U.S. DEPARTMENT OF HOUSING
AND URBAN DEVELOPMENT

FHA

FEDERAL HOUSING ADMINISTRATION

ANNUAL MANAGEMENT REPORT

Fiscal Year 2011

FHA'S MISSION

To contribute to sustainable communities by facilitating the financing of homes, rental housing and healthcare facilities and providing quality affordable housing options in a manner that mitigates taxpayer risks and protects consumers.

Your Door to FHA HOMEOWNERSHIP

A MESSAGE FROM THE ACTING COMMISSIONER

November 15, 2011

TO THE CONGRESS OF THE UNITED STATES, MEMBERS OF THE HOUSING INDUSTRY AND THE AMERICAN PUBLIC:

FHA continued to play a key role this past year in helping facilitate the housing market's recovery in the face of ongoing challenges. The dollar volume of single family loans insured by FHA was the third highest ever, after 2009 and 2010. Among home buyers, FHA's share of new mortgages was double its historical rate, at nearly 30 percent. As a group, this past year's FHA-insured borrowers had the highest credit quality ever recorded, and they are paying premium rates that are expected to provide historically high levels of net receipts in the years ahead. The independent actuarial study of the Mutual Mortgage Insurance (MMI) Fund reveals that the capital reserve ratio remains positive, but below the statutorily required two percent threshold. This is primarily due to the fact that HUD continues to build FHA's dedicated loss reserves in anticipation of high levels of claims in the next two years. The final assessment of the actuaries is that, barring a further downturn in home prices across the nation, the MMI Fund is projected to start rebuilding capital in 2012 and return to a level of two percent by fiscal year 2014. Further, the actuaries expect that the policies put in place by this Administration will permit capital to grow rapidly once the housing market recovers.

We remain committed to restoring MMI Fund capital reserves by insuring higher quality loans and executing robust risk management policies and procedures. In so doing, we will ensure that FHA preserves its ability to fulfill its mission of encouraging homeownership and facilitating affordable housing opportunities in America's communities.

In the past year, FHA continued to make great strides in mitigating risk to its insurance funds. We changed our credit score and down payment requirements so that FHA provides access to mortgage capital in a way that does not pose unnecessary risks to the MMI Fund. We also changed the mortgage insurance premium structure to put more emphasis on the annual and less on the upfront premium charge. This change better aligns total insurance payments by borrowers with the time over which they actually require insurance. It also reduces default risk because upfront premiums are financed into the mortgage and thus lessen borrower equity positions in their homes.

FHA also introduced innovative mortgage products to respond to current needs in the housing market. The new FHA Short Refinance program is designed to help responsible homeowners who are current on their mortgages but owe more than their homes are worth because of market decline. If a borrower meets the eligibility criteria and the lender agrees to write off at least ten percent of the remaining unpaid balance, then the borrower can refinance into a safer, more secure FHA-insured mortgage.

During fiscal year 2011, FHA also introduced a major new insurance option for reverse mortgages called HECM Saver. Saver gives senior homeowners an alternative option for accessing the equity in their homes. In response to concerns that upfront fees are prohibitive for many seniors, HECM Saver virtually eliminates the upfront Mortgage Insurance Premium requirement. In exchange, the Saver-option borrower accepts a lower limit on the amount of equity take-out available to them. By June of this year, Saver accounted for nine percent of all new monthly insurance cases, and 13 percent of dollar volumes of new insurance.

In a further effort to manage our risk, we increased our oversight and enforcement for FHA lenders. By publicly reporting lender performance rankings, we are encouraging lenders to be more accountable. With the full implementation of the Final Rule, "Federal Housing Administration: Continuation of FHA Reform – Strengthening Risk Management through Responsible FHA-Approved Lenders," we strengthened FHA lender approval requirements to ensure that FHA partners with stable and quality lenders, and focused our oversight resources to more effectively manage our counterparty risk.

During fiscal year 2011, FHA continued its vital function of providing access to credit in the mortgage market. FHA insured nearly 1.2 million single family forward loans during the year, with a total dollar value of approximately $218 billion, bringing the active single family portfolio to more than $1 trillion. Of the over 700,000 home-purchase mortgages endorsed during the year, 75 percent were for first-time homebuyers, and over a third (35 percent) were for minority borrowers. Since its inception, FHA has now issued more than 40 million single-family insurance certificates, each one representing a family and a home.

In the multifamily mortgage market, FHA had another record year, topping fiscal year 2010's record volume. FHA continued to help address a scarcity of private capital by insuring new loans for multifamily properties with a total mortgage amount of $12.4 billion. This activity not only bolstered the supply of much-needed rental housing, but also helped many multifamily owners refinance into more affordable loans. This record volume supported a total of 54,525 jobs.

FHA also experienced high volume in its healthcare facilities financing programs in fiscal year 2011. Together, the Section 232 program for Residential Care Facilities and the principal Hospital insurance program, Section 242, endorsed 423 new loans with a total mortgage amount of $3.7 billion. Through these transactions, FHA not only increased access to quality health care in many communities, but created thousands of jobs tied to construction and medical care.

As we begin fiscal year 2012, FHA will continue its historic mission, commenced more than 77 years ago in 1934, of providing access to mortgage credit to low to moderate income borrowers while acting as a stabilizing force in the nation's housing finance market.

Carol J. Galante
Acting Assistant Secretary for Housing-
FHA Commissioner

This report is divided into four sections:

- *A* ***Message from the Commissioner*** is a letter from the Acting Assistant Secretary for Housing that highlights FHA's mission, vision, achievements for the year and communicates the direction and priorities of the organization.

- ***Management's Discussion and Analysis (MD&A)*** defines the organization's mission, program activities, performance goals and objectives, and includes management's assurances regarding compliance with relevant financial management legislation.

- The ***Principal Financial Statements*** includes Financial Statements and Notes to the Financial Statements.

- ***Auditor's Report*** on the Federal Housing Administration's (FHA) fiscal year 2011 financial statements, internal controls and compliance with laws and regulations.


INCLUSIVE
SUSTAINABLE
COMMUNITIES

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MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

The Federal Housing Administration (FHA), a part of the United States Department of Housing and Urban Development (HUD), provides mortgage and loan insurance on single-family, multifamily, and healthcare loans made by FHA-approved lenders throughout the United States (U.S.) and its territories. FHA's headquarters is located in Washington, D.C. with field offices throughout the country, consisting primarily of 4 Single Family Homeownership Centers (HOCs), 18 Multifamily Hubs, and 47 Multifamily Production Offices.

FHA's role has customarily been to serve borrowers that are not being adequately served by the conventional market, including first-time homebuyers, minorities, low-income families and residents of underserved communities. However, more recently, FHA insured loans have been used by larger segments of the market during the mortgage crisis. This can be seen through FHA's increased loan activity which is a direct result of reduced or constrained activity by private mortgage insurers and private lenders. Since its inception in 1934, FHA has insured over 40 million single family homes.

FHA must now balance its role in supporting the mortgage markets with its statutory mandate to operate on a sound basis. FHA continues to work with Congress and the Administration to provide effective programs and sound pricing that reflects FHA's commitment to support the economic recovery. FHA is currently focused on the following three fundamental priorities:

- Stabilizing the housing market and assisting homeowners at risk of foreclosure
- Protecting FHA's fiscal health and strengthening risk management
- Ensuring responsible access to credit and liquidity to bring private capital back to the market and build a 21st century housing finance system

To address challenges in the housing market, FHA has developed new programs, modified existing programs, and improved controls. More specifically, FHA has:

- Expanded its capacity to identify and eliminate lenders committing fraud or abuse
- Modified the premium structure to restore FHA's capital reserves
- Strengthened underwriting procedures and requirements
- Expanded loss mitigation programs
- Created a risk management office within FHA
- Implemented the HECM Saver program

All of these actions have been taken to aid homeowners and mitigate risk to FHA's insurance funds.

The Management's Discussion and Analysis section of this report describes FHA's current programs, recent initiatives, and performance goals and results.

MISSION AND ORGANIZATIONAL STRUCTURE

FHA was created to address a set of economic conditions during the 1930's similar to those the country is facing today. Property values were declining, unemployment was rising, incomes were dropping, homeowners were defaulting on their mortgages, and credit markets were contracting. FHA eased the mortgage crisis by bridging the gap between lenders and homeowners so that families could have access to new ways of financing their homes with long-term affordable mortgages. Today FHA continues to play a critical role in supporting mortgage markets to stimulate the economy, stabilize neighborhoods heavily impacted by foreclosures, and catalyze housing construction and renovation.

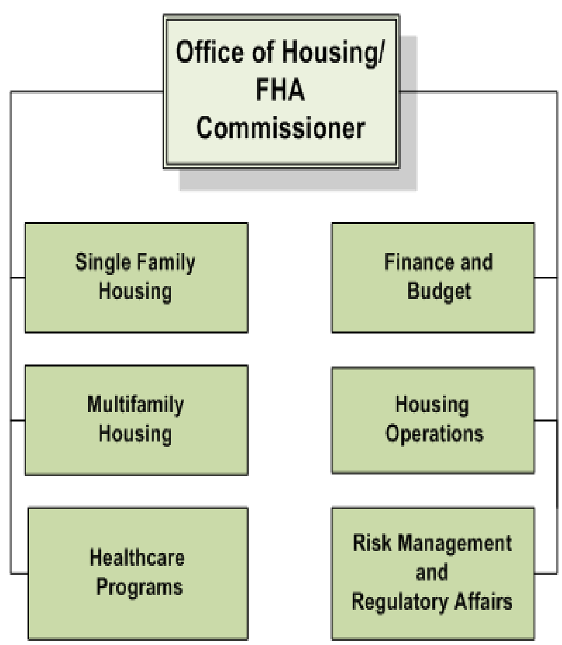
FHA's Mission

To contribute to sustainable communities by facilitating the financing of homes, rental housing and healthcare facilities and providing quality affordable housing options in a manner that mitigates taxpayer risks and protects consumers.

Even though FHA is a government entity, in many aspects it functions similarly to a private mortgage insurer. For each of its programs, FHA assesses risk, collects insurance premiums, pays claims, and predicts future liabilities. However, as a government entity FHA has additional requirements and standards. For example, the Loan Guarantee Liability presented on FHA's balance sheet represents the projected liability for FHA's entire insured portfolio for the full life of each loan. As required by the Federal Credit Reform Act, each year FHA must re-estimate its liability on the outstanding loans. The Act also requires FHA to keep sufficient resources equivalent to its projected long-term liability.

FHA provides three basic categories of mortgage insurance – Single Family, Multifamily, and Healthcare. Each of these areas administers different programs under the direction of the Federal Housing Commissioner. These programs are also supported by the offices of Finance and Budget, Housing Operations, and Risk Management and Regulatory Affairs. The adjacent organizational chart depicts FHA's current functional areas.

FHA Functional Organizational Chart



Note on Forward-Looking Information Presented

Information contained in this document is considered "forward-looking" as defined by the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 15, "Management's Discussion and Analysis," and Statement of Federal Financial Accounting Concepts (SFFAC) No. 3, "Management's Discussion and Analysis Concepts." Such forward-looking information includes estimates and is subject to risks and uncertainties that could cause actual results to differ materially from the estimates used in the document.

PERFORMANCE GOALS AND OBJECTIVES

HUD Strategic Plan

In May 2010, HUD released its new Fiscal Year 2010 – 2015 Strategic Plan which further defines and expands HUD's strategy for the future. This ambitious plan is the roadmap for HUD to achieve specific, measureable goals. In addition, it defines areas of accountability and actions needed to transform HUD and reemphasize its mission "***to create strong, sustainable, inclusive communities and quality, affordable homes for all*.**" FHA is responsible for achieving substantial portions of the Fiscal Year 2010 – 2015 Strategic Plan and will contribute to achieving each of the goals and sub goals listed below.

