessible rental housing, and realize economic opportunity.

HUD depends upon the Department of Justice as well as state and local government partners to assist in furthering fair housing. State legislation that is substantially equivalent to the Federal Fair Housing Act is critical to increase the Nation's capacity to effectively enforce fair housing laws. State regulation of finance, insurance and real estate also affects fair housing and homeownership within specific populations or neighborhoods. FHA has worked to ensure equal housing opportunities through targeted marketing and outreach activities to un-served and underserved markets.

Local policies, including land use controls and accessible building code enforcement, will continue to influence levels of discrimination, income isolation, and disparities in homeownership rates. The private sector likewise plays a central role in achieving fair housing outcomes. Businesses which adopt fair housing policies and practices go far to promote justice. Finally, some individuals continue to discriminate because they lack awareness of their fair housing responsibilities.

# Strategic Goal 3: Promote Housing Stability, Self-Sufficiency, and Asset Development by Families and Individuals

In FY 2002, HUD had the following objectives related to these outcomes:

- Homeless families and individuals achieve housing stability.
- Poor and disadvantaged families and individuals become self-sufficient and develop assets.
- The elderly and persons with disabilities achieve maximum independence.

## Homeless Families and Individuals Achieve Housing Stability

As economic conditions have worsened, the need for housing resources has become greater. The U.S. Conference of Mayors reports that in 2001, demand for emergency shelter increased by 13 percent overall—and 22 percent among families—in the 27 major cities that were surveyed. Furthermore, 37 percent of the overall need and 52 percent of the need among families was unmet.

Addressing homelessness requires a comprehensive approach. Data from a December 1999 HUD report entitled, ***Homelessness: Programs and the People They Serve*** demonstrate that most people who become homeless have suffered severe hardships—including physical and sexual abuse, childhood trauma, poverty, poor education, disability, and disease. When homeless persons get the housing assistance and needed services—such as health care, substance abuse treatment, mental health services, education and job training—76 percent of those living in families and 60 percent of those living alone end their homeless status and move to an improved living situation.

HUD is committed to ending chronic homelessness over ten years in cooperation with Federal partners. The Department of Health and Human Services and the Veterans Administration are funding services while HUD concentrates on providing shelter, transitional and permanent housing. Beginning in FY 2003, all three Departments are participating in a jointly administered homeless initiative to further increase the efficiency and impact of the overall effort to reduce homelessness and in particular to eliminate chronic homelessness over 10 years.

### Continuum of Care

HUD is partnering with communities through a Continuum of Care (CoC) approach to addressing homelessness. This strategy is used by communities nationwide to organize and coordinate delivery of housing and services to homeless persons as they move off the streets, into stable housing, and towards self-sufficiency. The CoC process encourages public and private organizations to work together to identify the unique needs in their communities, seek alternative resources, and determine their priorities for HUD funding. Several programs funded by HUD under the McKinney-Vento Homeless Assistance Act of 1987 help meet the needs of homeless individuals and families.

During FY 2002, HUD helped approximately 47,905 homeless persons move into HUD McKinney-Vento funded permanent housing compared to an estimated 30,000 in FY 2001. The number of formerly homeless persons who move to HUD funded permanent housing is a result of demand by communities for new permanent housing assistance and a Congressional directive and HUD commitment that 30 percent of homeless funds be used for permanent housing projects for homeless persons with disabilities. Increased permanent housing is crucial to meeting HUD's goal of eliminating chronic homelessness over 10 years.

Transitional housing with supportive services can be an important intermediary step between emergency shelter and permanent housing. In 2002, approximately 192,392 homeless persons moved into HUD-funded transitional housing with supportive services, far exceeding our goal of over 77,000.

To streamline the provision of homeless assistance services, HUD has proposed to consolidate several homeless assistance programs into a single program in FY 2003. This change will reduce the administrative burden associated with the current application process and provide communities with the flexibility they need to appropriately address homelessness.

In support of the President's Faith-Based and Community Initiative, HUD is undertaking a Department-wide effort to increase the participation of faith-based and community organizations in HUD's programs. Increasing the already high level of participation of these groups in HUD's homeless assistance programs will introduce more partners in the overall effort to address homelessness.

## Poor and Disadvantaged Families and Individuals Become Self-Sufficient and Develop Assets

### Self-Sufficiency Tools in Public and Assisted Housing

The housing stability provided by public and assisted housing creates better opportunities and a safety net so welfare families can step towards self-sufficiency. Over the past several years, HUD has been transforming public housing to reduce the geographic and economic isolation of low-income households. HUD provides funding for microenterprise and small business development for public housing residents with an entrepreneurial spirit.

**Family Self-Sufficiency.** The Family Self-Sufficiency (FSS) program uses several means to support self-sufficiency among residents of public and assisted housing. FSS provides job training and employment services to voucher holders, and funds program coordinators to support residents' transitions to self-sufficiency. FSS also allows a portion of increases in earnings to be deposited into an escrow account that can be used for purchasing a home, continuing education, or other personal goals.

**Welfare to Work Vouchers.** In FY 1999, Congress appropriated 50,000 Welfare to Work (WtW) vouchers that require coordination between local housing authorities and welfare agencies. Because stable housing is so critical for steady employment, and because many jobs are located in suburbs while the people leaving welfare are in central cities, these vouchers are an important tool in promoting self-sufficiency. By the end of FY 2002, all WtW vouchers were being fully utilized and emphasis had shifted to tracking the employment status of WtW voucher families as described under Indicator 3.2.2.

### Community and Economic Development Tools

Increasing self-sufficiency requires investments in job training, economic development, supportive services, and other infrastructure needs. HUD's Community Development Block Grants (CDBG) provide a mechanism for making these investments while recognizing the unique needs of every community. The Empowerment Zones (EZ) program targets flexible assistance to the most distressed communities. Many eligible uses of the CDBG and EZ program are related to self-sufficiency:

- Job Training, including the Youthbuild program
- Supportive services, including health care, transportation, and child care
- Education assistance
- Job Fairs

The Faith-Based and Community Initiative is also contributing to HUD's efforts to activate faith-based and community organizations in the objective of meeting the needs of disadvantaged families and individuals.

Homeownership is a milestone on the road to self- sufficiency for many families, so HUD is promoting homeownership among residents of public and assisted housing.

## The Elderly and Persons With Disabilities Achieve Maximum Independence

The elderly population is projected to expand at an increasing rate as baby boomers age. Elderly households and persons with disabilities have special needs that require flexible housing strategies. HUD intends to maximize the independence of these households by promoting community-based living opportunities where appropriate. The Department also makes supportive services available to residents to help them live as independently as possible in the most integrated setting.

**Assisted Living.** Many people who are elderly or disabled need some assistance with daily tasks yet are otherwise able to live independently. HUD supports such assisted living arrangements in several ways. Under a HUD conversion program, two Section 202 elderly projects were converted to assisted living during FY 2002, with eight more scheduled to be converted in FY 2003, which will meet HUD's goal of converting ten by the end of FY 2003.

In FY 2000, Congress authorized the Department to increase assisted living opportunities by allowing housing agencies to use housing vouchers in assisted-living developments. By the end of FY 2002, HUD had authorized the use of vouchers for assisted living facilities in at least five states.

HUD's Service Coordinator program allows managers of assisted multifamily housing to hire service coordinators to help elderly residents. During FY 2002, Service Coordinator grants funded service coordinators for 25,012 additional units in elderly projects. This is a 40 percent increase to over 88,000, far exceeding the goal of a 10 percent increase. HUD also funds service coordinators in public housing through the Resident Opportunity and Self-Sufficiency program.

## Risks, Trends and Factors Affecting this Goal

Success in aiding the homeless to become self-sufficient is affected by a variety of factors beyond HUD's control. The incidence of homelessness is affected by macroeconomic forces such as unemployment levels, structural factors, including the supply of entry-level jobs, and the availability of low-cost housing. Personal factors such as domestic violence, substance abuse, disabilities, and the extent of a person's educational or job skills also may underlie homelessness. Successful transitions to society from prisons, treatment facilities or other institutions are increasingly recognized as critical to reductions of chronic homelessness.

Participation levels by partners in the provision of homeless assistance—including State and local agencies, nonprofit organizations, service providers, housing developers, neighborhood groups, private foundations, the banking community, local businesses, and current and former homeless persons—will substantially determine the success of homeless families and individuals in becoming more self-sufficient. Increasing fiscal strains on these governments may reduce their ability to make contributions towards HUD's objectives. State and local governments also make critical decisions about zoning and the use of funds from programs such as CDBG, HOME, and tax-exempt bonds for rental housing, which may affect the local housing supply.

The recent economic downturn has led to increased unemployment, which hampers self-sufficiency efforts. Recessions tend to affect homeless people and other low-income people disproportionately, because they are usually among the first to be laid off, and generally have few marketable skills. An economic rebound will make it easier for many low-skilled or inexperienced workers to enter the workforce in the coming years.

Opportunities for better paying jobs continue to be concentrated in technical fields for which many recipients of HUD assistance are not prepared. Jobs continue to grow faster in suburban areas, while families making the transition from welfare are more likely to live in inner-city or rural areas. Many of the educational, training, and service programs available to help families make the transition to self-sufficiency are operated by local recipients of Federal funds from agencies other than HUD.

External factors also affect the supply of affordable rental housing for the elderly and persons with disabilities. The share of the population who are elderly (65 and older) is projected to increase from 13 percent to 20 percent of the population by 2030, with rapid growth beginning around 2010. Other factors include local rental markets, building codes and land use regulations, State and local program decisions, and the actions of HUD's partners.

The Supreme Court held in 1999 that States must place persons with disabilities in community settings rather than institutions when treatment professionals determine that community placement is appropriate ***(Olmstead v. L.C.)***. As a result of this decision, more persons with disabilities will be moving into communities at a time when affordable housing is increasingly scarce.

# Strategic Goal 4: Improve Community Quality of Life and Economic Vitality

In 2002, the National economic performance was uneven and a recession began in March. Over the year, the unemployment rate increased from its previous level and income growth slowed. Concentrations of poverty, joblessness, and homelessness continue to degrade the social and economic fabric of communities across the country. A key to reviving these markets is expanding access to private equity investment in business and industries that serve these communities. The Nation's economic challenges are not confined to the cities and suburbs in metropolitan areas. Many rural communities are struggling as well—especially in Appalachia, the Mississippi Delta, Indian country, and the borderland colonias. The Department's efforts in the economic development arena are based on a partnership and leveraging of resources model working with private and non-profit groups, State and local governments, and other Federal Departments and agencies.

In FY 2002, HUD had the following objectives related to these outcomes:

- The number, quality, and accessibility of jobs increase in urban and rural communities.
- Economic conditions in distressed communities improve.
- Communities become more livable.

## Doubly Burdened Cities

One measure that captures changing conditions in urban areas is the number of "doubly burdened" cities. Doubly burdened cities are defined by HUD as cities that experience unemployment rates 50 percent above the national average, accompanied by either a population loss of five percent since 1980 or poverty rates of 20 percent or higher. The combined effects of population loss, high unemployment, and high poverty drain a city's fiscal capacity and limit its ability to improve aging infrastructure and invest in new economic opportunities. Doubly burdened cities decreased from 75 cities in FY 2001 to 66 cities in FY 2002, surpassing our goal of a two-city reduction. The variance observed in this measure between 1999 and 2002 suggests that the impact of macroeconomic factors exceeds the span of control of HUD's economic development programs.

## Block Grant Assistance

The Community Development Block Grant (CDBG) is HUD's largest block grant program, and an important vehicle for improving the community quality of life and economic vitality. During FY 2002, States and more than 1,000 cities entitled to receive CDBG grants expended $5.12 billion of non-disaster CDBG funds, an increase of $178 million over FY 2001 expenditures. Grantees have discretion to use this funding for a variety of eligible purposes, including economic development, housing construction and rehabilitation, and infrastructure improvements. Several small categorical programs—Youthbuild, the Self-Help Opportunities Program, and others—are also included in the CDBG total above, and while not part of the formula program, generally fund activities consistent with the overall CDBG program.

CDBG formula grantees are required to use at least 70 percent of this funding for activities that principally benefit low- and moderate-income persons. During FY 2002, entitlement communities used 94.4 percent of funds and States used 96.4 percent of funds for such activities.

During FY 2002, HUD, in response to the President's Management Agenda, began with our partners a consideration of ways to streamline the Consolidated Planning process. Consolidated planning requires that every large city, urban county, and State develop a three- to-five-year strategic plan describing how they plan to use CDBG, HOME Investment Partnerships, Housing Opportunities for Persons with AIDS (HOPWA), and Emergency Shelter Grants to meet their priorities. The planning process provides HUD with a way to review grantees' needs.