Strategic Goal 1: Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers

1A. Stem the foreclosure crisis
1B. Protect and educate consumers when they buy, refinance, or rent a home
1C. Create financially sustainable homeownership opportunities
1D. Establish an accountable and sustainable housing finance system

Strategic Goal 2: Meet the Need for Quality Affordable Rental Homes

2A. Expand the supply of affordable rental homes where they are most needed
2B. Preserve the affordability and improve the quality of federally assisted and private unassisted affordable rental homes
2C. Expand families' choices of affordable rental homes located in a broad range of communities

Strategic Goal 3: Utilize Housing as a Platform for Improving Quality of Life

3A. Utilize HUD assistance to improve educational outcomes and early learning and development
3B. Utilize HUD assistance to increase economic security and self-sufficiency
3C. Utilize HUD assistance to improve housing stability through supportive services for vulnerable populations, including the elderly, people with disabilities, homeless people, and those individuals and families at risk of becoming homeless

Strategic Goal 4: Build Inclusive and Sustainable Communities Free From Discrimination

4A. Catalyze economic development and job creation, while enhancing and preserving community assets
4B. Promote energy-efficient buildings and location-efficient communities that are healthy, affordable, and diverse
4C. Ensure open, diverse, and equitable communities
4D. Facilitate disaster preparedness, recovery, and resiliency

Strategic Goal 5: Transform the Way HUD Does Business

Fiscal Year 2011 High Priority Performance Goals

Among the strategic goals and sub goals, HUD identified four high priority performance goals (HPPG) to focus on during fiscal years 2010 and 2011. FHA supports the first HPPG, Foreclosure Prevention and the second HPPG, Rental Assistance, which correspond to Strategic Goal 1, sub goal 1A and Strategic Goal 2, sub goal 2A, respectively. FHA plans to assist homeowners avoid foreclosure through FHA programs as well as through third-party lender loss mitigation initiatives. This goal also projects that additional homeowners will be assisted through joint HUD-Treasury programs. FHA programs facilitate the development and preservation of affordable housing to support the Rental Assistance HPPG. FHA also plans to expand the supply of affordable rental homes where they are most needed.

Performance Reporting

FHA has developed a comprehensive Management Action Plan to address a substantial number of the strategic goals and sub goals. The significant targets and achievements for each FHA program goals are presented in the following sections. Targets and actual achievements for each goal are reported as of June 30, 2011. Targets and actual achievements as of September 30, 2011 will be reported in HUD's Annual Performance Report (APR), published February 2012.

FHA Programs

Office of Single Family Housing

Balancing Strategic Objectives

- Manage the long term viability of the Mutual Mortgage Insurance Fund
- Maintain the FHA mission to serve the underserved and first-time homebuyer by providing affordable housing options
- Provide liquidity in the counter-cyclical role that supports the housing market

Single Family Programs

FHA encourages homeownership by making loans readily available through its Single Family Housing mortgage insurance programs. These programs insure mortgage lenders against losses from default enabling those lenders to provide mortgage financing to homebuyers. FHA's Single Family mortgage insurance programs make substantial contributions to the rate of sustainable homeownership nationwide. These programs are the most visible evidence of FHA's success in providing homeownership opportunities for all Americans.

FHA strives to strengthen the nation's housing market, bolster the economy and to protect and educate consumers when they buy, refinance or rent a home. One way this is accomplished is by focusing on outreach to underserved communities by providing pre-purchase housing and financial counseling workshops in underserved communities. FHA conducted 163 of these workshops during fiscal year 2011.

During fiscal year 2011, FHA endorsed 1.2 million single-family forward (non-HECM) mortgages totaling $218 billion. FHA's share of mortgage originations has been at an all-time high over the last few years, increasing from 3 percent in fiscal years 2005 and 2006 to a high of nearly 29 percent in the fourth quarter of fiscal year 2008. FHA's fiscal year 2011 share of mortgage originations was approximately 17 percent. FHA's market share is higher among home purchase loans than among refinance loans. Its purchase-loan share peaked at 47 percent in the third quarter of fiscal year 2010 and remains over 30 percent today. That business primarily supports first-time homebuyers. In fiscal year 2011, 75 percent of FHA purchase-loan endorsements were for first- time homebuyers, which is a 5 percent decline from fiscal year 2010.

In spite of offering loan limits in excess of traditional FHA loan limits since February 2009, and its increasing market share, FHA continued to maintain its mission to serve minorities, low-to- moderate income and first-time homebuyers while improving the quality of the portfolio.

The following table reflects the FHA single family forward insurance profile in fiscal years 2011 and 2010:

	FY 2011		FY 2010		Percentage
	Number	Percent	Number	Percent	Change
Total Insurance-In-Force (EOY)	7,304,368		6,624,780		10.3%
Total Forward Endorsements	1,197,821		1,667,610		-28.2%
Average Loan Amount	$181,840		$178,460		1.9%
First Time Home Buyers	585,007	75.3%	882,098	79.5%	-4.2%
Minority Borrowers	265,238	26.1%	370,461	25.5%	0.6%
Low/Moderate Income	605,283	59.2%	897,301	61.4%	-2.2%
Average FICO Score	701		692		

Note: Data reflects number of endorsements (not dollar amount), unless preceded by a dollar sign. The First Time Home Buyers percentage is based on the total purchased loans for the year; the minority borrowers' percentage is based on the total of all loans for the year; the Low/Mod income percentage is based on all fully-underwritten loans.

FHA offers a number of loan programs that meet a wide range of borrower needs. FHA mortgages are attractive to lenders because they can be packaged into mortgage-backed securities, guaranteed by the Government National Mortgage Association and backed by the full faith and credit of the United States Government. The following table shows loan volume by program for fiscal years 2011 and 2010.

Section of Act	FHA Primary Programs	FY 2011	FY 2010	Volume Change	Percentage Change
203(b)	One-to-Four Family Home Mortgage Insurance	1,175,917	1,644,819	-468,902	-28.5%
	Purchases	757,807	1,088,412	-330,605	-30.4%
	Refinance	418,110	556,407	-138,297	-24.9%
203(k)	Rehabilitation Loan	21,266	22,484	-1,218	-5.4%
255	Home Equity Conversion Mortgages	73,093	78,757	-5,664	-7.2%
	HECM Standard	69,264	78,757	-9,493	-12.1%
	HECM Saver	3,829	0		

Note: Data reflects number of loans (not dollar amount)

A more in-depth discussion of the programs highlighted below illustrates the important role FHA plays in providing options to meet a variety of borrower needs.

Additional details on these and other Single Family FHA insured mortgage programs are available on HUD's website at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/insured.

Section 203(b): *Mortgage Insurance for One-to-Four Family Homes*

Section 203(b) is the largest of FHA's Single Family programs covering 97 percent of total Single Family Insurance-in-Force and 98 percent of fiscal year 2011 insurance issued for homes (including condominiums) with up to four housing units excluding Home Equity Conversion Mortgages (HECM). This program supports a stable mortgage finance market and serves otherwise underserved borrowers. This program offers purchase and refinance products, including FHA-to-FHA Streamline Refinances, low down payment and higher loan-to-value options for eligible borrowers.

Section 203(k*): Rehabilitation Loan*

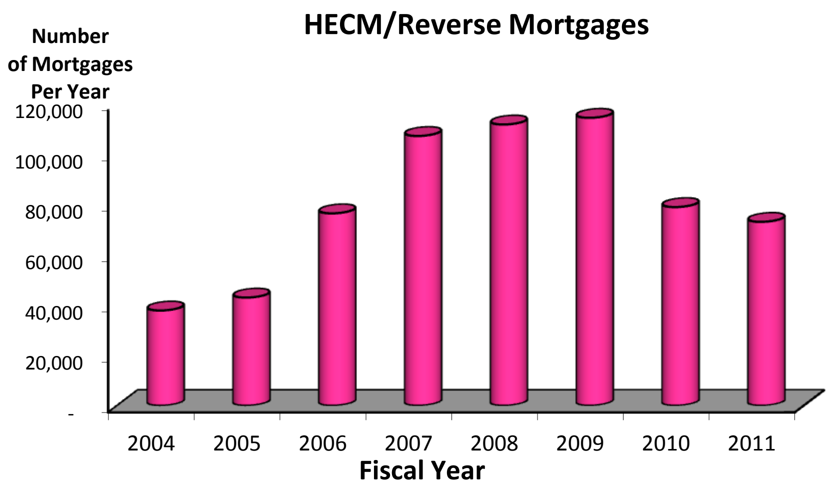
Section 203(k) is FHA's Single Family program designed to finance acquisition costs and the costs of property improvements into one mortgage loan. This program offers purchase and refinance products and may be utilized to make repairs necessary to meet minimum property standards, as well as property improvements to increase functional utility. This program is available in two formats, Standard and Streamline, based upon the complexity of the improvements requested. This program serves as a vital tool in the revitalization of aging housing stock.

Section 255: *Home Equity Conversion Mortgages (HECM)*

FHA was the first entity to promote and insure reverse mortgages on a national scale. The HECM program provides eligible homeowners who are 62 years of age and older access to the equity in their property with flexible terms. Homeowners may opt for a lump sum payment of mortgage proceeds, monthly payments, line of credit or a combination thereof.

The HECM program offers two distinct sets of borrowing options, the traditional HECM Standard option and the new HECM Saver. The HECM Saver, introduced October 4, 2010, allows for a smaller withdrawal of equity accompanied by a significantly lower upfront Mortgage Insurance Premium (MIP). This new option, available to borrowers looking for less money, lowers the risk to the FHA Insurance Fund.

Since the program's inception, FHA has endorsed over 724 thousand HECM loans. The number of reverse mortgages insured by FHA increased over the fiscal years 2004 – 2009; however, endorsements decreased from 115 thousand in fiscal year 2009 to 79 thousand in fiscal year 2010 and declined to 73 thousand in fiscal year 2011.



The HECM Program has experienced challenges in fiscal year 2011. Two of the larger originators of HECM loans withdrew from the market place. While there are several lenders that continue to offer the HECM program, FHA is working closely with industry partners and entities representing seniors to propose and formulate changes to the program that will ensure its effectiveness and sustainability.

On January 3, 2011, FHA published a Mortgagee Letter addressing a growing number of delinquent HECM mortgages on which borrowers have not paid required property charges such as taxes, insurance or homeowner association dues. In most cases, mortgagees have advanced corporate funds on the borrower's behalf. The Mortgagee Letter provides extensive guidance to the reverse mortgage industry on issuing property charge delinquency notices and initiating extensive loss mitigation and counseling efforts to ensure that HECM borrowers are provided an opportunity to establish repayment plans to repay amounts advanced on their behalf and bring the mortgages into compliance.

Title I & Title II: *Manufactured Housing and Property Improvement*

FHA offers loan and mortgage insurance programs for manufactured housing under both Title I and Title II sections of the National Housing Act. Title I loans are available for financing manufactured homes that are to be secured solely by the dwelling; also referred to as "chattel" loans, they finance manufactured homes that are classified as personal property. Title II loans are available for manufactured homes placed on a permanent foundation that are classified as real estate. Title I loans are also available for Property Improvement loans. These loans may be either first or second lien mortgages, as well as unsecured loans to finance the cost of home improvements. The Power Saver loan program (described below) has been established inside of the Title I program.

While FHA is aware of the contraction of available financing for homebuyers wishing to purchase manufactured homes, FHA does not have the authority to mandate which loan products a lender may offer. Historically, manufactured housing has not performed as well as stick- built housing, especially as it relates to the retained value of the collateral. Due to the ongoing decline in the housing market, many lenders have implemented more restrictive credit guidelines in an effort to help manage and mitigate risk. Thus, the availability of financing for manufactured housing has decreased because of these changes.

Volumes by fiscal year are as shown below:

Title I and Title II Endorsements Counts			
Loan Type	**FY 2011**	**FY 2010**	**FY 2009**
Title I Manufactured Homes	986	1,776	2,368
Title I Property Improvement	5,563	4,407	3,881
Title I Total	6,549	6,183	6,249
Title II Manufactured Housing	21,378	30,751	46,463

FHA PowerSaver

A new pilot program was implemented in fiscal year 2011, which offers credit-worthy borrowers low-cost loans to make energy-saving improvements to their homes. Backed by the Federal Housing Administration, these new **FHA PowerSaver** loans offer homeowners up to $25,000 to make these improvements. Unlike FHA's core insurance program for mortgages in first-lien position, PowerSaver insures a lien positioned in first or second place, and insures loans without a lien, provided the loan amount is less than $7,500. The volume of PowerSaver loans is estimated to reach 24,000 with an average loan amount of $12,500, over the two-year pilot period.

Section 513: *Energy Efficient Mortgages (EEM) (First-trust mortgages only)*

FHA's Energy Efficient Mortgages program (EEM) helps homeowners save money on utility bills by enabling them to finance the cost of adding energy efficiency features to new or existing housing as part of their FHA insured home purchase or refinancing mortgage. During fiscal year 2011, FHA insured 1,065 Energy Efficient Mortgages, totaling $234 million. The volume of EEM loans has declined in recent years. This program is being reviewed to determine if improvements can be made to expand originations as part of the Department's commitment to energy efficient initiatives.

Performance Goals and Objectives

The Office of Single Family Housing is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan target activities that address the Office of Single Family Housing's Sub Goals.

Strategic Goal 1 (G1): *Strengthen the Nation's Housing Market to Bolster the Economy and Protect Consumers*

G1 Sub Goal
1A Stem the foreclosure crisis

Target Activities

- Assist 300,000 seriously delinquent homeowners through FHA loss mitigation tools. Through the third quarter ending on the June 30, 2011, the target has been met with 365,932 seriously delinquent homeowners that have been assisted.

- Assist 400,000 early delinquent homeowners (< 90 days in default) with early intervention/loss mitigation. This goal has been exceeded with 411,441 homeowners assisted through June 30, 2011.

- Achieve a Consolidated Claim Workout (CCW) Ratio of 75 percent for all FHA borrowers that receive loss mitigation assistance,. The CCW Ratio indicates how many defaulted cases were saved from foreclosure through loss mitigation. Through the end of June, 2011 the CCW Ratio is 73 percent. It is not expected that the goal will be met by September 30, 2011. The Consolidated Claim Workout (CCW) Ratio is another tool used to measure the quality of a servicer's loss mitigation actions. It provides FHA with a comparison of the number of loss mitigation actions a servicer takes as it relates to the number of insurance claims the servicer files. A steady decline in home retention loss mitigation claims has been occurring since June 2011 as compared to the same period in Fiscal year 2010. The country's unusually high unemployment rate and exceptionally low depreciated property values are strong contributors to FHA's CCW decline.

- Achieve a re-default rate of loss mitigation program participants of 20 percent or less within the first 6 months following the loss mitigation action. The re-default rate for fiscal year 2011 modifications and partial claims as of June 30, 2011 was 14 percent, exceeding the goal of 20 percent or less. The re-default rate is an important tool used to measure the quality and efficacy of the loss mitigation actions undertaken by servicers. A loan is considered to have re-defaulted when 3 full monthly payments become due and unpaid within the first 6 months following a loan modification or a partial claim. The re-default rate has decreased by 13 percent from fiscal year 2010 to fiscal year 2011.

- Provide at least 80 workshops (20 per HOC) in 2011. This goal has been greatly exceeded since 3,225 workshops have been provided as of June 30, 2011. New asset managers came on board as a result of the Management and Marketing contracts and these new managers were required to conduct workshops. Since the managers wanted to introduce themselves to the communities that they were involved with, the result was that many more workshops were conducted than required by the goal.

- Attain a target of 12 Real Estate Owned (REO) workshops being provided by Single Family towards Neighborhood Stabilization Program areas. This goal target has been exceeded as of June 30, 2011 since 17 REO workshops have been provided.

- Reduce the average number of days in inventory of REO properties by 5 percent to less than 204 days, compared to the fiscal year 2010 average of 215 days. As of June 30, 2011, the average number of days for properties remaining in REO Inventory is 190, exceeding the goal of 204 days.

Single Family Housing successfully completed three Management Action Plan Goals related to the HECM program in fiscal year 2011:

- Implemented HECM Saver – October 2010
- Published Mortgagee Letter 11-01, addressing policy related to Property Charge delinquencies as described above – January 2011

- Obtained Property Charge delinquency data from servicers and established a baseline to measure success in resolving issues going forward – June 2011

Management Initiatives and Program Improvements

FHA continues to advance policies and implement initiatives to ensure that its programs serve target communities while maintaining strong financial viability. These initiatives include:

Mortgage Insurance for Condominiums

The condominium homeownership market represents 4.6 percent of all 203(b) endorsements and 3.2 percent of all HECM endorsements. Condominium purchases provide affordable homeownership opportunities for individuals who may not otherwise be able to secure financing. Since implementing baseline guidance for Condominium project approvals and loan level requirements which are mandated by the Housing and Economic Recovery Act (HERA) of 2008, FHA staff has routinely met with industry stakeholders and other parties to discuss current market conditions and further expansion and definition of FHA condominium guidelines. FHA issued new condominium baseline guidance in June 2011. FHA will continue to monitor the performance of condominium loans and market conditions and will issue proposed rules to formalize condominium regulations. This process includes providing the public an opportunity to comment on proposed guidelines and regulatory content.

Housing Counseling Program

HUD's Housing Counseling Program is authorized by Section 106 of the Housing and Urban Development Act of 1968 to provide or contract with organizations to provide counseling to tenants and homeowners seeking to improve their housing conditions. Over 2,700 HUD-approved agencies currently provide these services. Although Housing Counseling activities are not funded through FHA resources, they have a significant impact on FHA programs.

HUD awards grants annually to HUD-approved housing counseling agencies through a competitive process. In fiscal year 2011, HUD awarded nearly $73 million in housing counseling grants to more than 500 agencies. The $73 million in grants were allocated to support the following services: comprehensive housing counseling; HECM counseling; mortgage modification and mortgage scam assistance; and housing counseling training.

In September 2011, HUD awarded an additional $10 million in Mortgage Modification and Mortgage Scam Assistance (MMMSA) counseling funding. This includes predominantly foreclosure prevention counseling, assistance with application to Federal and other mortgage modification and loss mitigation programs, and related outreach. The awards will also support outreach and counseling efforts designed to identify and assist victims of mortgage modification scams, and report those cases to the applicable authorities.

Congress did not provide any new funding for the Housing Counseling program in HUD's fiscal year 2011 appropriations.

FHA Short Refinance Program

On March 26, 2010, HUD and the Department of the Treasury announced enhancements to the existing Making Home Affordable Program and FHA refinance program. FHA implemented the enhancements with the publication of Mortgagee Letter 2010-23 on August 6, 2010. These enhancements were designed for borrowers who owe more on their conventional mortgages than the value of their homes. The borrowers were given the opportunity to refinance into affordable FHA loans. This program requires the lender or investor to write-off the unpaid principal balance of the original first lien mortgage by at least 10 percent. Lenders are not required to offer this program and it has not been widely adopted by mortgagees because of issues related to forgiving principal and restrictions placed by investors on this, and other, loss mitigation programs. FHA is reviewing possible enhancements to the program that may expand mortgagee support for the program. Through September 30, 2011, FHA has endorsed 334 Short Refinance mortgages with an outstanding principal balance of $73 million.

HOPE for Homeowners (H4H)

H4H was authorized in fiscal year 2008 by Title IV of HERA, as a temporary FHA insurance program. The goal of the program was to help distressed homeowners refinance from underwater and unsustainable mortgages into safe and sustainable, fixed-rate FHA-insured mortgages. The primary feature of the program required principal balances to be written down to meet loan-to-value and debt-ratio targets. In the end, H4H was not cost-effective to lenders, and few committed the resources necessary to participate. As of the program's sunset on September 30, 2011, 762 loans were insured for a total of $125 million. For those borrowers who were assisted through H4H, the average principal write down was 37 percent, or $92,000.

Expansion of Loss Mitigation Tools

FHA assists homeowners facing financial difficulties to remain in their homes through its loss mitigation programs. FHA's loss mitigation program helps reduce losses to the FHA Insurance Fund by requiring servicers to evaluate borrowers for various home retention and disposition options that either keep borrowers in their homes and reinstate their mortgages or dispose of their homes in a timely manner, thereby reducing costs. FHA also tracks and evaluates various data that indicate the success of the loss mitigation program.

Risk Management

- *Lender Enforcement Activities on Risk and Fraud.* In order to protect the health of the FHA insurance fund during this fragile point in economic recovery, FHA has strengthened its lender network by implementing select monitoring rules and lender requirements:

- Lender Approval and Recertification. As part of the implementation of Final Rule FR 5356-F-02 "Continuation of FHA Reform—Strengthening Risk Management Through Responsible FHA-Approved Lenders," FHA now requires that lenders meet new net worth requirements. Effective May 20, 2011, each FHA-approved lender must have a net worth of at least $1 million, with an exception for lenders that meet the size standards for a small business as defined by the Small Business Administration. The small business net worth requirement is $500,000. All lenders must carry at least 20 percent of the net worth requirement in liquid assets. This change ensures that all lenders are sufficiently capitalized. FHA waived the requirement that supervised lenders with less than $500 million in consolidated assets submit audited financial statements. Instead, these lenders are required to submit a fourth quarter Call Report along with an independent auditor's report on compliance and internal controls over compliance.

  During fiscal year 2011, FHA has removed its approval of over 30 noncompliant lenders. In addition, FHA ended approval for loan correspondents, a lender approval category. Loan correspondents may participate in FHA programs as sponsored third-party originators and will be monitored by their sponsoring underwriting entity. FHA's monitoring emphasis will hold the underwriter/sponsor responsible for the practices and performance of their sponsored third-party originators.

  FHA has issued a number of Mortgagee Letters implementing policies that enhance risk management. Mortgagee Letter 2010-38 provided clarification for FHA's electronic annual certification requirements and procedures. FHA-approved mortgagees must certify that they are not subject to unresolved findings contained in a governmental audit or investigation and that employees participating in FHA programs have not committed a felony related to the real estate or mortgage loan industries. Revised requirements for obtaining, maintaining, and utilizing an entity's FHA lender approval were announced with the publication of Mortgagee Letter 2011-34.

  Mortgagee Letter 2011-04, published on January 5, 2011, informed mortgagees that HUD will now collect the unique identifiers assigned by the Nationwide Mortgage Licensing System and Registry to individuals and entities participating in FHA loan origination programs. This will enable FHA to ensure that participants in its programs are appropriately licensed and comply with state and federal requirements governing their activities.

- Lender Monitoring and Enforcement. Monitoring reviews of FHA-approved lenders are conducted to ensure that FHA-insured mortgages are originated, underwritten and serviced in compliance with the Department's requirements. During fiscal year 2011, the Quality Assurance Division (QAD) conducted 299 monitoring reviews of FHA-approved lenders, evaluating 17,133 loans for compliance with HUD requirements. When material deficiencies are discovered on loans in the course of a monitoring review, FHA may seek indemnification from the lender against future insurance claim losses. This fiscal year, FHA received 1,373 indemnifications from lenders through its QAD, thereby avoiding substantial insurance claim losses.

FHA's oversight of approved lenders was strengthened in fiscal year 2011 with the issuance of three Mortgagee Letters. Mortgagee Letter 2011-02 clarifies quality control requirements for approved mortgagees that underwrite FHA-insured loans for sponsored third-party originators, and appended existing Handbook requirements to clarify timelines for the review and reporting of early payment defaults, fraud and material deficiencies and mortgage record changes for the sale and transfer of legal rights to service FHA-insured loans. Mortgagee Letter 2011-17 set forth strict guidelines to the mortgage industry on acceptable uses of the HUD/FHA logo, name and acronym. Mortgagee Letter 2011-33 reaffirms the Mortgagee Review Board's authority to sanction mortgagees for failure to report Mortgage Record changes for mortgage sales, transfers, and terminations of mortgage insurance.