## Community Renewal

In 1994, 73 distressed urban communities across the country were designated as either one of 8 empowerment zones (EZs) or 65 enterprise communities (ECs). In 1999, an additional 15 urban EZs were designated. On December 31, 2001, the Secretary also designated eight tax benefit only Round III EZs and 40 tax benefit only Renewal Communities (RCs). The purpose of the EZ/EC initiative is to combine "seed" grants (Rounds I and II only)—for capacity building, workforce and business development, supportive services, and physical improvements—with tax incentives to encourage partnerships between the residents, nonprofits, governments, and businesses in a community (all EZs, ECs and RCs). The EZ/EC Initiative is focused on the creation of self-sustaining, long-term development in distressed areas. It is based on a holistic, participatory approach whereby community stakeholders partner together to develop and implement innovative and comprehensive strategic plans for revitalization. HUD measures the percentage of completed EZ/EC programs and projects for which locally defined goals in seven categories were achieved. During FY 2002, local performance improved in only two of the seven categories of activity.

The Department is partnering with localities to improve their capacity and efficiency and goals are being re-examined to better capture outcomes. It is important to note that a 2001 study of Round I EZs did find that the majority of EZ/EC's had significant impact in job growth, increased minority businesses, increased resident businesses and increased resident employment.

## Leveraging Private Capital

The future prospects for many distressed communities are contingent on the amount of capital being invested today. In addition to providing direct investment, HUD programs help leverage other sources of public and private capital. In 2001, the latest year for which data are available from lenders under the Home Mortgage Disclosure Act, $6.167 billion of private capital was used to rehabilitate housing in underserved neighborhoods.

### Private Lending for Housing Rehabilitation in Underserved Areas

(Dollars in Billions)

| 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|
| $5.737 | $6.078 | $5.862 | $6.167 |

## FHA Lending

To enhance homeownership opportunities in lower-income and minority neighborhoods, HUD seeks to extend single-family mortgage lending in under-served communities. During FY 2002, FHA endorsed 491,592 mortgages in underserved areas, exceeding the target of 432,802 endorsements, and surpassing the approximately 412,000 such endorsements made in FY 2001.

### FHA Single Family Mortgage Endorsements in Underserved Areas

(Thousands)

| 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|
| 449 | 357 | 412 | 492 |

The increase is partially a result of changes in the real estate market that affected most FHA single-family programs, including lower interest rates. There was a general increase in FHA single-family activity in FY 2002. As a percentage of all single family lending, the number of endorsements in underserved areas was relatively stable.

FHA also insures loans to develop and rehabilitate multifamily properties in underserved neighborhoods. In FY 2002, approximately 33 percent of the multifamily projects (372 of 1,105) endorsed by FHA insurance were for properties in underserved areas. Multifamily properties that received FHA-insured mortgages for the first time during FY 2002 included 13,903 units in underserved areas, compared with 5,464 in FY 2001.

### Rental Units in Newly Endorsed Multifamily Developments in Underserved Areas

| 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|
| 5,480 | 9,072 | 5,464 | 13,903 |

### Fannie Mae and Freddie Mac

The Department sets four types of public purpose targets for Fannie Mae and Freddie Mac (the Government-Sponsored Enterprises or GSEs). One target requires that the GSEs must fund mortgages that support underserved areas. During calendar year 2001, each GSE's goal was 31 percent of the total number of dwelling units financed. This is an increase from the previous year's goal of 24 percent. During the 2001 calendar year (the latest year for which data is available), Fannie Mae exceeded the goal by achieving 32.6 percent, which represented a slight increase from 31 percent in 2000. Freddie Mac achieved 31.7 percent, an increase from its 29.2 percent performance in 2000.

**Fannie Mae Mortgage Purchases in Underserved Areas**
(Percent of All Units Financed)

| 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|
| 27.0% | 26.8% | 31.0% | 32.6% |

**Freddie Mac Mortgage Purchases in Underserved Areas**
(Percent of All Units Financed)

| 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|
| 26.1% | 27.5% | 29.2% | 31.7% |

## Risks, Trends and Factors Affecting this Goal

The country's economic growth has produced millions of new jobs, including many in central cities and other older communities. Reversals of macroeconomic trends, however, can overcome recent successes as well as HUD's partnership efforts. In addition, there are sizable imbalances in the job market, with most jobs requiring high skill levels, while many persons seeking employment are looking for low-skill jobs. The changing structure of the global economy has made it challenging for communities to compete when capital is highly mobile, markets for goods and services are widely dispersed, and wages for low-skilled employment are much lower in many locations abroad.

Local shortages of low-skilled jobs are compounded by mismatches between the locations of available jobs and the residences of the unemployed. Many older communities tax rates exceed rates in newer communities because they struggle to provide quality services despite declining tax bases. Job development is complicated by large concentrations of poor residents. School systems struggle to provide the education and job skills essential for their students, but in many cases, have fewer resources as tax bases decline and capital maintenance costs increase. Crime, whether real or perceived, deters businesses from locating in these communities. The extent to which residents of areas of concentrated poverty are increasingly minorities may add barriers of racial discrimination to the mix.

Rural communities face additional challenges because of the changing structure of the farming industry, under-investment, weak infrastructure, limited services, and few community institutions. Rural labor forces are more narrowly based and are more dispersed. Both urban and rural communities are further affected by the extent to which their States provide financial assistance to overcome these obstacles.

While ultimately job creation is dependent upon the investment decisions of the private sector, the coordinated efforts of all levels of government, along with the private sector, are needed to address these challenges.

Another factor that must be considered is that communities have a great deal of flexibility when using HUD funds to address their economic conditions. Many programs, including the Community Development Block Grants (CDBG), may be used for a wide variety of eligible activities at the discretion of the grantee. When communities do choose to address job growth for low-income individuals, there are a wide variety of approaches that are difficult to measure. Some communities may support infrastructure to increase business development in certain areas, while others may directly apply CDBG funds toward preparing individuals for employment. Thus the ability of communities to respond with discretion to local conditions also establishes constraints on assessing results at a national level.

# Strategic Goal 5: Ensure Public Trust in HUD

To better achieve its mission, HUD is focused on the goal of establishing and maintaining the organizational competence and capacity to deliver effective programs and services to the public. In pursuing that goal, HUD is fulfilling its fundamental responsibility to build performance, customer service, ethical standards and accountability into all aspects of its program delivery and stewardship of the billions of public and private dollars entrusted to the Department.

## Management Challenges

As independently reported over the past decade by the GAO and HUD's Office of Inspector General (OIG), improvements are needed in HUD's management of its human capital and information systems in order to provide adequate internal controls, reduce risk, and improve performance in HUD's core program areas. HUD's rental housing assistance and single family housing mortgage insurance programs have been designated as "high risk" program areas by the GAO. Those program areas also have internal control weakness issues, as discussed in the Independent Auditor's Report on the Financial Statements section of this report.

The ***President's Management Agenda*** contains the following interrelated government-wide and HUD-specific initiatives to comprehensively address HUD's longstanding management challenges, high-risk program areas, and material control weaknesses.

***Government-Wide Initiatives:***

1. Strategic Management of Human Capital

2. Competitive Sourcing

3. Improved Financial Performance

4. Expanded Electronic Government

5. Budget and Performance Integration

***HUD-Specific Initiatives:***

6. HUD Management and Performance

7. Faith-Based and Community Initiative

Information on the goals, progress, and remaining plans under each of these initiatives is provided in the President's Management Agenda section of this report. In addition, the HUD Inspector General's independent assessment of HUD's major management and performance challenges and progress is provided in the Financial Information section of this report.

FY 2002 was a year of substantial progress in addressing the longstanding management and control deficiencies that have hindered HUD's past program delivery and fiscal stewardship. As examples of that progress during this period, HUD:

- Received an unqualified audit opinion on HUD's consolidated financial statements for the third consecutive year—a strong indicator of financial management stability.

- Produced mid-year financial statements and accelerated the year-end close-out, financial audit, and production of the annual Performance and Accountability Report—to provide more timely information for HUD, OMB and Congressional oversight and decision making.

- Completed implementation of a new staffing resource estimation and allocation system—with use of the resultant information to re-deploy staff to critical program needs and support development of staffing plans and budget proposals.

- Enhanced staff recruiting, development and training programs; planned a HUD Integrated Human Resources and Training System (HIHRTS); and established a Human Capital Steering Committee that developed a draft Five-Year Strategic Human Capital Management Plan that provides for succession planning and filling of mission critical skill gaps.

- Improved the Department's Information Technology (IT) Capital Planning and Investment Control process—to better assure the Department's $376 million portfolio of IT investments in FY 2002, and future year investments, adequately address HUD's business needs and are managed to achieve expected benefits against accurate and complete cost, schedule, technical and performance baselines.

- Completed development and implementation of FHA's new general ledger system on schedule—a major step in a multi-year effort to replace FHA's commercial accounting system with an integrated financial management system that fully complies with federal requirements, including budgetary and credit reform accounting and funds control.

- Updated program guidance, provided staff training, and re-instituted monitoring of program administrator income and rent determinations—as important steps in reducing erroneous payments in HUD's rental assistance programs.

- Initiated new program rules to strengthen requirements for lenders, underwriters and appraisers participating in the single family housing mortgage insurance programs—to reduce FHA's risk and curtail predatory lending practices.

- Consolidated security and emergency planning functions in a new Office of Security and Emergency Planning—which completed the first Continuity of Operations Program (COOP) plans by a federal Department to ensure that critical HUD programs and services are provided during any national emergency or catastrophic event.

## Program Monitoring

Third party intermediaries, who include government, non-profit and for-profit entities, perform most of the direct processing or administration of HUD's program services. HUD's primary role is to provide guidance and assistance to its program partners, and to monitor and enforce program compliance and performance requirements. HUD's continuing improvement of its program monitoring and oversight is having a positive benefit on program results.

### Rental Housing Assistance Programs

HUD performs periodic assessments of the physical condition, financial soundness, management capability, and resident satisfaction applicable to the HUD-supported rental housing portfolio. This portfolio consists of 14,000 public housing properties at approximately 3,160 Public Housing Agencies (PHAs), and over 28,000 multifamily housing properties, which collectively serve over 2.8 million households. The improving physical conditions in this housing portfolio are discussed under HUD Strategic Goal No. 1. Information on the significant monitoring results on PHAs and multifamily housing projects follows.

**Resident Satisfaction.** During the 2002 assessment year, HUD conducted a random sample survey of 543,985 public housing residents and a stratified sample of 112,869 multifamily tenants. To date, 89 percent of public housing residents have indicated that they were "Satisfied" or "Very Satisfied" with "overall living conditions."[2] 2002 Multifamily results will be available in February 2003.

**Public Housing Assessment System (PHAS).** The PHAS rule process was developed to provide a more comprehensive and independent assessment of a PHA's performance and risk to HUD. PHAS aggregates the scores of the following four component indicators:

- Physical Condition, based on independent annual HUD project inspections (30 points);

- Financial Condition, based on independent annual financial and compliance audits (30 points);

- Management Performance, based on annual PHA certifications (30 points); and

- Resident Satisfaction, based on annual resident surveys (10 points).

*[2] This data pertains to PHAs with fiscal years ending 03/31/02, 12/31/01, 09/30/01, and 06/30/01. Due to delayed funding, 2002 survey assessments for PHA fiscal years ending 6/30/02 and 9/30/02 will not be available until February 2003.*

The scores of each of the four component indicators are aggregated in conjunction with a PHA's fiscal year-end to arrive at an integrated or combined PHAS "score" and "designation" in one of the following categories:

- High Performers: Overall PHAS Score of 90 or greater.
- Standard Performers: PHAS Score of 60 to 89 with no score less than 18 for the component indicators for Physical Condition, Financial Condition or Management Performance (Indicator Nos. 1, 2 or 3).
- Troubled Performers: PHAS Score less than 60 or more than 60 with at least one major component (Indicator Nos. 1, 2 or 3 ) with a sub-standard score (less than 18).

PHAS scores and underlying information provide a basis for HUD staff to target risk-based monitoring efforts, as well as necessary technical assistance and program intervention. HUD established Troubled Agency Recovery Centers (TARCs) to assist troubled PHAs in correcting major physical, financial and management deficiencies. In worst-case situations, HUD can take over a PHA directly or through an administrative receivership, or seek a court appointed receiver to replace PHA management. High performing PHAs receive less HUD oversight and can be eligible for certain funding preferences.

The PHAS rule was originally scheduled to be effective for PHAs with fiscal years ending September 30, 1999, and thereafter. PHA fiscal years end on calendar year quarters, with a fairly even distribution of PHAs between each quarter. Due to delays in the formal implementation of the PHAS rule, the scores for FY 2001 were considered "advisory scores." During the PHAS advisory scoring period, PHAs could not be referred to a TARC solely on the basis of PHAS scores, except for PHAs that self-certified a troubled "management performance" indicator.