- Credit Watch Termination. Through the Credit Watch Termination Initiative, FHA continues to exercise its authority to terminate lenders' approval to originate loans for insurance when those lenders' default and claim rates in HUD field office jurisdictions exceed the Department's threshold.

- Risk and Fraud Transformation. The ever increasing need for FHA to intensify its anti-fraud efforts requires implementation of early-warning detection tools and system enhancements. One important component of FHA's fraud detection efforts over the past year has been the implementation of the Mortgage Risk and Fraud Initiative (MRFI), a group of risk mitigation and fraud prevention activities under the broader FHA Transformation Initiative. These activities are divided into the following three functional areas:

  1. Counterparty Risk Management – This functional area focuses on aggregating counterparty information from various systems and databases onto a single Financial Industry Standard Platform. FHA is implementing the Lender Approval process as the first functionality on the new platform. The overall initiative will facilitate data sharing, information exchange, and risk metrics across process areas and throughout FHA.

  2. Master Data Management and Business Intelligence (MDM/BI) Risk and Fraud Tool Implementation – Under this functional area, FHA is procuring robust, scalable third-party risk and fraud tools to enhance detection and analysis of emerging risk trends in its inbound pipeline. In addition, FHA has acquired analytical consulting services to help establish and maintain a lifecycle for business intelligence implementation within the FHA environment. These services will also help FHA use new data sources and consolidated systems to better manage and mitigate loan-level risk.

  3. Loan File Review – FHA completed a number of enhancements to its loan file review processes during fiscal year 2011. On March 30, 2011, FHA completed revisions to its post endorsement review selection criteria hierarchy. On June 30, 2011, FHA released system modifications to its underwriting review system, providing enhanced file review and tracking, and risk analysis.

Appraiser Roster

FHA maintains and manages a roster of real estate appraisers authorized to conduct appraisals for FHA insured mortgages. There are over 54,047 appraisers nationwide listed on the roster. As part of FHA's risk management, each appraiser's work is reviewed regularly for compliance with written guidelines and adherence to quality standards. FHA imposed 1,980 sanctions and terminated 3,568 appraisers from its appraiser roster in fiscal year 2011 as part of its oversight functions.

Single Family Asset Management

FHA acquires single family properties through conveyance claims. HUD utilizes its third generation of Management and Marketing (M&M III) Contractors to sell Single Family Real Estate Owned (REO) properties to owner-occupants and to investors. The M&M III disposition structure streamlines operations to capitalize on the expertise of its contractors and provides flexibility to meet changing market conditions in the REO industry. The performance measurements for M&M III reduce risk to HUD, reduce losses to the Insurance Fund, decrease holding times, and ensure properties are safe and secure from hazardous conditions and maintained in a manner that preserves communities.

HUD structured the M&M III contracts to provide for:

- Centralization of mortgagee compliance functions under a Mortgagee Compliance Manager (MCM) responsible for activity before and after the property is conveyed, including approval of claims for payment, title reviews, and inspection reviews.
- Separation of marketing functions (Asset Managers) from property management functions (Field Service Managers). Field Service Managers provide property maintenance and preservation services consisting of, but not limited to, inspecting the property, securing the property, performing cosmetic enhancements/repairs, and providing on-going maintenance. The Asset Managers are responsible for the marketing and sale of REO properties.
- A centralized REO case management system and centralized property bidding/listing site. This system ensures that HUD receives the highest net return for its sealed bid process and the Department has an audit trail for oversight of the conveyance and REO processes.

Single Family Notes Inventory

As of June 30, 2011, Secretary-held notes, including HECM, totaled $3,223 million. Single Family Notes are assigned to the Secretary when FHA pays claims to lenders prior to foreclosure and takes possession of mortgage notes for servicing. Under the partial claim option, a lender will advance funds on behalf of FHA-insured homeowners in an amount necessary to reinstate a delinquent loan. Upon acceptance of the advance, the borrower executes a promissory note, creating a secondary mortgage payable to HUD. This promissory note or "partial claim" is not due and payable until the borrower pays off the first mortgage or no longer owns the property. Outstanding Single Family Notes Partial Claims increased by 22 percent (89,034 notes in fiscal year 2010 to 109,037 in fiscal year 2011). The increase is primarily due to the FHA-HAMP program, which combines a partial claim with a loan modification. Single Family Notes assigned through HECM comprised $2,073 million of the total Secretary-held mortgage notes inventory through the end of fiscal year 2011.

Single Family Loan Sale

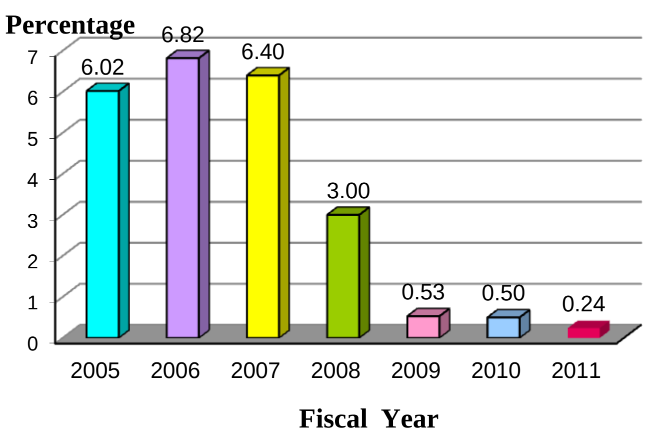
In fiscal year 2011, the Department continued the Mortgage Acquisition and Recovery Initiative Pilot (MARI) that began in fiscal year 2010. This Pilot provides another disposition alternative for defaulted single family assets. The goals of the initiative are to preserve home ownership and maximize returns to the FHA insurance funds. Three sales of defaulted Secretary-held assets were conducted during the fiscal year. In these offerings the Department accepted bids on pools of defaulted mortgages. 1,616 claims were paid after the winning bidders had been identified, thereby ensuring that the loans would be in HUD's inventory for a minimal period of time. The next sale is scheduled for December 2011.

MMI Capital Ratio

In the National Affordable Housing Act of 1990, Congress created a capital-ratio metric for gauging the financial soundness of FHA's Mutual Mortgage Insurance (MMI) Fund (see, 12 USC 1711(f)(4)). Today, the MMI Fund encompasses nearly all of FHA's single family business, including reverse mortgages insured since fiscal year 2009. The capital ratio compares the "economic net worth" of the MMI Fund to the dollar balance of active, insured loans, at a point in time. Economic net worth is defined as a net asset position, where an estimate of the present value of expected future revenues and net claim expenses is added to current balance sheet positions. The capital ratio computation is part of a mark-to-market valuation of the outstanding portfolio of insured loans HUD performs at the end of each fiscal year.

FHA is required to maintain an MMI Fund capital ratio of at least 2 percent. The housing crisis that began in fiscal year 2008 has resulted in the capital ratio falling below that 2 percent threshold for three years in a row. This fiscal year, the ratio is close to zero, at .24 percent.

MMI Capital Ratio



Note: The fiscal year 2005 – fiscal year 2008 ratios are based on unamortized IIF and do not include HECM loans. The fiscal year 2009 - 2011 ratio calculations use amortized IIF and include HECM loans endorsed starting in fiscal year 2009.

The low capital ratio today reflects an expectation that FHA's current pool of insured loans still has significant foreclosure and claim activity yet to occur. Projected losses are particularly large for the fiscal year 2006 – 2008 loans that were underwritten close to the peak of the housing market. In contrast, fiscal year 2010 and 2011 loans are expected to produce significant net revenues that can be used to offset losses from earlier years. At this point in time, the fiscal year 2009 endorsements are expected to be close to break-even, principally because the fiscal year 2009 book-of-business is carrying many streamline refinance loans from the fiscal years 2006-2008 books-of-business.

FHA has sufficient liquid assets to pay for all expected future losses on currently insured loans. A capital ratio close to zero reflects a lack of a reserve for unexpected losses. However, a worse-than-expected outcome would not necessarily require that FHA call upon its permanent-and-indefinite budget authority with the Treasury for additional support. New insurance commitments in fiscal year 2012 and 2013 are expected to generate significant additional capital resources for meeting unexpected losses from early-recession books-of-business. FHA continues to benefit from much stronger borrower credit quality than was experienced prior to fiscal year 2009, and FHA has raised premium rates four times in the past three years. FHA will not stop insuring loans, and the independent actuary projects that fiscal year 2012 commitments will provide nearly $9 billion in additional capital resources.

The fiscal year 2011 independent actuarial study predicts that, absent any changes made by FHA, the capital ratio will return to 2.0 in fiscal year 2014. This expectation of a rapid recovery of the capital ratio is based upon continuation of current premium rates, and all of the policies implemented since fiscal year 2009 to control credit risk in the portfolio. The independent actuary projects that each dollar of loans endorsed in fiscal year 2012 will produce 5.3 percent of capital.

Office of Multifamily Housing

Multifamily Housing Programs

Multifamily Housing Programs (MHP) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, cooperatives, and mobile home parks. Multifamily Housing also offers risk sharing on loans originated by state Housing Finance Agencies (HFAs), Freddie Mac and Fannie Mae for multifamily rental properties. During fiscal year 2011, Multifamily Housing initially endorsed 1,143 FHA-insured apartment loans totaling $11.6 billion through 91 lenders. In addition, Multifamily endorsed 95 Risk Sharing loans totaling $781 million (Table 1). In fiscal year 2011, Multifamily introduced Green Refinance Plus – a partnership with Fannie Mae to increase energy efficient upgrades in older affordable properties.

Multifamily insurance programs offer non-recourse financing with high loan-to-value ratios and favorable debt service coverage for a variety of housing loans. FHA's broad range of programs and non-recourse favorable loan terms induce developers to produce needed housing and provide consumers with a wide array of shelter options for all life stages. Multifamily's most popular programs are described briefly below.

Sections 221(d)(3) and 221(d)(4): *New Constructions and Substantial Rehabilitation Program*

Sections 221(d)(3) and 221(d)(4) provide mortgage insurance on loans to facilitate new construction or substantial rehabilitation of cooperatives and apartment rentals. The principal difference between the two programs is the amount of insured mortgage available for non-profit and for-profit sponsors. Under Section 221 (d)(3), non-profit owners can be insured up to 95 percent of the replacement cost in contrast to the Section 221(d)4 program, where for-profit owners can be insured up to 87 percent of the project's estimated replacement cost. While both programs offer market-rate loans, these programs can be combined with federal and state housing initiatives such as Low Income Housing Tax Credits (LIHTC), tax exempt bonds and rental subsidies for low and moderate income families.

Sections 223(f) and 223(a)(7): *Purchase/Refinancing Program of Existing Multifamily Housing Projects*

The Section 223(f) program insures loans for the purchase or refinancing of existing multifamily rental properties financed with conventional or FHA loans. The program allows for the financing of long-term mortgages by Government National Mortgage Association ("Ginnie Mae") Mortgage Backed Securities. The flexibility for purchase in the secondary mortgage market improves the availability of loan funds and permits more favorable interest rates.

The FHA Section 223(a)(7) mortgage insurance program offers a streamline refinancing option for multifamily properties already insured by FHA. In addition to expedited processing, the Section

223(a)(7) program can reduce debt service and free up operating income to property owners for other project needs.

Section 542(b) and 542(c): *Multifamily Mortgage Risk-Sharing Program*

Under these programs, FHA shares risk on loans originated, underwritten and serviced by Fannie Mae, Freddie Mac or state Housing Finance Agencies. FHA assumes a loss percentage on these loans and pays the agencies when they dispose of the defaulted loans. Most often FHA assumes a 50 percent loss risk, but the actual percentage varies depending on the terms of each risk sharing arrangement. By absorbing part of the loss, FHA provides an incentive for these agencies to fund multifamily housing.

Table 1: Multifamily Endorsements by Program

Section of the Act	Endorsements for Fiscal Year 2011		
	Dollars (millions)	Percentage	# of Mortgages
Sections 221(d)(3) and 221(d)(4):New Construction and Substantial Rehabilitation Program	$ 2,772	22%	174
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing MHP Projects	$8,503	69%	950
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	$781	6%	95
Other Programs	$331	3%	19

Additional details on these and other Multifamily loan programs are available at http://www.hud.gov/offices/hsg/mfh/progdesc/progdesc.cfm

Performance Goals and Objectives

The Office of Multifamily Housing is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan target activities that address MHP's Sub Goals.

Strategic Goal 2 (G2): *Meet the Need for Quality Affordable Rental Homes*

G2 SubGoals

2B Expand the supply of affordable rental homes where they are most needed.

Target Activities

- Provide 8,200 occupied Low-Income Housing Tax Credits/Tax Exempt Financing (LIHTC/TE units) in support of affordable rental homes. This goal was exceeded with 8,257 LIHTC/TE units provided as of June 30, 2011.

- Have affordability, preservation or sustainability components in 75 percent of endorsed projects. The average through June 30, 2011 was approximately 57 percent. As this was a first year goal for this activity, achievement of 57 percent of the target is a significant accomplishment. Multifamily Housing expects to achieve the 75 percent target in fiscal year 2012 during the second full year of goal implementation.

2C Preserve the affordability and improve the quality of federally assisted and private unassisted affordable rental homes.

Target Activities

- Complete restructurings for 80 percent of the Mark-to-Market (M2M) pipeline. The average through June 30th was approximately 44 percent. Multifamily Housing expects to meet the goal by the end of the fiscal year. The baseline is eligible properties with approvable action plans during the fiscal year. The M2M program was created to reduce rents to market levels and restructure existing debt to levels supportable by these rents. M2M transactions result in the financial and physical repositioning of projects that are FHA-insured and made affordable through Section 8 Project Based Rental Assistance. The restructuring preserves the affordability and viability of projects for the long term.

Office of MHP Development

The Office of MHP Development provides direction and oversight for FHA mortgage insurance and risk sharing loan origination. During fiscal year 2011, the Office of MHP Development endorsed 1,143 loans. MHP Development initial endorsements of FHA-insured and Risk Sharing Apartment loans totaled $12.4 billion and covered 187,407 units, creating or supporting 54,525 private sector jobs in the construction, property management, service provision and administrative fields.

Because of the continued significant difficulties in the housing market during fiscal year 2011, the dollar volume for FHA endorsements maintained historic volume and has increased consistently over the most recent three-year period, providing significant credit liquidity to the market during the country's major economic downturn. Additionally, Multifamily supports special initiatives directed to the elderly and underserved areas having high concentrations of low income or minority families.

Hebron 121 Station

New Construction:
Hebron 121 Station will be the first transit-oriented housing development in Denton County, TX. This FHA-insured property is located in Lewisville and will occupy over 13 acres of land and will offer 234 units in six multi-story buildings. Community features will include a dog park, boardwalk, lounge, picnic area, fitness center, business center, and media room. Hebron will feature cutting-edge architecture and a tropical-themed environment for its residents.

Office of Affordable Housing Preservation

The Office of Affordable Housing Preservation (OAHP) was established to assure the smooth continuation of the Mark–to-Market program (M2M). Under this program, OAHP administers restructuring of existing debt, for certain privately owned assisted multifamily properties, to levels that are supported by comparable market rents affordable to tenants. OAHP also provides assistance for oversight and preservation of a wide spectrum of affordable housing programs.

Under the M2M program, OAHP restructures FHA-insured multifamily properties for which Section 8 rents exceed comparable market rents and makes appropriate reductions to the mortgages to allow the project debt to be serviced with reduced subsidy payments while remaining financially viable with market rate rent schedules. The M2M process involves either a full or partial payment of claim by FHA on the original mortgage, followed by FHA's commitment of a new mortgage that can be supported at market rents.

During fiscal year 2011, OAHP completed restructuring on 122 properties, covering 11,951 units under the M2M program, of which 68 properties or 56 percent resulted in reduced rents and Section 8 savings. Of the 122 properties, 36 resulted in full debt restructuring, contributing to the long-term preservation of 3,622 units, which represented an annual Section 8 loss of $19.2 million. Additionally, 61 properties consisting of 5,364 units reduced rents only, representing an annual Section 8 savings of $82.1 million. The restructured units yielded an annual net savings (non-incurrence of cost) to FHA of over $62.9 million.

Multifamily Asset Management

At the end of fiscal year 2011, FHA's Multifamily insured portfolio totaled 12,627 mortgages that covered more than 1.5 million units, with a total outstanding principal balance of approximately $52,844,457 billion. Of these 12,627 mortgages, HUD holds 2,683 notes in inventory, with a total outstanding principal balance of more than $3.1 billion; however, the majority of these notes are subordinate liens. During fiscal year 2011, Multifamily did not hold any property in inventory.

Management Initiatives and Tools for Multifamily Asset Management

FHA's Multifamily Asset Management has significantly improved the accuracy and timeliness of its information in recent years through automation and workload streamlining. Better management information and updated systems have allowed FHA to make improvements in the physical condition of FHA's Multifamily portfolio.

- *Note Sales.* To dispose of multifamily assets, HUD can either sell a property through foreclosure or sell the mortgage note. Note sales have historically demonstrated a greater return to the FHA Insurance Fund as compared to foreclosures. FHA conducted two competitive Multifamily Note Sales during fiscal year 2011 that sold 26 Multifamily first and second lien mortgage notes to successful bidders. The gross proceeds from these sales were more than $89.8 million.

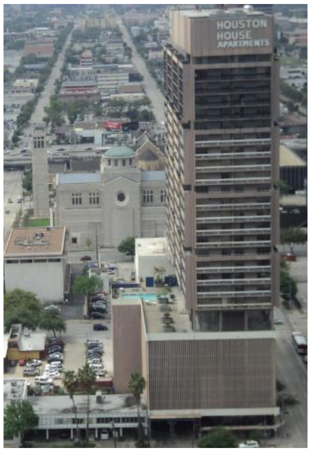
- *Lead-based paint.* FHA has been an active leader in the fight against lead-based paint. Property owners are required to comply with the Department's Lead Safe Housing Rule. Multifamily refers owners who fail to comply with the regulations to HUD's Departmental Enforcement Center for enforcement action. During fiscal year 2011, the lead-based paint compliance rate reached 95.1 percent, with 3,981 properties in compliance with HUD's Lead-Based Paint regulations.

- *Computer Integration of data.* The Office of Multifamily Asset Management uses a number of tools in its oversight of insured and subsidized properties, mortgage notes, and HUD-owned properties. The Office uses various computer subsystems and integrated systems such as Physical Assessment Subsystem (PASS), Financial Assessment Subsystem (FASS), Integrated Real Estate Management System (IREMS), Multifamily Default and Delinquency Reporting System (MDDR), and Online Property Integrated Information Suite (OPIIS), to capture, track, and maintain physical property conditions and financial data of their inventory. Data in the subsystems are integrated to provide management and field personnel financial information and physical property conditions needed for comprehensive monitoring and management of the inventory.

- *Administrative reforms.* MHP has issued a series of policy directives to facilitate the repair and recapitalization of older HUD properties, while extending their affordability for current and future generations.

- *FHA refinances*. Processing of Section 223(a)(7) applications, (FHA refinances of HUD properties) was consolidated in Multifamily's Office of Affordable Housing Preservation. This has reduced processing time by weeks, and significantly decreased the backlog of applications.
- *Addressing obsolete housing*. Notice 11-03 allows for the conversion of efficiency units into 1-bedroom units, to reduce vacancies.
- *Flexible subsidy debt*. Notice 11-05 allows for the deferral of flexible subsidy debt, creating more options for owners.
- *FHA reforms*. HUD is developing a Tax Credit Pilot program to facilitate the refinance and rehab of Section 8 properties using FHA mortgage insurance. We are also making enhancements to the 223(f) refinance program to allow for additional repairs.

Houston House Apartments



Preserving older properties: FHA insured the $43 million loan needed for the preservation of this historic building. The substantial rehabilitation of *Houston House*, originally built in 1966 and consisting of 396 units, turned an older property into more modern apartments. This is one of Houston's few high-rise developments in the downtown area, mixing residential and commercial space. The 31-story building is located one block from the rail line connecting downtown with the Medical Center, and the property is within walking distance to the downtown attractions, including the new Houston Pavilions and Discovery Green.

Management Initiatives and Program Improvements

MHP initiated a process to review and streamline application processing to be more efficient and to better handle an increased loan volume. This process includes a partial electronic delivery of loan applications and an effort to reengineer MHP's entire business process and update the information technology platform to better manage the insurance fund and meet the future needs of the industry.

The Office of MHP has enhanced policies and implemented initiatives in an effort to continue servicing the community while maintaining financial viability. The initiatives are:

- *Multifamily Accelerated Processing (MAP*). MAP is the primary tool used by the Office of MHP to expedite and manage the development process. MAP allows approved lenders to perform most of the underwriting activities that were performed by HUD staff and submit an underwriting summary and recommendation to HUD. Currently, 91 lenders are approved to process loans under MAP. Participating MAP lenders are required to perform yearly internal control reviews of at least 10 percent of the MAP loans endorsed by HUD. If the reviews disclose weaknesses in processing procedures, FHA's Lender Quality and Monitoring Division (LQMD), a division established to monitor the performance of MAP lenders, works with the lender to improve internal control procedures and ensures that lender's staff receives training on the new processes. In addition, LQMD conducts annual in-depth reviews of loans processed by MAP lenders to provide assurance on the general loan quality. In fiscal year 2011, LQMD completed reviews of 13 MAP lenders. The MAP Guide was published in August 2011 and implements various underwriting changes and updates other relevant processing standards.

- *Credit Risk Management*. For the purpose of aligning Hub and Program Center loan commitment authority with the management of credit risks and to ensure the integrity and stability of the FHA Insurance Fund, FHA created a national loan committee approval structure. Credit risk management, as implemented through a Hub and National Loan Committee approval process, provides a method to ensure oversight of Hub and Program Center commitment authority and to ensure consistency in underwriting throughout the nation, as well as to provide a platform to share best practices.

- *Transformation*. In fiscal year 2011, the Office of MHP continued its business process reengineering initiative to increase the percentage of newly constructed or rehabilitated multifamily housing units financed by FHA-insured mortgages. Multifamily expects to increase efficiency in its operations, and strengthen front-end risk assessments. The business processing reengineering effort will include:

  - FHA Insurance – Provide recommendations for business process and information technology solutions that will best support the multifamily housing programs;

  - Risk Sharing – Provide analysis and recommendations for improved process for the insurance and reinsurance for multifamily housing projects whose loans are originated, underwritten, serviced, and disposed of by a Qualified Participating Entity (QPE) or its approved lenders or by State and local Housing Finance Agencies;

  - Asset Management/Loan Servicing – Analysis of the property and loan level data submitted during the application process will be used to populate the asset management and loan servicing database and support future asset management and loan servicing systems.

  - Interim steps have been taken to improve loan processing times immediately. FHA studied the workflow of two Hubs, analyzed the findings and created a change program that will temporarily reduce processing times.

Risk Management

The Office of Multifamily Housing Program (MHP) imbedded risk management in all of its programs and processes. Borrower mortgage credit analysis became central to the Office's underwriting standards. MHP revised program underwriting standards, created both National and Hub loan committees to review and approve loans, and produced new loan closing documents. Working with risk management staff, they developed new credit policies and held monthly reviews of the portfolio performance and of the new production data.

In an effort to improve its overall risk management, the Office of MHP is currently developing a Credit Watch tool and revising lender/underwriter qualifications to further minimize the Department's risk. The Credit Watch tool and lender/underwriter qualification revisions will be published in mid-fiscal year 2012.