For FY 2002, the number of units managed by officially designated "troubled" agencies at the beginning of the year was reduced by 23 percent. On October 1, 2001, 55 PHAs, which were responsible for 31,549 low rent units, were assigned to the TARCS. By September 30, 2002, 16 of these PHAs had been returned to their HUD HUBs after TARC recovery assistance, thus reducing the low rent units counts by 7,289 units to 24,260 low rent units.

The complete PHAS scores are the best available information on PHA conditions. Complete PHAS scores were available for 3,092 PHAs, or 98 percent of the 3,171 PHAs active during the FY 2002 reporting cycle. Scores not yet available or reported are primarily due to filing extensions, waivers and pending appeals. The distribution of designations and scores for PHAs with complete PHAS scores for FY 2002 are as follows:

**FY 2002 PHAS Designations**
**Advisory Scores for PHAs**

| | PHAs | Units |
|---|---|---|
| High Performer | 1,361 | 336,681 |
| Standard Performer | 1,374 | 619,616 |
| Troubled – Physical Only | 49 | 41,554 |
| Troubled – Management Only | 14 | 7,677 |
| Troubled – Financial Only | 215 | 43,267 |
| Troubled – Overall* | 79 | 23,340 |
| Troubled – Total** | 357 | 115,838 |
| Total Scored | 3,092 | 1,072,145 |

**PHA with a score less than 60 or with more than one sub-standard component*

***"Troubled-Total" is the aggregate of the four Troubled categories; it is not included in the "Total Scored" to prevent a double count of Troubled Performers.*

Comparison of the FY 2002 and FY 2001 PHAS score results reveals that the number and proportion of high performing PHAs has increased markedly while troubled PHAs have decreased markedly.

### Comparison of FY 2001 and FY 2002 Advisory Scores for PHA Performance Assessments

| | FY 2001 (2,714 PHAs) | FY 2002 (3,092 PHAs) |
|---|---|---|
| High Performer | 22.2% | 44.0% |
| Standard Performer | 59.1% | 44.4% |
| Troubled Performer | 18.7% | 11.6% |

**Multifamily Housing Financial Compliance.** All insured and some non-insured multifamily housing (MFH) projects are required to electronically submit annual financial and compliance audit information to the MFH Financial Assessment Subsystem (FASS). These submissions facilitate risk-based monitoring and management of program compliance requirements to reduce the financial and program risk related to the MF housing portfolio.

For the third submission cycle for project fiscal years ending 12/31/00 – 12/30/01 (Cycle III), 20,676 financial statements were required. Of this number, HUD received and reviewed 19,390 submissions through September 30, 2002; the number will increase as overdue submissions for this cycle continue to be received. HUD also received and reviewed an additional 1,428 non-insured project financial statement submissions that were not required to be submitted to FASS.

Of the 20,818 total submissions received for Cycle III, 20,597 were processed with 51 percent having no financial compliance deficiencies. Of the 10,187 submissions with deficiencies, 3,925 were referred to the Departmental Enforcement Center (DEC) and the remaining 6,262 to MFH program field staff for additional action.

The increase in the total number of Cycle III submissions with conditions, and the higher percentage of cases referred to the DEC, are attributed to a number of factors, including: (1) the addition of new compliance deficiency indicators that were not applicable in Cycles I and II; (2) the cumulative effect of open DEC cases from Cycle II resulting in automatic referrals of Cycle III submissions on the same projects; and (3) the increased number of submissions received in Cycle III. In addition, HUD has increased action on "non-filers" from all cycles. Until actions are completed against "non-filers" from Cycles I and II, submissions from those same projects in Cycle III are also referred for the DEC's consideration, even if the submission reflects "no conditions" for Cycle III.

### Multifamily Housing Financial Assessment Results

| | Cycle II | Cycle III |
|---|---|---|
| No Conditions | 70% | 51% |
| MFH Referrals | 23% | 30% |
| DEC | 7% | 19% |
| Total Processed | 100% | 100% |

Despite the sharply increased number of referrals, both the DEC and MFH improved their follow-up performance. For DEC, the percentage of open or unresolved cases decreased from 39 percent to 33 percent while the percentage of MFH open referral cases decreased from 16 percent to four percent.

**Lender Oversight.** HUD monitors lenders who make FHA loans to ensure compliance and to deter fraud. In FY 2002, HUD conducted 916 lender reviews, exceeding the goal of 900 reviews. These reviews resulted in 213 case referrals to the Office of the Inspector General (OIG), 147 Final Debarments, and 3,105 indemnification agreements. The importance of these reviews and the actions taken is in the degree of risk reduction they provide to FHA through uncovering fraudulent activity, and in the protection that FHA insured borrowers receive by not being taken advantage of by unscrupulous entities. FHA will be assisted in future lender reviews through a system called "Neighborhood Watch Early Warning System" that will monitor the rate of defaults and claims on mortgages by lenders down to branch office levels.

**Departmental Enforcement Center.** DEC addresses serious problems of distressed multifamily properties that have failed physical and financial inspections and require corrective action by owners, lenders and management agents. DEC also enforces administrative and regulatory business agreements through the debarment or suspension of individuals in noncompliance in single and multiple family properties. DEC is also charged with imposing monetary penalties in cases of serious non-compliance.

DEC was established within HUD to work in a collaborative fashion with all Program Offices in implementing necessary enforcement actions. The DEC aggressively pursues enforcement actions against owners, landlords, lenders, management agents, recipients, grantees and other participants who are in non-compliance or in violation of statutes, regulations and/or other program requirements relating to programs administered by HUD. DEC refers criminal cases to the Office of the Inspector General and civil cases to the Department of Justice. These actions bring resolution to the most difficult and significant non-compliance issues among recipients of HUD program resources and ensure compliance with legal requirements under HUD agreements to preserve decent, safe and sanitary housing for low- and moderate-income households.

This year the DEC received 15,883 referrals (393 physical referrals, 8,199 financial referrals, and 7,291 Annual Financial Statement (AFS) non-filer/ late filers) more than four times the number of referrals received from Multifamily Housing via the REAC system in the prior three years. The DEC closed 7629 referrals, nearly 41 percent of all referrals received since FY 1999. On those projects received from REAC with a score below 30 points, 1st inspection scores averaged 23 points. After DEC involvement, 2nd inspection scores improved to an average of 64 points, an improvement exceeding 200 percent.

In FY 2002, the DEC continued special emphasis on non-filers and late-filers of annual financial statements. Civil Money Penalties (CMPs) resulting from settlements and judgments against non-filers and late-filers amounted to $718,350 from 160 Settlement Agreements. In the last 2 years the DEC has imposed $1.3 million in CMPs. Additionally, the DEC has increased referrals to the Department of Justice and increased interaction with the Inspector General's office. The DEC enforcement actions this year have resulted in approximately 5,000 housing units being restored to decent, safe, and sanitary condition, bringing the total of housing units restored since FY 1999 to 230,000.

In FY 2002, judgments, assessments of penalties, settlements of lawsuits or administrative actions, or other agreements that obligated HUD participants to make payments to HUD, or returned funds to HUD insured/subsidized projects resulted in financial recoveries of $36,689,179.

The Mortgagee Review Board (MRB or Board) is a statutorily created entity within the Department responsible for the sanctioning of FHA approved lenders. The primary source of MRB referrals comes from Single Family's Quality Assurance Division. As the volume of Quality Assurance reviews has increased in recent years, so has the number of Board referrals. In FY 2002, the MRB met four times and considered 14 lender cases. It voted to enter into 12 settlement agreements, to withdraw the lender's FHA approval in 2 cases, and to impose civil money penalties in 12 cases. In addition, lenders agreed to indemnify HUD for any losses incurred in 97 loans. MRB staff also worked with the Office of Multifamily Housing on a project to force multifamily mortgagees to comply with the requirement to inspect projects. Notices of Violation were issued to the first group of offenders this year.

The Compliance Division processed 536 Administrative sanctions (including debarments, suspensions, and proposed debarments) that resulted in 760 actions taken in FY 2002 for a total of 3,022 actions since FY 1999.

The DEC *exceeded* all FY 2002 management goals. It reduced the number of multifamily cases in the DEC as of the end of FY 2001 by 81 percent, issued sanction notices for suspension and/or proposed debarments to 85 percent of participants referred this year and closed 88 percent of the Mortgagee Review Board cases that had reached the dispatch of the 30-day letter stage as of October 1, 2001.

**Fannie Mae/Freddie Mac Risk Capitalization**. The Office of Federal Housing Enterprise Oversight (OFHEO), financial safety and soundness regulator for Fannie Mae and Freddie Mac, released test results December 30, 2002 stating that Fannie Mae and

Freddie Mac met both their statutory risk-based and minimum capital standards as of September 30, 2002. This is the first official application of both standards. Fannie Mae and Freddie Mac are Congressionally chartered, Government Sponsored Enterprises (GSEs) that provide a ready supply of mortgage funds for housing by linking capital markets and mortgage lenders. They guarantee securities backed by pools of mortgages and invest in mortgage assets.

OFHEO's risk-based capital standard relies on a state-of-the-art stress test that includes broad swings in interest rates and changes in house prices that can create risks and losses for the GSEs. The GSEs must balance their portfolios and hold enough capital to protect against these inherent risks. OFHEO found Fannie Mae's total capital level of $27.3 billion exceeded the risk-based capital requirement of $21.3 billion by almost $6 billion. Freddie Mac's $23.1 billion in total capital was over $18 billion more than its required $4.9 billion. Both GSEs continued to exceed their required minimum capital levels, another statutory component of capital adequacy. These tests complement OFHEO's comprehensive risk-based examination program and internal research and analysis program to ensure the continued financial safety and soundness of the Enterprises. OFHEO will announce results for the GSEs' next quarterly capital classification in late March. More information on OFHEO's examination standards or capital requirements can be found at *www.ofheo.gov*

**Grantee Oversight.** Communities develop five-year Consolidated Plans to guide their use of CDBG, HOME, Emergency Shelter, and HOPWA grants. Grantees have a wide array of eligible activities from which to choose, so the quality of planning for self-defined objectives is critical. A goal of reviewing 956 Consolidated Plans for measurable performance goals for housing and community activities was established at the beginning of FY 2002. The Department reviewed over 1000 plans by the end of the fiscal year . In addition, the Department monitored 464 grantees on-site, monitored 178 non-homeless grantees, and monitored 533 Continuum of Care projects, all three of which exceeded the FY 2002 goals.

## Risks, Trends and Factors Affecting this Goal

Ensuring Public Trust in HUD requires that HUD both ensure operational consistency in reforms it has already instituted, and complete effective corrective actions on remaining material management control weaknesses and other concerns discussed in the "President's Management Agenda" and "Financial Management Accountability" sections of this report.

To better ensure operational consistency, it is essential that HUD complete the comprehensive workforce analysis and execute its Strategic Five-Year Human Capital Management Plan to assure mission critical functions are adequately staffed and performed. Succession planning is critical, in light of the fact that HUD has an aging workforce where over 40 percent of the employees are eligible to retire. It is also essential that efforts continue to improve upon the use of risk-based monitoring techniques in HUD programs, so as to use existing staff and program resources more efficiently and effectively. When significant performance and compliance problems are identified - be they from single family mortgage lenders, MF project owners or agents, PHAs, local governmental entities, or other participants - HUD must act appropriately to address those problems to minimize the risk and further program objectives.

To address material weaknesses in rental subsidy programs, HUD will need the cooperation of its program partners and tenant groups to push for simplification of program requirements and improved internal controls for assuring that subsidy payments go to those for whom they were intended, in the proper amounts. Statutory change may be required to simplify and standardize subsidy program requirements, and to provide increased authority to conduct effective upfront income data matching, thereby reducing administrative burdens and costs and the risk of payment errors.

In the area of information systems, the Office of the Chief Information Officer has instituted many process improvements to better support the planning, development and maintenance of HUD's Information Technology (IT) investments. However, it is essential that HUD program managers assume a stronger systems ownership role in assuring that systems requirements and controls over data quality are properly established to better support their program delivery and mission.

In response to widespread concerns that faulty appraisals are facilitating predatory lending and financial risk to the FHA funds, FHA is developing a system to monitor individual appraisers and the rate of early defaults and claims on mortgages. This system, termed Appraiser Watch, will rely on statistical analysis of default and claim rates to identify appraisers whose appraisals were performed on properties securing loans with early defaults and claims. FHA recognizes that appraisers do not perform the underwriting of a mortgage or make the decision to lend. However, when considering the performance of all loans for which an individual appraiser performed the appraisal, FHA has found the default and claim rates for some of these loans are far in excess of the default and claim rates for the area in which the appraiser operated. Under Appraiser Watch, appraisals performed by appraisers associated with these loans will be examined, and the associated appraisers will be considered for removal from participation in FHA single-family programs.