During fiscal year 2011, Multifamily continued to introduce initiatives with a goal of managing risk within its programs, given the current state of the housing market. These initiatives originated in June 2010 with Mortgagee Letter 2010-20, Implementation of Final Rule FR 5356-F-02, "Federal Housing Administration: Continuation of FHA Reform—Strengthening Risk Management through Responsible FHA-Approved Lenders." The improvements from this issuance increased the net worth requirements for FHA-approved lenders; thereby, ensuring FHA lenders are sufficiently capitalized.

In an effort to mitigate risks and ensure continued viability of Multifamily Programs, Mortgagee Letter (ML) 2010-21 and HUD Notice H2010-11 were issued in July 2010. These initiatives (1) updated core program underwriting standards and processes, (2) adjusted the debt service coverage and loan ratios, (3) enhanced the mortgage credit analysis, and (4) mandated in-depth reviews of principals with FHA-insured debt balances exceeding the threshold.

In addition, a monthly risk management assessment is conducted to review portfolio performance by lender and by loan, for each geographic area, in an effort to determine trends in defaults and delinquency, application sharing and areas of concerns.

Office of Healthcare Programs

Healthcare Programs

The Office of Healthcare Programs (OHP) administers the following programs that enable the affordable financing of health care facility projects and improve access to quality health care by reducing the cost of capital.

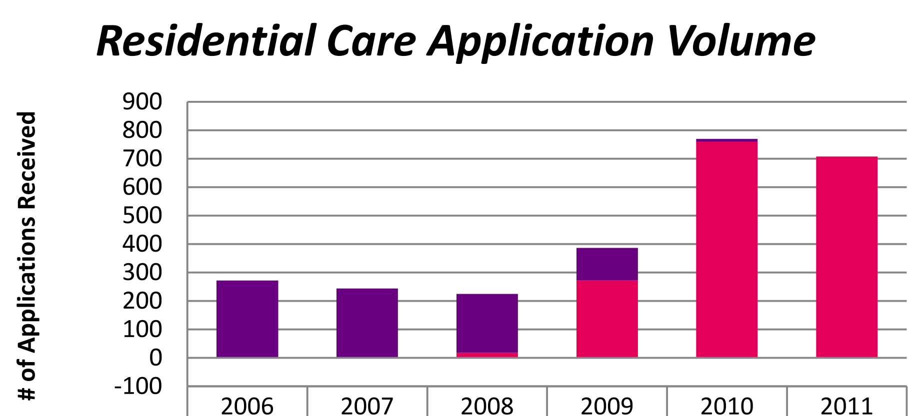
Section 232 Mortgage: *Insurance for Nursing Homes, Intermediate Care, Board & Care and Assisted-living Facilities*

The Residential Care Facilities program insures loans to finance the construction, substantial rehabilitation, acquisition or refinancing of healthcare facilities. Eligible facilities include nursing homes, intermediate care facilities, board and care homes and assisted living facilities. During fiscal year 2011, OHP endorsed 415 loans totaling $3.3 billion for 51,221 units. In fiscal year 2011, the portfolio contained 2,613 loans with an unpaid principal balance of $17.7 billion. Since fiscal year 2008, industry demand for the program has grown from 224 initial applications received to 708 in fiscal year 2011.

FHA's Healthcare Programs enable more affordable financing of needed healthcare facilities, thereby improving access to quality healthcare, creating construction and patient care jobs, and strengthening communities, at no cost to the taxpayer.

Roger Miller

Deputy Assistant Secretary
for Healthcare Programs



	2006	2007	2008	2009	2010	2011
MultiFamily	271	243	206	114	10	0
OHP			18	271	758	708
% Increase	9.27%	-10.33%	-7.82%	71.88%	99.48%	-7.81%

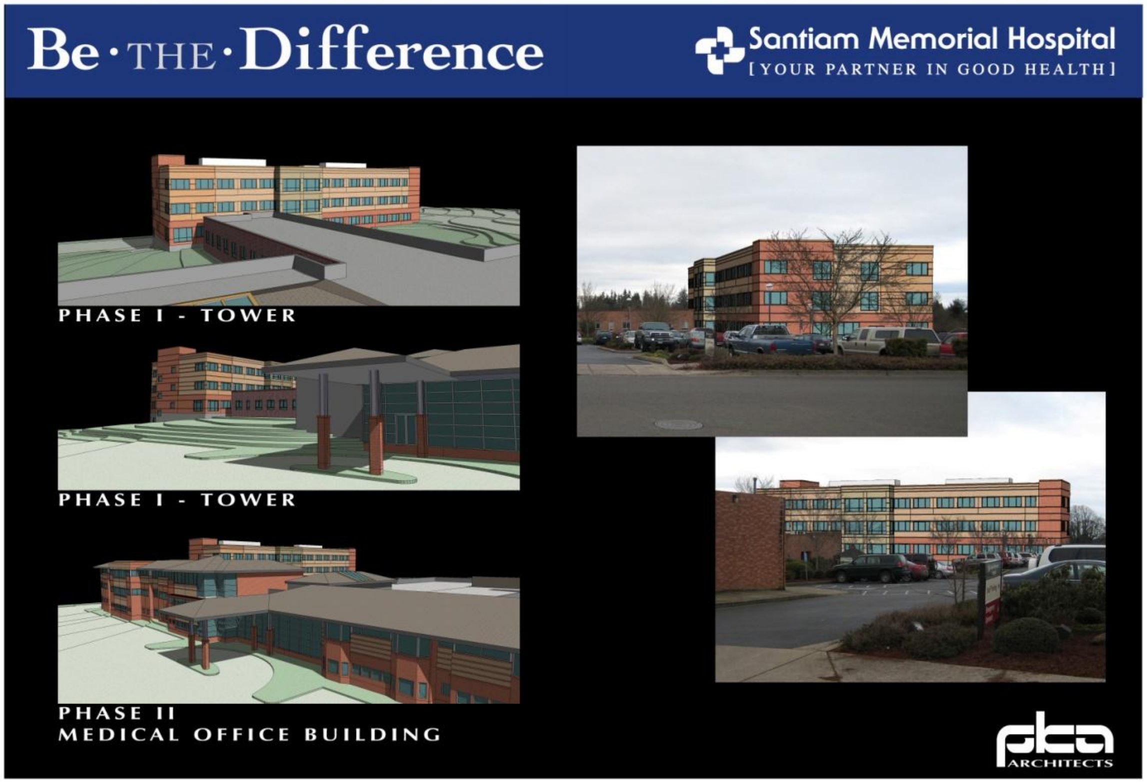
Note: Fiscal year 2005 – 2007 applications were processed by Multifamily Housing only. 2011 fiscal year application volume includes 116 applications associated with one large portfolio.

Elizabeth Seton Pediatric Center obtained $100,000,000 as a result of the Section 232 program to construct a "Replacement Skilled Nursing Facility" to better serve Medically Fragile Pediatric Patients in Yonkers, NY, a designated underserved area.

Highlighted 232 Project -Yonkers, NY

FHA insured a new facility for Elizabeth Seton Pediatric Center in Yonkers, NY, which is scheduled to be opened in February, 2012. This new facility will include 137 beds to serve medically fragile children from the ages of birth to 21 years and will replace the current facility being closed in the borough of Manhattan, New York. The Sisters of Charity of New York established the center in 1987 as an affiliate of the New York Foundling, the social agency of Sisters of Charity. As a current 5 Star Medicare-rated facility, Elizabeth Seton Pediatric Center will continue to provide a full continuum of care for children involving the expert attention of professionals in many disciplines. And in addition to generating more jobs in the medical profession, the project has generated construction-related jobs and an economic stimulus of $75.8 million in the local community.

Elizabeth Seton Pediatric Center also houses on-site education through the John A. Coleman School. Funded through the NY State Department of Education, this school offers a New York State-approved private special education preschool and school-age program, as well as early intervention group and individual program. A Long Term Home Health Care Program is also available to support the children when they leave the facility. In addition, Elizabeth Seton Pediatric Center is committed to creating and sustaining a healthful, healing environment for its resident, building users and community and has taken great efforts to design a green, sustainable building. The new building is expected to attain a Leadership in Energy and Environmental Design (LEED) Silver Certification. Partnerships with patients, staff, partners, and the local community have been key to the success of this project. The grand opening of this new facility is scheduled for February, 2012.



HUD's $27.1 million insured mortgage for Santiam Memorial Hospital in Stayton, Oregon is enabling the Hospital to build a new patient tower and medical office. building."

Section 242: *Mortgage Insurance for Hospitals*

Mortgage Insurance for Hospitals provides access to affordable financing for capital projects, including new construction or modernization. Clients range from small rural hospitals to major medical centers. Hospitals with FHA-insured loans serve as community anchors, providing jobs as well as health care services. FHA currently has 109 active hospital loans with unpaid principal balances totaling over $9 billion. In fiscal year 2011, FHA issued eight insurance commitments totaling $398 million for hospitals in seven states. The unpaid principal balance of insured loans has more than doubled from $4 billion in fiscal year 2004 to $9 billion in fiscal year 2011. HUD attributes this significant growth to an amendment to Section 242 of the National Housing Act that made it easier for critical access hospitals and hospitals in states without certificate of need requirements to qualify for insurance under the program. Other factors contributing to the growth include the significant decrease in application processing time, marketing efforts for the program, and the overall market conditions.

Highlighted 242 Projects

Chicago, IL

In Chicago, a safety net hospital (Mercy Hospital and Medical Center) serving a socio-economically disadvantaged neighborhood obtained a $66 million mortgage as a result of FHA insurance. This mortgage allowed improved patient care through the renovation of a birthing center, improvement in a 10-bed Cardiac Care Unit, and updates to meet local building codes and improve patient safety.

Riverside, CA

In Riverside, California, the Parkview Community Hospital Medical Center obtained FHA insurance for a $29 million mortgage. This allowed the hospital to refinance existing debt and significantly reduce existing interest rates. The reduction in interest rate saved approximately $63 million in interest over the expected life of the mortgage. This provides a direct savings to the patient and the taxpayer through reduced health care costs.

Performance Goals and Objectives

The Office of Healthcare Programs is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan target activities that address the
Office of Healthcare Programs' SubGoals.

Strategic Goal 2 (G2): *Meet the Need for Quality Affordable Rental Homes*

G2 SubGoal

2B Expand the supply of affordable rental homes where they are most needed.

Target Activities

- Initially endorse Section 232 Residential Care Facility mortgages that provide 2,000 newly constructed or substantially rehabilitated dwelling units. As of June 2011, mortgages were provided for 1,733 units and it is expected that this goal will be met by September 30, 2011.

Strategic Goal 3 (G3): Utilize Housing as a Platform for Improving Quality of Life.

G3 Sub Goal

3B Utilize HUD assistance to improve health outcomes

Target Activities

- Through the issuance of Section 242 FHA mortgage insurance, enable 8 hospitals to obtain affordable financing for construction or modernization projects that result in the provision of needed healthcare to communities. As of June 30, 5 hospitals obtained affordable financing and the goal was met by September 30, 2011.
- Increase the average CMS (the Centers for Medicare/Medicaid Services) quality rating of the FHA residential care facility portfolio by issuing fiscal year 2011 skilled nursing home commitments at an average CMS quality rating greater than 2.2. The current national average quality rating of proprietary skilled nursing facilities is 2.2, on a scale of 5.0, as of June 2010. As of June 30, 2011, this goal has been exceeded with a 2.8 quality rating of FHA-insured nursing facilities.

Risk Management

With an outstanding portfolio balance of $26.7 billion, managing risk has become an even more important component of the OHP programs. Risk is mitigated upfront during the underwriting process, after loan closing by the identification and monitoring of troubled properties, and through actions to reduce claim payment.

OHP is working to improve underwriting standards and ensure consistent application while reducing processing time. Utilization of Lean Processing in the Section 232 program has improved business practices by standardizing nationwide submission and underwriting. This process has allowed for greater focus on the creditworthiness of the operator and its principals.

Pro-active asset management also plays an important role in risk management and loss prevention. Account Executives are assigned to manage each lender portfolio and turnaround teams are utilized early on to work out problems. Approaches to loss prevention include working with State Agencies on early notification of potential adverse action; expediting refinancing; working with lenders who have identified potential owners, operators or equity providers and using available options to supplement funds until a property is stabilized. Options for minimizing losses on HUD-held loans include partial payments of claim, positioning notes for re-assignment, modifying mortgages and identifying equity providers/purchasers.

Additionally, standard policies are being developed for the overall asset management and loss mitigation process. Specifics include reviewing underwriting standards for the Section 242 program and revising Section 232 regulatory agreements and other closing documents to protect HUD's interest.

ANALYSIS OF FINANCIAL STATEMENTS

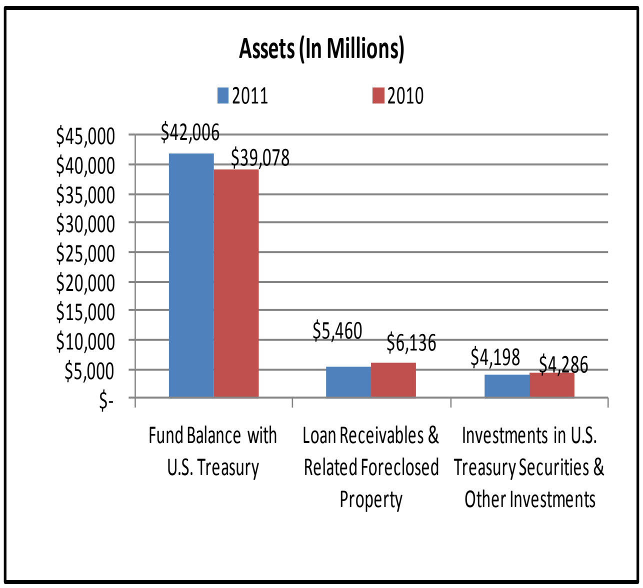
This section presents a summary analysis of the FHA's financial statements. The financial statements in this report were prepared using accounting principles generally accepted in the United States (GAAP) for Federal entities, the Federal Credit Reform Act of 1990 and in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, revised. FHA's management is responsible for the integrity and objectivity of the financial information presented in the statements. This is the 19th consecutive year FHA has received an unqualified audit opinion on its financial statements.

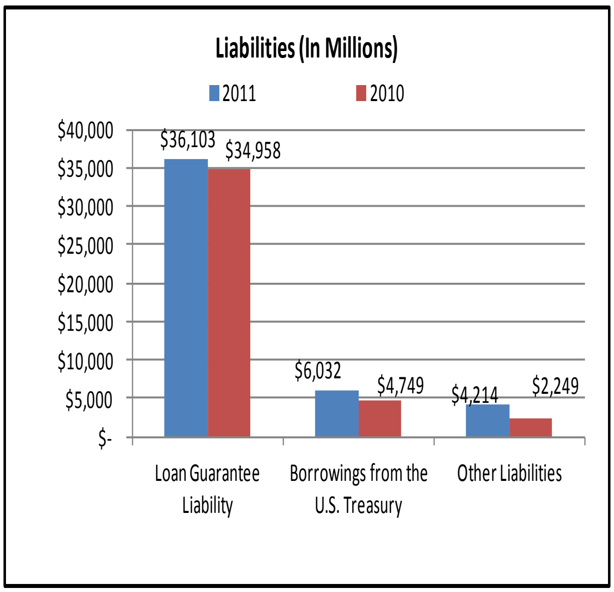
Overview of Financial Position

A summary of FHA's change in financial position from fiscal year 2010 to fiscal year 2011 is presented in the following sections on Assets and Liabilities, Net Cost and Budgetary Resources.

Assets and Liabilities

FHA's balance sheet assets primarily consist of fund balances with the U.S. Treasury and investments in non-marketable, market-based securities issued by the U.S. Treasury. The nature of FHA's business requires it to carry, or acquire through borrowing, the fund balance necessary for claim payments on defaulted guaranteed loans. Additionally, FHA must meet credit reform requirements of transferring subsidy expense and credit subsidy reestimates. The subsidy expense and reestimate calculations are based on assumptions of premium collections, prepayments, claims, and recoveries on credit program assets. Accordingly, FHA's net assets can fluctuate significantly depending largely on economic and market conditions, volume of activity, and customer demand.





The increase in assets is primarily attributable to interest FHA earned on the cash balances in the financing accounts. This amount totaled $1,799 million in fiscal year 2011. FHA also earns interest and realizes gains on investments in the MMI capital reserve account. Interest earned on the investments totaled $173 million and the gain on sale of investments totaled $133 million. The Loans Receivable and Related Foreclosed Property decreased in fiscal year 2011 due to increased single family property sales and an increase in the property allowance from higher loss rates.

Loan Guarantee Liability

The loan guarantee liability (LGL) is comprised of two components, the liability for loan guarantee (LLG) for post-1991 loan guarantees and the loan loss reserves (LLR) for pre-1992 loan guarantees.

Post-1991 LLG

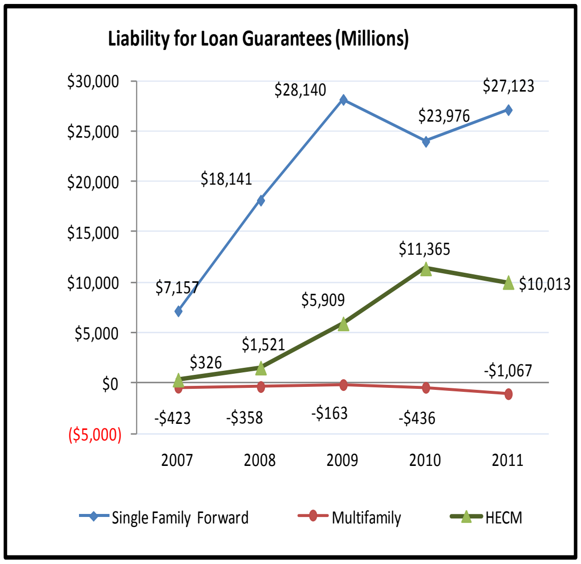
The LLG related to Credit Reform loans (made after September 30, 1991) is comprised of the present value of anticipated cash outflows, such as claim payments, premiums refunds, property expense for on-hand properties and sales expense for sold properties, less anticipated cash inflows, such as premium receipts, proceeds from property sales and principal and interest on Secretary-held notes.

Schedule of Liability for Loan Guarantees
(Dollars in Millions)

	FY 2011	FY 2010	Difference	% Change
Single Family Forward	$ 27,123	$ 23,976	$ 3,147	13%
HECM	10,013	11,365	(1,352)	-12%
Multifamily	(1,067)	(436)	(631)	145%
Total	**$ 36,069**	**$ 34,905**	**$ 1,164**	**3%**

The $3,147 million single family forward LLG increase can be attributed to better than anticipated credit quality of borrowers, but worse than expected declines in home prices. Additionally, some forward loan claims that would normally have been expected to be paid in 2011 have been delayed because of problems with which major loan servicers are facing with verification that foreclosure processes have been properly documented and that agents initiating foreclosure had legal standing to do so. The less optimistic forecast increased expected claims, decreased expected prepayments and decreased the expected return on credit program assets.

The $1,352 million HECM LLG decrease is primarily due to the more favorable forecast of long term house price appreciation this year in the major states where HECM loans are primarily concentrated, namely, California, Texas, and Florida. The $631 million multifamily LLG decrease can be attributed to decreases in several multifamily programs. The 223(f) liability decreased by $174 million principally due to lower claim expectations. Section 232 Refinance liability decreased by $98 million due to lower claim expectations and significantly increased insurance-in-force in fiscal year 2011 endorsements. The Section 242 liability decreased due to higher premium revenue caused by decreased prepayment expectations.



Pre-1992 Loan Loss Reserve (LLR)

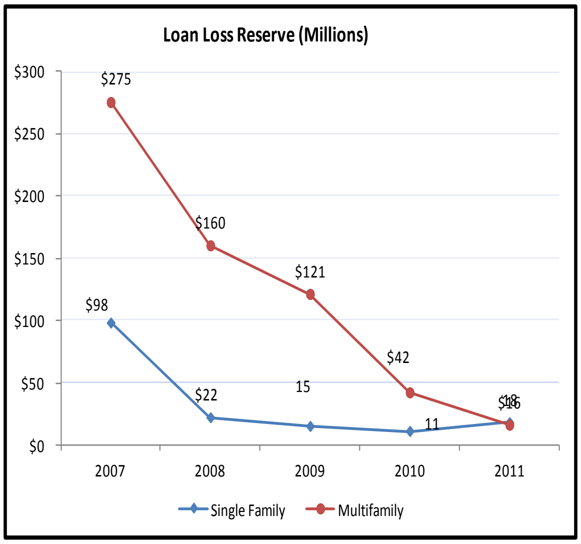
FHA maintains loss reserves for the estimated costs of future mortgage insurance claims resulting from defaults that have occurred or are likely to occur among insured single family, multifamily and Title I loan guarantees. FHA records a loss reserve for its pre-Credit Reform insured mortgages to provide for anticipated losses which may occur on claims for defaults that have taken place but have not yet been filed.

Schedule of Loan Loss Reserve
(Dollars in Millions)

	FY 2011	FY 2010	Difference	% Change
Single Family	$ 18	$ 11	$ 7	64%
Multifamily	16	42	(26)	-62%
Total	**$ 34**	**$ 53**	**$ (19)**	**-36%**

The LLR is computed using the present value of anticipated cash outflows, such as claim payments, premium refunds, property expense for on-hand properties and sales expense for sold properties, less the present value of anticipated cash inflows such as premium receipts, proceeds from property sales and principal and interest on Secretary-held notes.

Overall, loss reserves decreased by $19 million from $53 million in fiscal year 2010 to $34 million in fiscal year 2011. The majority of the decrease can be attributed to decreasing liability for pre-credit reform multifamily loans outstanding.



Net Cost/ (Surplus)

FHA's program costs exceeded revenues in fiscal year 2011, resulting in a net loss. The most important facet of FHA's cost and revenue activity is the treatment of loan guarantee subsidy cost. Loan guarantee subsidy cost is the estimated long-term cost to FHA of a loan guarantee calculated on a net present value basis, excluding administrative costs. The cost of a loan guarantee is the net present value of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements as well as payments made to FHA, including premiums, penalties, and recoveries are also included in the calculation.

Schedule of Net Cost (Surplus)
(Dollars in Millions)

	FY 2011	FY 2010	Difference	% Change
Program Cost	$ 5,697	$ 1,132	$ 4,565	403%
Less: Program Revenues	2,178	2,680	(502)	-19%
Net Cost (Surplus)	**$ 3,519**	**$ (1,548)**	**$ 5,067**	**-327%**

FHA had a net program loss in 2011. The program cost difference is primarily due to the increase in subsidy cost in fiscal year 2011 for the reestimates of the Loan Guarantee Liability.