The Department has issued an Advance Notice of Proposed Rulemaking for Appraiser Watch and has received comments preparatory to issuing a proposed rule. Meanwhile, FHA is using the statistical analysis to identify appraisers for field reviews. Using this approach, the number of appraisers removed from the FHA Roster during FY 2002 was four times the number for FY 2001 under previous appraiser review processes. The Department intends to issue a rule establishing Appraiser Watch during FY 2004.

# The President's Management Agenda

The President's Management Agenda is designed to improve the overall efficiency and effectiveness of the Federal government and to address significant management deficiencies at individual agencies. The below numbered interrelated government-wide and HUD-specific program initiatives in the President's Management Agenda are structured to correct HUD's remaining material management control weaknesses and improve the Department's critically important housing and community development program delivery and results.

HUD fully embraces this sound management agenda and is on-target with the necessary plans and actions to meet the challenging goals set by the President. To sustain the focus needed to achieve these goals, they have been engrained in HUD's strategic and annual performance and operating plans. Details on the goals, progress and remaining plans under each of the President's Management Agenda initiatives are as follows:

## 1. Strategic Management of Human Capital

HUD's staff, or "human capital" is its most important asset in the delivery and oversight of the Department's mission. However, HUD's need to deploy effective strategic and systematic human capital management practices is particularly acute. Over the past decade, HUD experienced a thirty percent reduction in staffing during a period of program and budget growth. This left HUD with staff shortages and skills gaps in many mission critical areas. Furthermore, HUD's remaining workforce is among the most mature in the federal government, with about half of HUD staff eligible for retirement over the next five years. The effectiveness of HUD's future program delivery depends on effective succession planning today. Lastly, HUD has lacked a systemic means to identify and justify staff resource needs and to properly allocate staff resources provided. Actions have been taken or planned to address these and other human capital management challenges.

In FY 2002, HUD completed implementation of the new Resource Estimation and Allocation Process (REAP) and Total Estimation and Allocation Mechanism (TEAM) to provide a systemic basis for estimating and justifying its staffing resource needs and allocating staffing resources available. Baseline outputs of the REAP were used to assist in making decisions on redeploying HUD's existing staff resources to address priority program staffing needs, and as inputs to HUD's 2002-2003 staffing plans and 2004 budget justification. HUD hiring actions in FY 2002 positioned the Department to fully utilize its staffing authorization in FY 2003.

To address the human capital issues facing the Department, the Human Capital Management Executive Steering Committee was established in June 2002. The Committee developed a draft Strategic Human Capital Management Plan in December 2002, which is projected for completion in the second quarter of FY 2003. This strategic plan includes three goals: first, to become a mission-focused agency, work will be aligned to promote adequate and affordable housing, economic opportunity, and a suitable living environment free from discrimination; second, to maintain a high quality workforce, HUD will recruit, develop, and manage a highly qualified and diverse workforce; and, third, to implement effective succession planning over the next five years to ensure employees retiring are succeeded by qualified staff.

Careful planning is underway to conduct a comprehensive workforce analysis and develop a Departmental Workforce Plan. This comprehensive plan will identify the kind of work to be done now and in the future; knowledge, skills and abilities of staff to do this work; capabilities and development needs of staff and appropriate deployment across organizations; and strategies for identifying and filling gaps.

Implementation of HUD's Human Capital Management Plan will support other HUD management improvement initiatives, such as integrating budget and performance and providing the skills needed to better manage information technology and reduce risks in the rental housing assistance and single family housing programs.

## 2. Competitive Sourcing

The reduction in staffing over the past decade increased HUD's dependency on outsourced services to deliver and oversee its programs. HUD's previous outsourcing was done without the benefit of competitive public-private cost comparison studies because staffing was reduced through attrition, buy-outs or redeployments. Competition promotes innovation, efficiency and greater effectiveness. Under the Federal Activities Inventory Reform (FAIR) Act of 1998, HUD is required to conduct and publish an annual inventory of commercial functions performed by its staff, for use in consideration of competitive sourcing studies. The President's Management Agenda calls for 15 percent of the full time equivalent (FTE) staffing level in each agency's baseline year 2000 FAIR Act commercial activities inventory to be subjected to competitive public-private cost comparison studies or direct contract conversion to realize cost efficiencies and improved service.

HUD's Competitive Sourcing Plan identifies some initial opportunities for possible outsourcing or in-sourcing studies or direct conversions to meet the President's goal. During the period January through May 2003, HUD will conduct a Feasibility Analysis and Planning Phase to determine whether or not to proceed, and how to proceed, with sourcing studies or conversions in the areas identified. Other possible study opportunities will be assessed in conjunction with performing HUD's 2003 FAIR Act inventory update. Any studies or direct conversions pursued will be in accordance with revised guidelines under OMB Circular A-76, Performance of Commercial Activities.

In order to meet the President's 15 percent goal, HUD needs to study or directly convert activities related to 870 FTE staff. However, given HUD's significant downsizing and extensive outsourcing of administrative and program functions over the past decade, opportunities for further competitive sourcing are limited and need to be carefully considered in the context of program risk exposure. In recognition of HUD's situation, the Office of Management and Budget has approved HUD to also consider competitive "in-sourcing" studies to see if bringing outsourced functions back in-house proves to be more cost-efficient and effective.

## 3. Improved Financial Performance

HUD's biggest financial management challenge is to replace the Federal Housing Administration's (FHA) commercial accounting system with a system that is fully compliant with Federal financial management systems requirements and applicable Federal accounting standards. To meet this challenge, the FHA Subsidiary Ledger Project was established and funded as a multi-year phased development effort that will utilize a commercial-off-the-shelf (COTS) software package to establish a new fully compliant FHA general ledger system with integration to 19 program feeder systems over the period 2002 through 2006. FHA successfully completed the general ledger implementation phase of the project on-schedule in October 2002, and is on-schedule with remaining phases of the project.

HUD has 48 financial management systems of which 17 fail to fully conform to federal financial management systems requirements. The FHA Subsidiary Ledger Project is addressing 14 of the 17 non-conforming systems. Remediation plans are also in place and progressing on the other three non-conforming systems.

Regarding HUD's core financial management system, the focus of the past two years has been to enhance and stabilize the existing financial management systems operating environment to better support the Department and produce auditable financial statements in a timely manner. Action on the prior administration's Financial Management Systems Vision of 2000 was deferred. Now that the existing financial management systems operating environment has been enhanced and stabilized, HUD will proceed to study the feasibility, cost and risk of various options for the next generation core financial management system for the Department.

HUD is also strengthening its administrative control of funds under this initiative. Policies and procedures on funds control were updated and revised to provide a more disciplined process that reduces the risk of Antideficiency Act violations. Actions to fully implement these new policies and procedures in FY 2003, will serve to eliminate reportable conditions from the OIG's annual financial statement audits regarding the timely obligation, expenditure and recapture of funds in HUD programs.

## 4. Expanded Electronic Government

Under this initiative, HUD is not only pursuing increased electronic commerce and actively participating in the President's "E-Government" (eGov) projects, but is also focused on more fundamental HUD-specific information technology (IT) management improvements.

HUD's Government Paperwork Elimination Act (GPEA) Compliance submission of October 2001 identified opportunities to unify, simplify and reduce redundancy in IT systems. HUD also conducted an eGov assessment to determine how HUD's IT projects meet the President's goals to unify, simplify and reduce redundancy in IT systems government wide. As part of HUD's eGov Strategic Plan, current, short-term and long-term eGov opportunities were identified. HUD currently has over 75 eGov efforts at various levels of sophistication and maturity, serving citizens, business partners and the HUD enterprise. These efforts have been assessed and coordinated with the 24 eGov projects included in the President's Management Agenda. HUD is participating as a Partner Agency in the following 17 projects with the greatest potential benefit to HUD:

- *Government-to-Citizen:* E-Loans, Federal Asset Sales, GovBenefits, USA Services.
- *Government-to-Business:* Online Rulemaking Management.
- *Government-to-Government:* Disaster Management, E-Grants, Geospatial Information One-Stop.
- *Internal Efficiency and Effectiveness:* E-Training, Recruitment One-Stop, Enterprise Human Resource Integration, E-Clearance, E-Payroll, E-Travel, Integrated Acquisition, Electronic Records Management.
- *Cross-Cutting Initiatives:* E-Authentication.

HUD also continues to improve its IT capital planning process, convert to performance-based IT service contracts, strengthen IT project management to better assure results, extend the data quality improvement program, and improve systems security on all platforms and applications.

## 5. Budget and Performance Integration

The Department consulted with the Congress and other stakeholders and will reissue its Strategic Plan in FY 2003 to streamline and clarify goals to better focus on the core mission of the Department. Continued integration of performance and the budget was pursued through the development of HUD's FY 2004 budget justification. HUD developed its fiscal year 2004 budget with a focus on collecting and using quality performance information, utilizing full cost accounting principles and emphasizing program evaluations and research to inform decision makers. HUD has presented its budget justifications in both the traditional format and in a new performance-based format. Staffing and other resources are aligned with strategic goals, objectives and accomplishments.

HUD views the integration of performance and budgeting as an iterative process that will reflect short-, intermediate and long-term results. Over time, the effort will require improved information and data in order to better mesh performance and budgeting efforts. Additional data will depend in part on systems and data development and pursuing needed program evaluations. The Department is working hard to continue to improve and measure program performance.

## 6. HUD Management and Performance

The objective of this initiative is to strengthen HUD's internal controls to eliminate all material weakness issues and remove all HUD programs from the GAO's high-risk list by addressing the following areas.

### Improve the Performance of Housing Intermediaries

HUD's considerable efforts to improve the physical conditions at HUD-supported public and assisted housing projects are meeting with success. HUD and its housing partners have already achieved the original housing quality improvement goals through fiscal year 2005, and are raising the bar with new goals.

HUD's oversight capability, and the related performance of the third party intermediaries that administer HUD's public and assisted housing programs on HUD's behalf, are expected to further improve upon the revision and full implementation of the Public Housing Assessment System (PHAS) and Section Eight Management Assessment Program (SEMAP) rules, and the full benefit of the Performance-Based Contract Administrators assisting in the oversight of the Office of Housing's project-based assistance programs. Further information on the improved oversight and performance of HUD's housing intermediaries is provided under other sections of this report addressing Strategic Goal 1: Increase the Availability of Decent, Safe and Affordable Housing, and Strategic Goal 5: Ensure Public Trust in HUD.

### Reduce Overpaid Rent Subsidies

HUD's rental housing assistance programs—including Public Housing, Section 8 Tenant-Based Assistance and Multifamily Housing Project-Based Assistance—have been collectively designated as a "high risk" area by the U.S. General Accounting Office, with material management control weaknesses reported by HUD's Office of Inspector General. These programs are HUD's largest appropriated program activity with $23 billion in expenditures in FY 2002. The programs are administered by third party intermediaries at public housing agencies, private housing owners or contracted housing management agents. HUD estimates that there are over $2 billion in net annual assistance overpayments attributed to program administrator processing errors or tenant underreporting of income.

Footnote 17 of the Department's Consolidated Fiscal Year 2002 Financial Statements, which are included in the Financial Performance section of this report, provides specific information on HUD efforts to establish a baseline rental housing assistance payment error estimate on year 2000 program activity.

Under the President's Management Agenda, HUD's goal is to reduce rental assistance program errors and resulting erroneous payments 50 percent by 2005.

A multi-organizational Rental Housing Integrity Improvement Project (RHIIP) Advisory Group developed a comprehensive strategy for addressing the root causes of all known sources of assistance payment error. The RHIIP strategy includes actions that seek to: (1) simplify overly complex program requirements that contribute to error; (2) enhance the existing capacity to effectively administer the programs; and (3) establish the controls, systems, incentives and sanctions necessary to improve program performance and accountability on the part of the Department, HUD's program intermediaries, and the tenant beneficiaries.

In FY 2002, HUD focused on updating and strengthening program guidance, initiating staff training, and re-instituting rental assistance program monitoring activity by (1) launching the Office of Public Housing Rental Integrity Monitoring (RIM) initiative to perform and track the results of income and rent reviews and (2) strengthening the efforts of the Office of Housing's outsourced performance-based contract administrator services. HUD also developed a legislative proposal for increased computer matching authority to provide for upfront verification of tenant income sources and amounts to eliminate income-related errors. Upfront income verification with automated state or federal data bases, such as the National Directory of New Hires database maintained for the

U.S. Department of Health and Human Services, has the greatest potential for reducing rental assistance payment errors.

### Improve FHA Single Family Risk Management

FHA manages its single-family housing mortgage insurance program area in a manner that balances program risks with the furtherance of program goals, while maintaining the financial soundness of the Mortgage Mutual Insurance (MMI) Fund that supports these programs. As confirmed by recent GAO audit work, the MMI Fund is financially sound and the single- family housing programs are contributing to record homeownership rates, with a focus on homebuyers that are underserved by the conventional market. Nevertheless, overall program performance and the condition of the MMI Fund could be further improved if all lenders, appraisers, property managers and other participants in FHA's program delivery structure fully adhered to FHA program requirements designed to reduce program risks and further program goals.

In FY 2002, FHA pursued a number of actions to improve the content, oversight and enforcement of its program requirements, including consideration of alternative business processes. Several new risk management rules were proposed or completed to protect both the FHA fund and homebuyers. One rule will deter a practice called "property flipping" to reduce the risk of loss to the FHA fund and protect homebuyers from a predatory lending practice. Other rules will further protect homebuyers from predatory lending practices and increase the accountability and performance of lenders, underwriters and appraisers. FHA is also developing an "Appraiser Watch" process where housing appraisers can be automatically targeted for monitoring or other appropriate action when the loans they are associated with hit certain unacceptable performance thresholds.

FHA also continued strong action against nonperforming participants—in the from of suspensions, debarments, withdrawals, monetary penalties, settlements, and terminations—through the efforts of HUD field staff, the Mortgage Review Board and the Credit Watch Program.

In addition, FHA continued to enhance its staff capacity for administering this program area, and continued to achieve favorable property disposition results through its performance-based management and marketing (M&M) contracts. M&M contracts have resulted in a steady decline in FHA's property inventory, from 36,000 homes at the end of FY 2000 to 30,113 at the end of FY 2002. The loss per claim has been cut from 37 percent to 29.5 percent.

### Reduce Meaningless Compliance Burdens

HUD is closely working with local program stakeholders to streamline the Consolidated Plan requirement to make it more results-oriented and useful to communities in assessing their own progress toward addressing the problems of low-income areas. A stakeholders group was convened to discuss alternative planning requirements and suggestions for improving the existing process. Working groups were formed to work with HUD in the design of pilot projects to be tested and evaluated. Working Groups indicated the need for the development of guidance to clarify the current Consolidated Plan process, and it was issued in early November 2002. Pilot efforts are being designed for the completion of pilot testing and evaluation over the 2003-2004 period.

## 7. Faith-Based and Community Initiatives

The President formed the HUD Center for Faith-Based and Community Initiatives (CFBCI)—along with centers in four other cabinet departments—to implement his vision of government and faith and community-based organizations working together to accomplish the shared objective of more effectively helping the needy. The Center's goal is simply stated: more organizations providing more services to help more people.

In pursuit of its goal, the Center conducted a review of HUD's regulations and identified eighty-two instances of unwarranted barriers to the participation of faith-based organizations (FBOs) in HUD programs. The Center spearheaded the regulatory reform process and new regulations were published in January 2003.

An in-depth examination of all HUD competitive grant award processes was also conducted to identify possible barriers to faith-based participation, as well as incentives to increase participation. The Center proposed reforms and worked on the implementation of the reforms with HUD's grant program offices.

The Center has also taken steps to create a welcoming environment for FBOs through numerous outreach efforts to make it clear that the Department welcomes faith-based partnerships. Such efforts have come in the form of brochures, Internet-based materials, and brokering of relationships between FBOs, HUD Program Offices and HUD's third party program administrators.

# Financial Management Accountability

**This section covers:**

*Federal Managers' Financial Integrity Act Reporting*

*Secretary's Audit Resolution Report to Congress*

*Delinquent Debt Collection*

## Federal Managers' Financial Integrity Act Reporting

### FMFIA Assurance Statement

*I am able to certify with reasonable assurance that, except for the material weakness and non-conformances specifically identified in this section of the FY 2002 Performance and Accountability Report, the Department is in compliance with the provisions of Section 2 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982. With regard to Section 4, I am unable to certify that HUD is in full compliance with FMFIA. While most of HUD's financial management systems are substantially compliant, the Department continues its efforts to ensure full compliance with capturing standard general ledger information at the transaction level.*

*HUD continues to be fully committed to bringing its internal controls and systems into full compliance with the requirements of FMFIA.*

*Mel Martinez, Secretary*
*Department of Housing and Urban Development*

### Material Weaknesses and Non-Conformances

Material weaknesses are management control deficiencies that preclude reasonable assurance that: obligations and costs are in accordance with applicable laws, assets are safeguarded, and accountability is maintained. Section 2 of FMFIA requires the annual reporting of material weaknesses and plans to correct any such weaknesses. Section 4 of FMFIA requires the reporting of any material non-conformance with financial management systems requirements prescribed in OMB Circular A-127. In addition, HUD reports on Management Concerns, which are areas that warrant actions to strengthen management controls, although the level of risk is assessed as within an acceptable materiality threshold.

HUD continues to make significant progress in addressing the material weaknesses, non-conformances and concerns reported in prior FMFIA assurance statements. Progress is independently verified by the Office of the Inspector General (OIG) in annual audits of the Department's Financial Statements.

### Material Weakness

At the beginning of FY 2002, the Department reported one open material weakness. While progress is being made on a comprehensive, multi-year corrective action strategy, HUD continued to report this material weakness as open at the end of FY 2002.

**Material Weakness**
**FY 2001 Carry Over Issue**
**and FY 2002 Status**

| First Reported | Material Weakness | Status at End of FY 2002 |
|---|---|---|
| 1996 | Controls Over Rental Subsidies[1] | Open |

*[1] This material weakness was presented in 1999 and prior reports as "Income Verification". In FY 2000, HUD expanded the weakness to include all issues associated with improving controls over rental subsidies, including a previously reported management concern entitled "Project-Based Subsidy Payments."[1]*

## Status of Remaining Material Weakness

HUD's rental housing assistance programs—including Public Housing, Section 8 Tenant-Based Assistance and Multifamily Housing Project-Based Assistance—have been collectively designated as a "high risk" area by the U.S. General Accounting Office, with material management control weaknesses reported by HUD's Office of Inspector General. Corrective actions are in process to reduce an estimated $2 billion in net annual rental assistance overpayments that are occurring as a result of inadequate management controls. Under the President's Management Agenda, a goal has been established to reduce processing errors and resulting erroneous payments 50 percent by 2005. Specific information on completed and planned corrective actions is provided in the President's Management Agenda section of this report.

## Financial Management Systems Compliance

The following material systems non-conformances are carried over from the prior year:

### Material Non-Conformances FY 2001 Carry Over Issues and FY 2002 Status

| First Reported | Material Non-Conformances | Status at End of FY 2002 |
|---|---|---|
| 1989 | Departmental Financial Management Systems | Open |
| 1991 | FHA Accounting and Financial Management Systems | Open |

In recent years, HUD's focus has been to stabilize and enhance the Department's existing core financial management systems environment to better support the Department and produce auditable financial statements in a timely manner. Now that the operating environment has been enhanced and stabilized, HUD is proceeding with plans to study the feasibility, cost and risks of various options for the next generation core financial management system for the Department. That study will begin in FY 2003, as part of a HUD Integrated Financial Management Improvement Project (HIFMIP) to establish a better integrated and more efficient core financial management system.

HUD continues to address financial management systems non-compliance with OMB Circular A-127 at the individual systems level. A listing of non-compliant financial management systems is shown in Appendix A-2. As of fiscal year end 2002, HUD is reporting 17 non-compliant systems, the same number as fiscal year end 2001. Fourteen of those non-compliant systems are in FHA. Prior year audits have discussed weaknesses with FHA's feeder systems, the need for manual processes and procedures to convert system data to be compliant with the U.S. Standard General Ledger, and the inability of FHA to update the Departmental general ledger on a timely basis.

As discussed in the President's Management Agenda section of this report, FHA is replacing its commercial accounting system to become fully compliant with the requirements of the Federal Financial Management Improvement Act and OMB Circular A-127. FHA's existing financial management system deficiencies preclude the Department's overall compliance with the Federal Financial Management Improvement Act provisions for compliance with: Federal Financial Management Systems Requirements; applicable accounting standards; and the U.S. Standard General Ledger (SGL) at the transaction level.

HUD has developed corrective action/remediation plans to address the identified deficiencies for its non-compliant systems. Since 1998, HUD has obtained independent reviews of its financial management systems to verify compliance with federal financial systems requirements, identify system and procedural weaknesses, and develop the corrective action steps to address identified weaknesses. Actions to address these systems non-conformance issues are being tracked under the President's Management Agenda.

## Management Concerns

At the beginning of FY 2002, HUD had 12 open management concerns. In FY 2002, progress was made on needed improvements in each of these areas. However, all concerns will continue to be reported pending completion of further planned improvements in FY 2003.

**Management Concerns**
**FY 2001 Carry Over Issues**
**and FY 2002 Status**

| Carry Over Issues | Management Concern | Status at End of FY 2002 |
|---|---|---|
| MC1 | Performance Measures * | Open |
| MC3 | PHA Monitoring | Open |
| MC4 | HUD's Computing Environment* | Open |
| MC5 | Personnel Security Over Systems* | Open |
| MC7 | Obligation Balances* | Open |
| MC8 | FHA Loss Prevention* | Open |
| MC10 | SF Property Inventory* | Open |
| MC12 | FHA Systems Controls* | Open |
| MC13 | Resource Management | Open |
| MC14 | Management Controls | Open |
| MC16 | Single Audit Act Coverage | Open |
| MC17 | Administrative Funds Control* | Open |

**Reportable Conditions in OIG's FY2002 HUD Financial Audit*

## Status of Remaining Management Concerns

**Performance Measures.** HUD continues to improve the completeness, accuracy and reliability of pertinent performance data in support of the Department's strategic goals and objectives. An OIG review of the reliability of data presented in HUD's FY 1999 Annual Performance Report found a number of performance indicators with inadequate measures or inadequate controls over data quality. While overall performance data has improved considerably over the last couple of years, concerns with the availability and reliability of some performance measure data remain. There have been major data clean-ups and improvements in HUD's data systems, resulting in greater data accuracy and timeliness. HUD's current data quality initiative includes assessment of data elements in mission-critical systems, correcting data problems, and certifying the systems. Information integrity is also being improved with a series of computer security projects and by implementing HUD's information quality policy for disseminated information. The nature of HUD's performance data is now clearly reported in HUD's Annual Performance Plans and Performance and Accountability Reports, along with plans for further improvements.

**PHA Monitoring.** During FY 2002, HUD continued its efforts to improve the monitoring of Public Housing Authorities (PHAs). The Office of Public and Indian Housing (PIH) risk-based targeting model has been finalized and is currently in use. Satellite monitoring training was provided to field office staff in June 2002, and the Compliance and Monitoring Training Program was continued. In addition, the Department plans to more fully develop the Public Housing Assessment System (PHAS) so that it will assess multiple dimensions of public housing management and conditions, and identify PHAs that are troubled in order to improve their operations. HUD will also fully implement and improve the Section 8 Management Assessment Program (SEMAP), used to objectively measure PHA performance related to their Housing Choice Voucher programs, and identify troubled agencies for remedial measures.

**HUD's Computing Environment.** The Department has significantly improved the controls over its computing environment; however, more needs to be done. HUD has to continue to improve the controls over the emergency software fixes; reduce the risk of unauthorized changes for applications; and complete the Configuration Management (CM) implementation for any remaining client/server financial applications. Actions taken during FY 2002 include the development of procedures to control mainframe applications and development of Department-wide policies and procedures for implementing and managing CM. Funds have been allocated to implement CM for those mission critical client/server financial applications without CM. Actions in process include the development of detailed procedures to verify the CM implementation for mission critical client/server applications and the implementation of an on-line user registration system that provides immediate notice to the Office of Administration for each access request for a mission critical system.

**Personnel Security Over Systems.** In the past, the Department's personnel security practices have been inadequate. Improvements were needed to ensure that only authorized individuals with appropriate clearances were granted access to HUD's critical systems. During FY 2002, all identified system users who were granted access to critical and sensitive systems without the appropriate background investigations were required to either submit the background investigation forms or have their access reduced to query. Background investigation policies and procedures were implemented and are being enforced. Execution of a planned quarterly reconciliation of access security authorizations in FY 2003 should close this concern.

**Obligation Balances.** While HUD has taken a number of actions to improve the monitoring of obligated balances, further improvements are needed and are planned to ensure that requirements for timely use of outstanding HUD obligations of funds are enforced. The Office of Public and Indian Housing demonstrated improvement in enforcing compliance with the United States Housing Act of 1937, as amended by the Quality Housing and Work Responsibility Act of 1998, for the timely expenditure and obligation by housing authorities of public housing capital funds. The Office of Multifamily Housing implemented new recapture procedures to ensure that all funds on contracts with expired terms are recaptured in a timely manner. In addition, an annual review of the entire portfolio was instituted to ensure that all contracts in the accounting system represent valid obligations. An Automated Renewals and Amendments Management System recapture module is in the final stages of development. This new module will improve documentation of actions relative to recaptures and provide for an interface with accounting systems to ensure that all amounts determined to be excess are de-obligated.

**FHA Loss Prevention.** During FY 2002, FHA continued to make progress in its effort to reduce the frequency and severity of losses on Single Family insured mortgages. FHA continued a steady increase in the number of loss mitigation efforts by paying 68,755 home retention claims, a 36.46 percent increase over FY 2001 levels. FY 2002 also marked the first year that the number of families assisted through loss mitigation exceeded the number of foreclosures. Aggressive training, combined with increased monitoring were key factors in the increase in loss mitigation activities. FHA also implemented a process that removes non-performing non-profits and 203(k) consultants from the roster of approved program participants. Additional regulations are being processed that will further strengthen the oversight of program participants. These regulations will establish an Appraiser Watch system to measure the performance of individual appraisers, establish procedures for ensuring that all approved appraisers meet the requirements of the Appraisal Qualifications Board, require lenders to exercise more oversight of appraisers they employ, and track the performance of lenders who underwrite loans. The Department is also promulgating a final rule to prohibit property flipping on FHA-insured mortgages. Several rules are also under development to increase the required qualifications of lenders who participate in the FHA program.

**Single Family Property Inventory.** FHA continues to improve its management acquisition services associated with the disposition of its Single Family properties. The entire approach to monitoring and accounting for properties in the single family Real Estate Owned (REO) inventory was revamped by implementing the REO property Management and Marketing (M&M) contracting model nationwide in FY 1999. Since then, FHA has seen an increased rate of return and more rapid sales of REO properties.

FHA is currently involved in a number of initiatives to improve controls over the disposition of single family assets. A new Accelerated Claim Disposition Demonstration program that experiments with new ways to handle assets—acquiring mortgage notes rather than properties—is currently underway.

**FHA Systems Control.** FHA relies on 20 different systems to process large volumes of data that include accounting data for program functions as well as cash receipts and disbursement transactions. Since these systems play such a vital role in FHA's accomplishment of its mission, FHA continues to make security concerns a priority to ensure that systems are properly controlled to prevent unauthorized access. FHA has taken action to ensure that that these systems are maintained in such a manner that data integrity and system continuity are not compromised.

A number of initiatives were undertaken to provide a more secure systems environment. These efforts included continued enhancement of segregation of duties for key data processing functions, implementing stronger access controls, and ensuring that security risk assessments are performed for key applications. As FHA moves forward in its efforts to develop an integrated financial management system, addressing systems security issues will continue to be a high priority.

**Resource Management.** In the past, OMB, GAO, Congress, and the OIG had criticized HUD for its inability to estimate staffing needs and support its staffing requests. In FY 2002, HUD completed implementation of a new staffing resource estimation and allocation system. Building on this foundation, HUD will prepare a comprehensive, strategic workforce plan. This comprehensive plan will identify the kind of work to be done now and in the future; knowledge, skills and abilities of staff to do this work; capabilities and development needs of staff and appropriate deployment across organizations; and strategies for identifying and filling gaps. Further information on HUD's efforts to improve its strategic management of its human capital is provided in the President's Management Agenda section of this report.

**Management Control Program.** The Department continues to strengthen the Management Control Program within HUD and to emphasize to all managers the importance of ongoing assessments of program controls. The Department has embraced high standards of ethics, management and accountability that extend not only to HUD's programs and business partners, but to each employee as well. Further ethics training and guidelines were issued to HUD staff in FY 2002.

Recognizing the importance of maintaining consistency and efficiency for HUD's program monitoring efforts, the Department again delivered the Compliance and Monitoring Training Program to HUD staff with monitoring responsibilities. This program was developed in FY 2000 to ensure that employees with program management or compliance responsibilities were prepared to perform in accordance with the Department's overall monitoring policies and procedures, as well as with those of their respective organizations. Two training sessions were held in FY 2002, and a total of approximately 214 employees were trained. In addition, a new Compliance and Monitoring Course designed specifically for managers and supervisors was introduced in FY 2002. Approximately 90 managers and supervisors were trained, bringing the total number of employees trained under the Compliance and Monitoring Program to over 1534.

FY 2002 marked the third cycle of reviews conducted under the Quality Management Review (QMR) Program. These reviews are internal assessments of program operations and deficiencies, as well as efficiencies. They provide for early-warning alerts on emerging management issues or problems, and the opportunity to provide immediate technical assistance and training and share exemplary practices. Eleven QMRs were conducted in FY 2002, with additional reviews planned for FY 2003. The QMR process has been used to review and monitor the execution of internal controls in the HUD field offices. This has been an excellent tool for identifying and addressing emerging problems. In addition, HUD will revise its Management Control Handbook to further strengthen HUD's Management Control Program.

**Single Audit Act Coverage.** Several actions to improve oversight of program participant compliance with the Single Audit Act requirements have been completed or are underway. GAO surveyed HUD's use of Single Audits and reported that improvements were needed in HUD's resolution and use of single audit reports. The need for improved control over this activity was most apparent in the Offices of Community Planning and Development (CPD) and Public and Indian Housing (PIH).

To help ensure compliance with audit responsibilities, CPD issued audit follow-up guidance to its field offices in March 2002, and PIH has drafted similar guidance and is providing for an automated tracking of the resolution of single audit report findings. In addition, Departmental guidance for all HUD program areas whose awards are subject to the Single Audit Act has been drafted. The Office of the Chief Financial Officer also assesses compliance with the Single Audit Act requirements as part of its QMR participation. In 2003, HUD plans to work with the Federal Audit Clearinghouse to obtain reports and data queries to strengthen HUD's management and oversight of single audit activity.

**Administrative Funds Control.** The Department has made significant improvements in the area of funds control. In its FY 2001 financial statement audit, the OIG reported weaknesses in the FHA's administrative funds control process. To address the FHA's weaknesses and strengthen funds control policies and procedures throughout HUD, a two-phase process was adopted.

Phase I consisted of FHA actions to enhance its interim Funds Control Database system and a corresponding Departmental effort to strengthen HUD's general policies and procedures for the administrative control of funds. The Chief Financial Officer (CFO) updated HUD's Administrative Control of Funds Handbook for implementation in FY 2003. Appropriations law training was also provided to HUD staff with key roles in the funds control process.

Phase II incorporates the longer-term systems development effort under the FHA Subsidiary Ledger Project. Under development are new funds control features of the FHA Subsidiary Ledger System that will fully comply with positive funds control requirements that current FHA systems do not support. These efforts will ultimately provide the basis for an improved FHA funds control process and full elimination of the management concern.

## Secretary's Audit Resolution Report to Congress

This information on the Department of Housing and Urban Development's audit resolution and follow-up activity covers the period October 1, 2001 through September 30, 2002. It is required by Section 106 of the Inspector General Act Amendments (P.L. 100-504) and provides information on the status of audit recommendations without management decisions and recommendations with management decisions but no final action. The report also furnishes statistics on the total number of audit reports and dollar value of disallowed costs for FY 2002, and statistics on the total number of audit reports and dollar value of recommendations that funds be put to better use.

### Audit Resolution Highlights

For only the third time since the Inspector General first began reporting overdue management decisions, the Department ended FY 2002 with no reportable management decisions. This hallmark event was due to the high degree of collaboration between HUD's managers and the Inspector General's auditors, from the managers of HUD's smallest field offices to the top levels of Headquarters and OIG management. In addition, the Chief Financial Officer is working with the Inspector General to develop a new on-line system for reaching management decisions and tracking the implementation of recommendations. This system, referred to as the Audit Resolution Corrective Action Tracking System (ARCATS), is targeted for implementation in the FY 2003 timeframe.

## Recommendations Without Management Decisions

The Department is required to provide a management decision (an action plan with milestones) for each audit recommendation within the six month statutory period from issuance of the related audit report issued by the Inspector General.

FY 2002 began with a total of 296 recommendations without a management decision. During the year, 649 recommendations requiring management decisions were added to our active workload and management decisions were made on a total of 666 recommendations. FY 2002 ended with 279 recommendations without management decisions. There were no recommendations beyond the statutory period of six months at the close of the year.

### Summary of Recommendations Without Management Decisions October 1, 2001 – September 30, 2002

| | |
|---|---|
| Opening Inventory | 296 |
| New Audit Recommendations Requiring Decision | 649 |
| Management Decisions Made | (666) |
| Audit Recommendations Awaiting Management Decisions | 279 |
| Audit Recommendations Beyond Statutory Period | 0 |

## Recommendations With Management Decision But No Final Action Taken

The Department began the year with an inventory of 942 management decisions requiring final action. During the year 666 additional management decisions were made. During FY 2002, the Department completed final action on a total of 825 recommendations. The total number of audit recommendations with management decisions but final actions not yet completed at the end of the year was 783. Of this 783 number, 64 are under active multi-year repayment plans that will remain open until the collected activities are completed.

### Summary of Recommendations With Management Decisions and No Final Action October 1, 2001 – September 30, 2002

| | |
|---|---|
| Opening Inventory | 942[1] |
| Management Decisions Made During FY 2002 | 666 |
| Sub-Total No Final Action at End of Period | 1,608 |
| Final Action Taken | (825) |
| Total Audit Recommendations Requiring Final Actions | 783[2] |

*[1] This value was reduced by 10 to reflect a one-time change to a systems report of greater reliability.*

*[2] The Department has 64 recommendations under current repayment plans. These recommendations are considered open and count in the audit inventory, until final repayment is made.*

## Status Of Audits With Disallowed Costs

As of October 1, 2001, there were 162 audits with management decisions on which final action had not been taken, with a dollar value of disallowed costs totaling $220 million. During FY 2002, management decisions were made for 44 audits with disallowed costs totaling approximately $20.4 million. The Department had 75 audits in which final action was taken during the fiscal year, with approximately $23 million in recoveries and $46.8 million in write-offs. As of September 30, 2002, there were 131 audits with disallowed costs awaiting final action, with an associated value of approximately $170 million.

Note that the Inspector General Act requires reporting at the audit report level versus the individual recommendation level. At the audit report level, disallowed costs are not recorded until all recommendations in a report are closed. When reporting is done at the more detailed recommendation level, the $170 million of disallowed costs awaiting final action are reduced by $46.5 million (See footnote 4).

### Management Report on Final Action on Audits With Disallowed Costs for the Fiscal Year Ending 9/30/02

| Classification | Number of Audit Reports | Disallowed Costs |
|---|---|---|
| A. Audit report with management decisions on which final action had not been taken at the beginning of the period. | 162 | $219,886,352 |
| B. Audit reports on which management decisions were made during the period. | 44 | $20,422,716 |
| C. Total audit reports pending final action during period | 206 | $240,309,068 |
| D. Audit reports on which final action was taken during the period | | |
| 1. Recoveries | 59[1] | $23,040,569 |
| (a) Collections and offsets | 59 | $22,971,569 |
| (b) Property | 0 | $0 |
| (c) Other | 1 | $ 69,000 |
| 2. Write-offs | 48 | $46,814,464 |
| 3. Total of 1 and 2 | 75[2] | $69,855,033 |
| E. Audit reports needing final action at the end of the period (subtract D3 from C) | 131[3] | $170,454,035 |
| | (266)[4] | ($123,986,857) |

*[1]Audit reports are duplicated in D.1.(a) and D.1.(c), thus the total is reduced by 1.*

*[2]Audit reports will not add by 32 because of partial recoveries and write-offs which are included in both D.1 and D.2.*

*[3]Litigation, legislation, or investigation is pending for 23 audit reports with costs totaling $44,036,951.*

*[4]The figures in brackets represent data at the recommendation level as compared to the report level.*

## Status of Audits With Recommendations That Funds Be Put to Better Use

At the beginning of FY2002, there were 17 audits with management decisions on which final action had not been taken with recommendations to put funds to better use (i.e., used more efficiently), with a dollar value of approximately $9.9 million. The Department had two recommendations which final action was taken during the fiscal year with a dollar value of $1.3 million, and two recommendations totaling $1.7 million that management concluded should not or could not be implemented. At the end of the year, there were nine audits with recommendations to put funds to better use awaiting final action with an associated value of approximately $8.24 million.

### Management Report on Final Action on Audits With Recommendations That Funds Be Put to Better Use for the Fiscal Year Ending 9/30/02

| Classification | Number of Audit Reports | Disallowed Costs |
|---|---|---|
| A. Audit reports with management decisions on which final action had not been taken at the beginning of the period | 17 | $9,964,117 |
| B. Audit reports on which management decisions were made during the period | 3 | $1,274,636 |
| C. Total audit reports pending final action during period (Total of A and B) | 20 | $11,238,753 |
| D. Audit reports on which final action was taken during the period | | |
| 1. Value of recommendations implemented (completed) | 2 | $1,293,672 |
| 2. Value of recommendations that management concluded should not or could not be implemented | 2 | $1,700,902 |
| 3. Total of 1 and 2 | 4 | $2,994,574 |
| E. Audit reports needing final action at the end of the period (Subtract D3 from C) | 16[1] | $8,244,179 |
| | (9)[2] | ($20,316,129) |

*[1]Litigation, legislation, or investigation is pending for 3 audit reports with costs totaling $4,675,692.*

*[2]The figures in brackets represent data at the recommendation level as compared to the report level.*

## Delinquent Debt Collection

| Fiscal Year Ending | Total Debt (In millions) | Delinquent Debt (In millions) | Delinquent Debt Collections (In millions) |
|---|---|---|---|
| 2002 | $12,933 | $1,130 | $3,237 |

In FY 2002, Due Process Notices were sent to 3,566 delinquent debtors advising them that their debts were past due. These notices provide the debtor with the right to establish a repayment plan or appeal the enforceability of the debt through the HUD Board of Contract appeals or an Administrative Law Judge (Federal employees). Debtors who fail to make payment arrangements or successfully appeal the enforceability of the debt are referred to Treasury where they are subjected to aggressive collection efforts, including offset of federal payments, referral to private collection agencies and administrative wage garnishment (AWG), a new collection tool that the Department implemented in FY 2002.

AWG is a collection tool authorized by the Debt Collection Improvement Act of 1996 that allows Federal Agencies to garnish up to 15 percent of the disposable pay of delinquent debtors. Unlike standard garnishments, which require a judgment and court order to implement, AWG is accomplished administratively. HUD's final rule regarding AWG was published in the Federal Register on July 18, 2002, with an effective date of August 19, 2002. HUD will rely primarily on Treasury to conduct AWG. In September 2002, HUD notified Treasury to initiate AWG for all eligible debts referred to Treasury by HUD.

During FY 2002, over 28,600 delinquent HUD debtors were eligible for the Treasury Offset Program (TOP). TOP offset collections during FY 2002 totaled $13 million. The Department also sent 2,691 debts, totaling $35.2 million to Treasury for cross servicing during the year, resulting in collections of $4.6 million.

In FY 2002, the Department continued to refer delinquent debtors to Treasury for offset on a weekly basis and to cross servicing on a monthly basis. During FY 2002, HUD's Financial Operations Center began working with Treasury on the development of a new Treasury debt collection system called "FedDebt". One of the main enhancements for the new system will be the ability to handle HUD's debts with multiple debtors. HUD is also modifying its Debt Collection and Asset Management System (F71) to incorporate the "Currently Not Collectible" (CNC) debt status. This improvement is a bookkeeping requirement mandated by OMB Circular A-129 and will allow HUD to reflect a more accurate value of the delinquent debts in its portfolio.

# Analysis of Financial Condition and Results

**This section covers:**

- *Analysis of Financial Position*
- *Analysis of Off-Balance-Sheet Risk*

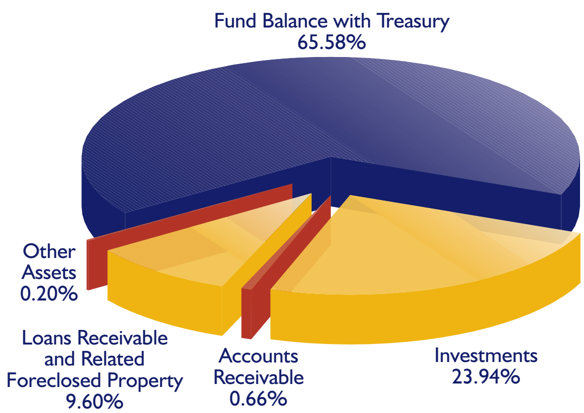
**Summarized Financial Data**
(Dollars in Millions)

| | 2002 | 2001[1] |
|---|---|---|
| Total Assets at End of FY | $118,377 | $109,817 |
| Total Liabilities at End of FY | $28,834 | $28,262 |
| Net Position at End of FY | $89,543 | $81,555 |
| FHA Insurance-In-Force | $563,378 | $555,463 |
| Ginnie Mae MBS Guarantees | $568,351 | $604,300 |
| Non-FHA/Ginnie Mae Commitments | $83,702 | $87,499 |

[1]*Change in FY 2001 Statements are due to FHA Restatements for FY 2001*

## Analysis of Financial Position

### Composition of HUD Assets




HUD's FY 2002 total assets of $118.4 billion are predominantly comprised of its fund balance with Treasury ($77.6 billion) and investments ($28.3 billion). The fund balance represents HUD's aggregate amount funds available to make authorized expenditures and pay liabilities.

The investments of $28.3 billion consist primarily of investments by FHA's MMI/CMHI Fund and by Ginnie Mae in non-marketable market-based Treasury interest-bearing obligations (i.e., investments not sold in public markets).

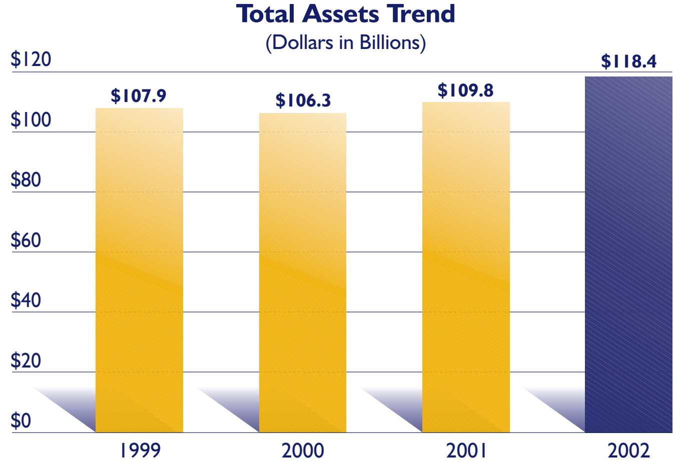
Accounts Receivable of $782 million primarily consist of claims to cash from the public and state and local authorities for bond refunding, Section 8 year end settlements, sustained audit findings, FHA insurance premiums and foreclosed property proceeds. A 100 percent allowance for loss is established for all delinquent debt 90 days and over.

Loans Receivable and Related Foreclosed Property of $11.4 billion are generated by HUD's support of construction and rehabilitation of low rent housing, principally for the elderly and disabled under the Section 202/811 program, and FHA credit program receivables.

Remaining assets of $239 million include cash; Other Monetary Assets; Property, Plant, & Equipment; and Other Assets.

### Trends in Assets

Total Assets increased 7.8 percent ($8.6 billion) from $109.8 billion at September 30, 2001 to $118.4 billion at September 30, 2002.

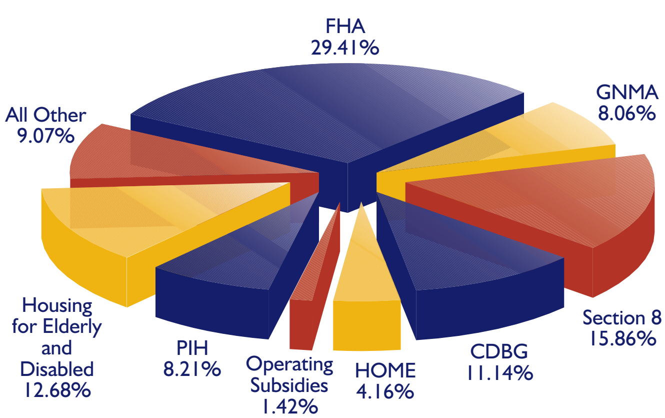


The net increase was due primarily to an increase of 5.0 percent ($3.7 billion) in fund balance with Treasury from $73.9 billion at September 30, 2001 to $77.6 billion at September 30, 2002 and an increase of 18.2 percent ($4.4 billion) in investments from $23.9 billion at September 30, 2001 to $28.3 billion at September 30,2002.

## Assets by Responsibility Segments

HUD's $3.7 billion fund balance increase was due to fund balance increases in the following programs: FHA ($154 million), Ginnie Mae ($466 million), Section 8 ($338 million), CDBG ($3,050 million), HOME ($257 million), and Housing for Elderly and Disabled ($242 million). The HUD programs that did not experience a fund balance increase were PIH, whose balance decreased by $570 million, Operating Subsidies, whose balance decreased by $143 million, and All Other, whose balance decreased by $110 million. The decrease was primarily attributable to increased program expenditures that consumed both new appropriations and portions of pre-existing funding during FY 2002.

**Assets by Responsibility Segments**

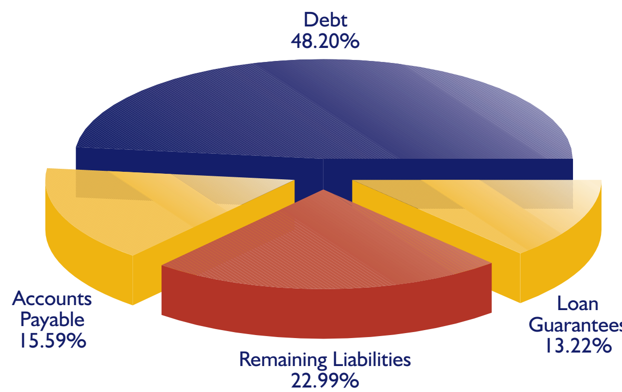



HUD's $4.4 billion investments increase was due to investments increases in the following programs: FHA ($4,008 million) and Ginnie Mae ($355 million).

## Composition of HUD Liabilities

HUD's Total Liabilities of $28.8 billion consists of $13.9 billion in debt, $3.8 billion in loan guarantee liabilities, $4.5 billion in accounts payable, and $6.6 billion in other liabilities. HUD's debt in the chart above includes intra-governmental debt of $11.7 billion and debt held by the public of $2.2 billion. The intra-governmental debt consists of loans from the Treasury, Public Housing Authorities (PHA), Tribally Designated Housing Entities (TDHE), Federal Financing Bank, and debentures issued by FHA in lieu of cash disbursements to pay claims. HUD's debt held by the public consists of new housing authority bonds and FHA debentures issued to the public at par.

**Composition of HUD Liabilities**




Accounts Payable consist primarily of pending grants payments and cash claims for single family properties and multifamily mortgage notes assigned.

Liability for Loan Guarantees (LLG) consist of:

- The LLG related to Credit Reform loans (made after October 1, 1991) is comprised of the present value of anticipated cash outflows for defaults such as claim payments, premium refunds, property expense for on-hand properties, and sales expense for sold properties, less anticipated cash inflows such as premium receipts, proceeds from property sales, and principal interest on Secretary-held notes.

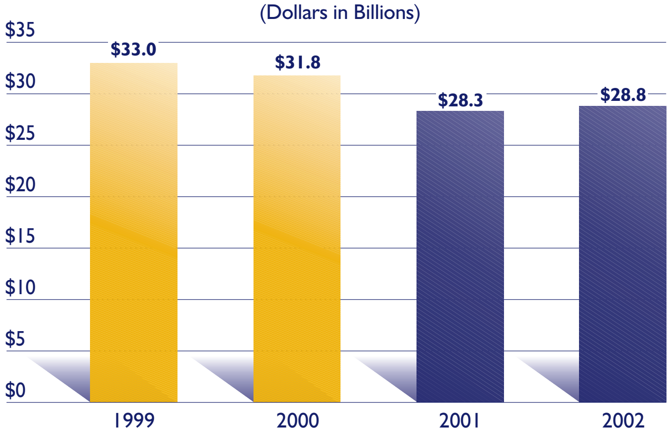
- The Pre-Credit Reform LLG is computed using the net realizable value method. The LLG for pre-Credit Reform single family insured mortgages includes estimates for defaults that have taken place, but where claims have not yet been filed with FHA. In addition, the LLG for pre-Credit Reform multifamily insured mortgages includes estimates for defaults which are considered probable but have not been reported to FHA.

Remaining Liabilities of $6.6 billion consist primarily of Insurance Liabilities, Loss Reserves, and Other Liabilities.

## Trends in Liabilities

Total Liabilities increased 2.0 percent ($0.57 billion) from $28.26 billion at September 30, 2001 to $28.83 billion at September 30, 2002.

**Total Liabilities Trend**
(Dollars in Billions)

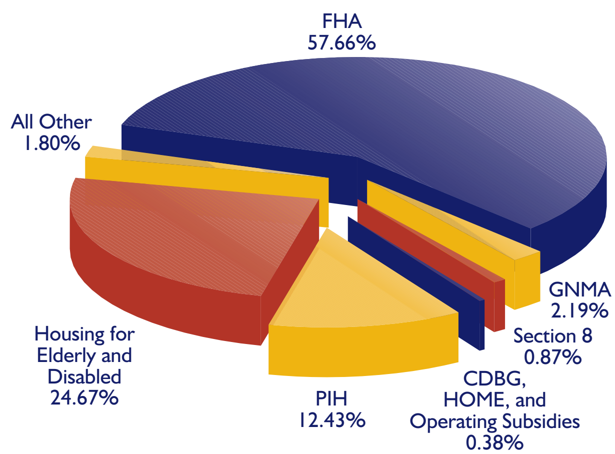



The increase was due to an increase of $1.0 billion in accounts payable and $2.2 billion in debt offset by a decrease of $2.3 billion in loan guarantee liability, and $0.3 billion in remaining liabilities.

## Liabilities by Responsibility Segments

The $1.0 billion increase in HUD accounts payable was primarily due to a $1.0 billion increase in FHA intra-government accounts payable. The $2.2 billion increase in HUD debt (repayments exceed new borrowings) was primarily due to a $3.0 billion increase in FHA debt offset partially by a decrease of $0.3 billion in Public and Indian Housing and $0.5 billion in Housing for Elderly and Disabled program debt. The $2.3 billion decrease in loan guarantees was almost completely due to an overall decrease in loan guarantees for FHA programs.

**Liabilities by Responsibility Segments**

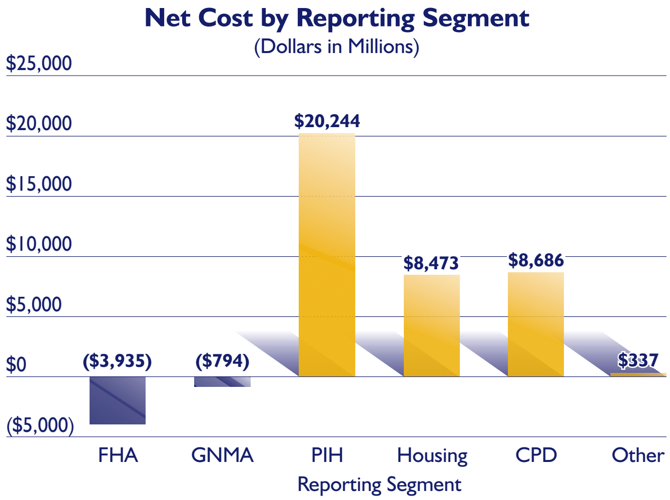



## Net Position

HUD's Net Cost of Operations, Financing Sources, and Change in Unexpended Appropriations combine to determine the Net Position at the end of the year. HUD's FY 2002 Net Position of $89.5 billion represents a 10 percent ($8.0 billion) increase over FY 2001. This increase is primarily attributable to a $5.9 billion increase in cumulative results of operations (Financing Sources in excess of Net Cost of Operations) and a $2.1 billion increase in Unexpended Appropriations.

## Net Cost of Operations

HUD's Net Cost of Operations consists of total costs, including direct and indirect program costs, as well as general Department costs, offset by program exchange revenues (in exchange for HUD services provided).



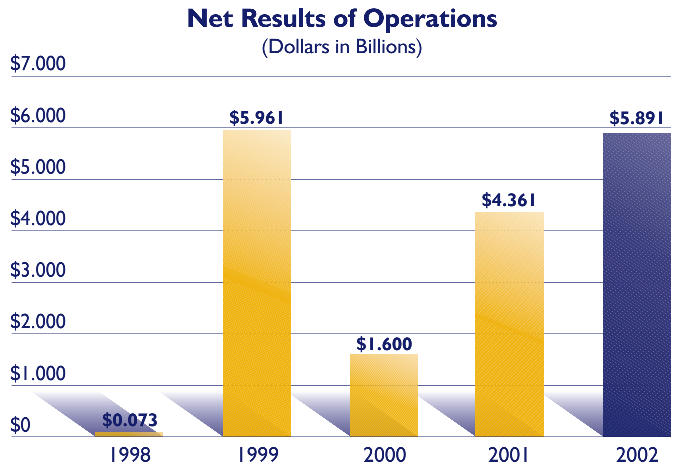

HUD's total Net Cost for FY 2002 was $33.0 billion. Of this amount, 56 percent ($18.5 billion) was spent in support of the Section 8 program (administered jointly by the Housing, Community Planning and Development (CPD), and Public and Indian Housing (PIH) programs). Total HUD Net Costs were offset by a FHA surplus of $3.9 billion, attributable to FHA's downward re-estimate of the anticipated long-term costs of its insurance programs.

## Financing Sources

As shown in HUD's Statement of Changes in Net Position, HUD's financing sources (other than exchange revenues contributing to Net Cost) for FY 2002 totaled $38.9 billion. This amount is comprised primarily of $40.5 billion in Appropriations Used, offset by approximately $1.7 billion in net transfers out. The transfers out consist of new FHA negative subsidy endorsements and credit subsidy downward re-estimates.

## Net Results of Operations

The combined effect of HUD's Net Cost of Operations and Financing Sources resulted in a 35 percent increase in Net Results of Operations of $5.9 billion during FY 2002. The significant year-to-year fluctuation shown below is due primarily to the annual re-estimation of long-term credit program costs, which can be impacted by both program performance and economic forecasts.




## Unexpended Appropriations

HUD's unexpended appropriations, which increased 3 percent ($2.1 billion) to $65.4 billion in FY 2002, represents the accumulation of appropriated funds not yet disbursed, and can change as the fund balance with Treasury changes. A significant portion of these unexpended funds is attributable to long-term commitments as discussed in the following section.

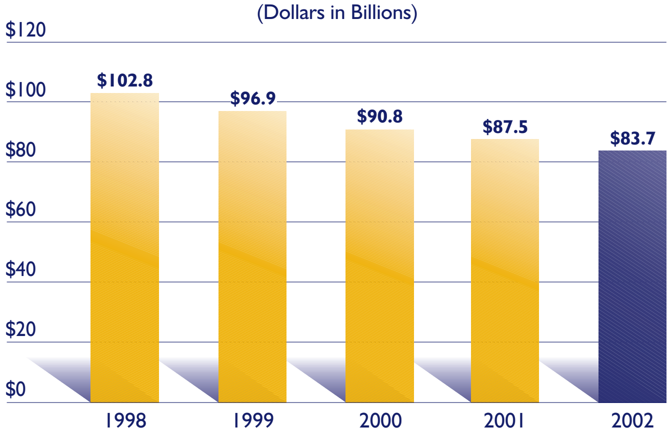
# Analysis of Off-Balance-Sheet Risk

The financial risks of HUD's credit activities are due primarily to managing FHA's insurance of mortgage guarantees and Ginnie Mae's guarantees of mortgage-backed securities. Financial operations of these entities can be affected by large unanticipated losses from defaults by borrowers and issuers and by an inability to sell the underlying collateral for an amount sufficient to recover all costs incurred.

## Contractual and Administrative Commitments

HUD's contractual commitments of $83.7 billion in FY 2002 represents HUD's commitment to provide funds in future periods under existing contracts for its grant, loan, and subsidy programs. Administrative Commitments (reservations) of $5.6 billion relate to specific projects for which funds will be provided upon execution of the related contract.

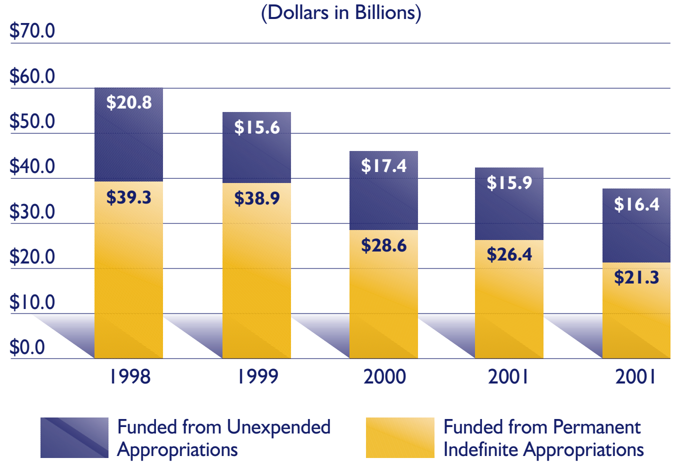
**Contractual Commitments Under HUD's Grants, Subsidy, and Loan Program**
(Dollars in Billions)




These commitments are primarily funded by a combination of unexpended appropriations and permanent indefinite budget authority, depending on the inception date of the contract. HUD draws on permanent indefinite budget authority to fund the current year's portion of contracts entered into prior to fiscal year 1988. Since fiscal 1988, HUD has been appropriated funds in advance for the entire contract term in the initial year, resulting in substantial increases and sustained balances in HUD's unexpended appropriations.

Total commitments (administrative and contractual) decreased $4.0 billion or 4.3 percent during FY 2002. The majority of this change is attributable to a decrease of $4.6 billion in Section 8 commitments, $2.3 billion decrease in All Other commitments partially offset by a $3.0 billion increase in CDBG commitments.

**Section 8 Contractual Commitments**
(Dollars in Billions)

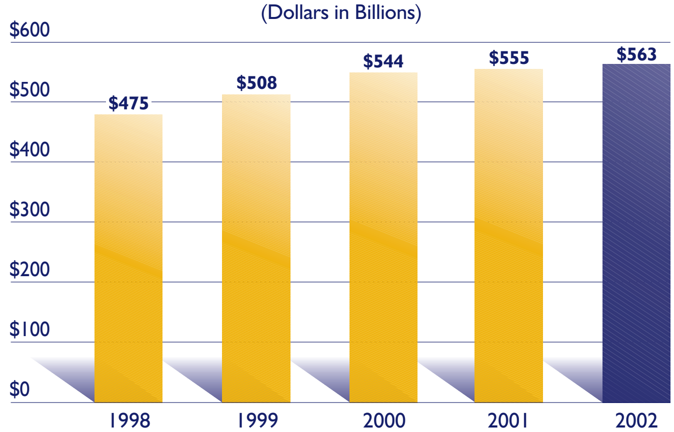



To contain the costs of future Section 8 contract renewals, the Department began converting all expiring contracts to 1-year terms during fiscal 1996. By changing to 1-year contract terms, HUD effectively reduced the annual budget authority needed from Congress to fund the subsidies while still maintaining the same number of contracts outstanding.

## FHA Insurance-in-Force

FHA's total insurance-in-force increased $8 billion or 1.4 percent from $555 billion in FY 2001 to $563 billion in FY 2002. Most of this increase was due to an $8.0 billion increase in the Mutual Mortgage Insurance (MMI) fund, which comprises almost 83 percent of FHA's total insurance-in-force.

**FHA Insurance in Force**
**As of September 30**
(Dollars in Billions)

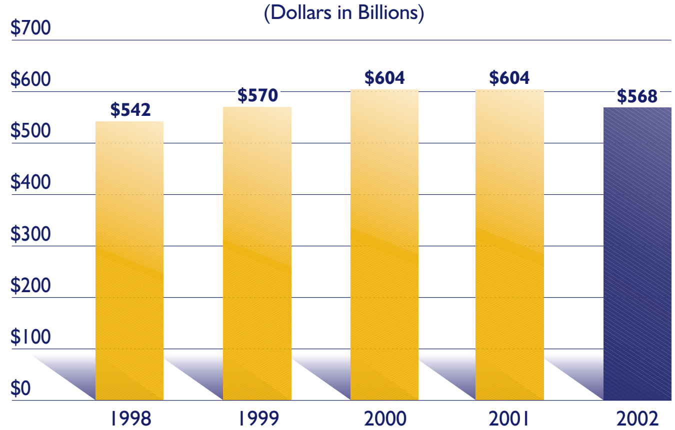


## Ginnie Mae Guarantees

Ginnie Mae financial instruments with off-balance sheet risk include guarantees of Mortgage-Backed Securities (MBS) and commitments to guaranty MBS. The securities are backed by pools of FHA-insured, RHS-insured, and VA-guaranteed mortgage loans. Ginnie Mae is exposed to credit loss in the event of non-performance by other parties to the financial instruments. The total amount of Ginnie Mae guaranteed securities outstanding at September 30, 2002 and 2001, was approximately $568 billion and $604 billion, respectively. However, Ginnie Mae's potential loss is considerably less because the FHA and RHS insurance and VA guaranty serve to indemnify Ginnie Mae for most losses. Also, as a result of the structure of the security, Ginnie Mae bears no interest rate or liquidity risk.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty MBS. The commitment ends when the MBS are issued or when the commitment period expires. Ginnie Mae's risks related to outstanding commitments are much less than for outstanding securities due, in part, to Ginnie Mae's ability to limit commitment authority granted to individual issuers of MBS. Outstanding commitments as of September 30, 2002 and 2001 were $43.2 billion and $42.8 billion, respectively.

**GINNIE MAE**
**Mortgage-Backed Securities**
**Outstanding at FY End**
(Dollars in Billions)




Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers.

In fiscal 2002 and 2001, Ginnie Mae issued a total of $122.9 billion and $67.4 billion respectively in its multi-class securities program (REMICs and Platinums). The estimated outstanding balance at September 30, 2002 and 2001, were $214.4 billion and $165.6 billion, respectively. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.