Budgetary Resources

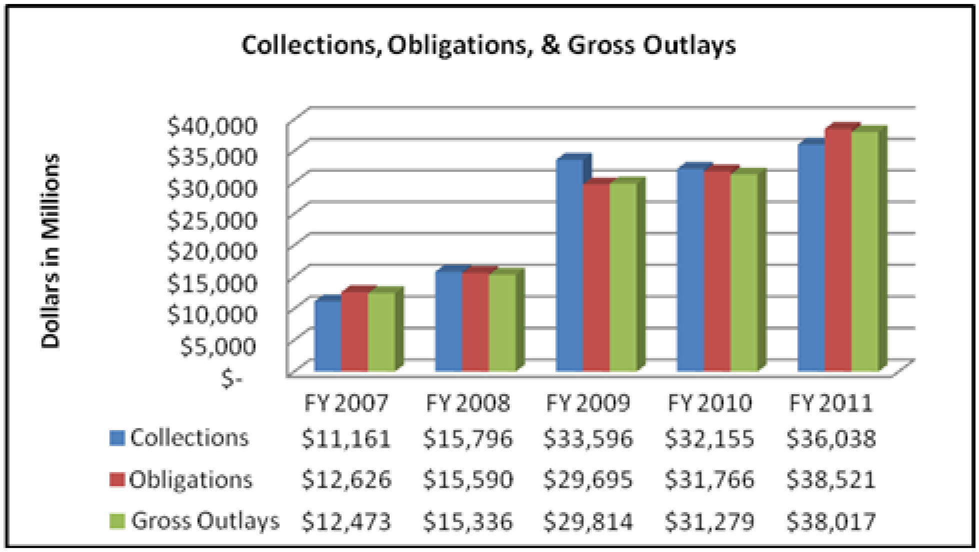
FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances carried forward.

Offsetting collections include collections of premiums, fees, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts. During the year, FHA used its borrowing authority to pay for loan guarantee claims. Additionally, FHA's budgetary resources are reduced by repayments of borrowings, the return of the unobligated GI/SRI liquidating account balances to Treasury, the return of cancelled program funds, and non-expenditure transfers for working capital fund expenses.

Budgetary Resources
(Dollars in millions)

	FY 2011	FY 2010	Difference	% Change
Offsetting Collections	$ 33,481	$ 32,154	$ 1,327	4%
Unobligated Balance Carried Forward	39,906	38,200	1,706	4%
Appropriations	3,243	1,238	2,005	162%
Borrowing Authority	3,838	800	3,038	380%
Recoveries, Transfers, and Other	(133)	(720)	587	-82%
Total Budgetary Resources	**$ 80,335**	**$ 71,672**	**$ 8,663**	**12%**

These resources were used to cover the fiscal year 2011 obligations totaling $38,521 million. These obligations included: claim payments on defaulted guaranteed loans and the cost of acquiring, maintaining and disposing of foreclosed properties.



SYSTEMS, CONTROLS, AND COMPLIANCE

FHA continues to make progress to improve its overall financial management and system control environment by addressing areas identified through regular self assessments, management reviews and independent auditor's reviews.

The independent auditors for FHA's fiscal years 2009 and 2010 Financial Statements identified a significant deficiency relating to systems. Noting FHA's substantial progress in managing and modernizing systems, the auditors recommended that FHA continue "effective monitoring of modernization efforts and existing systems as necessary to mitigate near-term financial reporting risks." The auditors recommended that the Chair of the FHA Transformation system modernization project, which FHA had established by the end of fiscal year 2009, further refine and develop risk management plans and assessments for the project and for FHA systems, and define a project governance structure to properly coordinate the many consultant teams working on system transformation activities.

Background Information

The economic upheaval over the past three years has highlighted the need to re-engineer the complex processes that support FHA's business. By many estimates, FHA now has approximately 30 percent of the market for single family mortgage originations, with over $1 trillion insurance-in-force. Lender applications for unconditional direct endorsement authority have increased and FHA has experienced higher delinquencies and claim payments. The substantive role played by FHA during the housing crisis accentuated the need to strengthen its risk management and fraud prevention framework to better protect its programs and insurance funds from fraudulent and abusive lending practices.

Subsequently, FHA began its Transformation Initiative, with the goal of implementing a modern "off-the-shelf" Financial Industry Standard Platform. The new platform is expected to provide the ability to aggregate loan transaction data, determine trends and patterns to help identify lending risks, and improve data quality. It will also enable risk detection and fraud prevention by capturing critical data points at the front-end of the loan lifecycle, and leveraging the right set of risk and fraud tools, rules based technology, and transactional controls to minimize exposure to FHA's Insurance Funds. The system will allow FHA to implement a "case management" business model that addresses the loan lifecycle (e.g., initial data submission, endorsement, servicing) and risk analytics platform to better understand dynamic market trends. The program initially focuses on Single Family programs and the following key transformational functional areas:

- Portfolio Analysis
- Counterparty Management
- Borrower/Collateral Risk Management, Fraud, Monitoring
- Infrastructure
- Legacy Application Migration

Project Management and Governance

As part of the overall project management and governance structure for FHA Transformation, formal Project Planning and Management (PPM) standards and procedures from the OCIO have been fully embraced and applied to activities for this initiative. These standards call for frequent IT governance reviews and approvals throughout the PPM Life Cycle to ensure projects are executed in accordance with applicable requirements and to assess projects' status, quality, risks and stakeholder ownership.

Additionally, the project management structure for FHA Transformation includes weekly cross functional checkpoints where both government and vendor teams review individual project status, recent and upcoming activities and high priority risks and issues. This collaboration among all project teams ensures successful communication is maintained throughout the various project phases and vendor staff is managed appropriately. The overall project management plan has been updated to reflect the latest governance structure.

Risk and Issue Management

The FHA Transformation Program Office has developed the Risk Management Plan for FHA Transformation, along with the methodology used for identifying, communicating, assessing, and monitoring project-related risks. This plan will be maintained throughout the project life cycle. Individual program and initiative risks are recorded and maintained in a combined Risk Log which is reviewed by management and the integrated project team on a routine basis (weekly/monthly) to determine status, probability, etc. The combined Risk Log will then be updated to reflect any revisions from these regularly scheduled reviews.

Issue Management is strongly correlated with the Risk Management process outlined in the Risk Management Plan. Risk register data elements include a section for "triggers" which is an event or signal that a risk could become an issue. Issues associated with FHA Transformation are managed and tracked at the individual thread/workstream level for resolution. When an issue cannot be solved at this level, it is escalated to the FHA Program Manager for resolution. The overall Risk Management plan has been updated to reflect the latest procedures.

Fiscal Year 2011 Material Weaknesses

There were no material weaknesses identified for fiscal year 2011.

FHA Compliance with OMB Circular A-123, Management's Responsibility for Internal Control

An internal control certification statement is provided to the Department's Chief Financial Officer by the Department's Assistant Secretaries to support the overall statement from the Secretary. Annually, Housing prepares an Internal Control Assurance Statement. This statement attests that Housing:

- Is in compliance with Sections 2 and 4 of the Federal Manager's Financial Integrity Act
- Systems generally comply with the requirements of the Federal Information Security Management Act (FISMA) requirements and Appendix III of OMB's Circular A-130, "Management of Federal Information Resources."
- American Recovery and Reinvestment Act funds are managed effectively, used solely for the purpose of the program, and monitored.

Each Housing Deputy Assistant Secretaries certifies compliance within their respective offices.

In addition, FHA conducted its assessment of the effectiveness of internal control over financial reporting in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHA can provide reasonable assurance that its internal control over financial reporting as of June 30, 2011 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2011

Annual Assurance Statement on Internal Control over Financial Reporting

The Federal Housing Administration (FHA) management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. FHA conducted its assessment of the effectiveness of the FHA internal control over financial reporting in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHA can provide reasonable assurance that internal control over financial reporting as of June 30, 2011 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Carol J. Galante

Acting Assistant Secretary for Housing,
Federal Housing Commissioner

Improper Payments Elimination and Recovery Act of 2010

In accordance with the Improper Payments Elimination and Recovery Act (IPERA) of 2010, enacted on July 22, 2010, and the OMB Memorandum dated April 14, 2011, FHA complied with the requirements and determined which of its program activities required review this year. Pursuant to the Act, FHA has analyzed the dollar volumes of each disbursement programs for the period between July 1, 2010 and April 30, 2011. Based on HUD threshold of $40 million, fiscal year 2011 disbursements from the following programs exceeded the threshold.

- Single Family Insurance Claims System (SFIC)
- Multifamily Insurance Claims (MFIC)
- Single Family Acquired Asset Management System (SAMS) Disbursement Program
- Contracts and Grants

During fiscal year 2011, limited risk assessments were conducted on all programs to determine that the programs are of low risk and there were no changes that might be vulnerable to improper payments. Our risk assessment revealed that there were no significant changes to processes by which the disbursements were processed, leading us to conclude that systems are not susceptible to improper payments. We have performed random statistical sampling and analyses of MFIC and SAMS case files and statistical testing of Single Family Insurance Claims (SFIC) claim disbursements in the fiscal year 2011. The findings from case files review have confirmed that programs are not susceptible to significant risk of improper payments for the fiscal year 2011. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A, concluded that each of these programs has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

Legislation passed in 2010 requires agencies that enter into contracts worth more than $1 million in a fiscal year to complete a cost-effective program for identifying errors made in paying contracts and grants and recovering any improper payments.

FHA's recovery auditing program is part of its overall program of effective internal control over disbursements. Internal controls policies and procedures establish a system to monitor improper payments and their causes; and include controls and actions for preventing, detecting, and recovering improper payments. In addition to implementing the controls established by the FHA, programs have taken specific actions to develop and regularly generate a report that identifies potential duplicate disbursements, research the questionable disbursements, resolve issues to identify payments that were proper, and initiate recovery actions for payments deemed to be improper.

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2011 financial statements:

- The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C.3515 (b).
- While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

PRINCIPAL FINANCIAL STATEMENTS

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

MESSAGE FROM THE DEPUTY ASSISTANT SECRETARY FOR FINANCE AND BUDGET

November 15, 2011

As FHA strives to meet the ongoing challenges in the housing market, the Office of Finance and Budget continually works to provide the highest quality financial information and maintain strong controls over financial transactions. This is accomplished by continual data analysis and reviews, implementing streamlined processes, and ensuring compliance with applicable laws and regulations. The success of these efforts is demonstrated by FHA obtaining 19 consecutive unqualified opinions on its annual financial statements and has had no material weakness for the last four years.

During fiscal year 2011, FHA implemented the corrective actions needed to close each of the recommendations identified during the fiscal year 2010 financial statement audit pertaining to the two significant deficiencies. One pertained to the risks associated with FHA's existing systems and ongoing efforts to modernize them. The other significant deficiency pertained to the risks associated with estimating FHA's Loan Guarantee Liability.

FHA also continued to work aggressively to resolve the non compliance with the Cranston-Gonzales National Affordable Housing Act of 1990 to improve the MMI Fund capital ratio. Despite an increase to borrower premiums and efforts to improve lender oversight and tighten underwriting standards, at the end of FY 2011, the minimum capital requirement of 2% was not achieved. However, over the next several years, it is projected that the MMI capital level will rise to meet the requirement.

The fiscal year 2011 financial statement audit identified one significant deficiency and two instances of noncompliance with laws and regulations. The significant deficiency identified risks to the security of FHA's system applications. FHA agreed with this finding and will be working closely with the Office of the Chief Information Officer (OCIO) to resolve the recommendations. This year, the auditors included a second instance of noncompliance with laws and regulations in their report. The report states that FHA is not meeting the requirements of the Office of Management and Budget (OMB) Circular No. A-127, *Financial Management Systems and the Federal Managers Financial Integrity Act of 1982*. While FHA agrees that its systems must be evaluated for their ability to continue to operate in an effective and efficient manner and to meet changing business conditions, FHA has concluded that its systems currently meet the OMB requirements.

As we work to achieve FHA's mission, strong financial management will continue to be a focus in the years to come.

George Tomchick III

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2011 and 2010
(Dollars in Millions)

	FY 2011	FY 2010
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 42,006	$ 39,078
Investments (Note 4)	4,135	4,150
Other Assets (Note 7)	3	5
Total Intragovernmental	$ 46,144	$ 43,233
Investments (Note 4)	$ 63	$ 136
Accounts Receivable, Net (Note 5)	32	16
Loans Receivable and Related Foreclosed Property, Net (Note 6)	5,460	6,136
Other Assets (Note 7)	69	76
TOTAL ASSETS	**$ 51,768**	**$ 49,597**
LIABILITIES		
Intragovernmental		
Borrowings from U.S. Treasury (Note 9)	$ 6,032	$ 4,749
Other Liabilities (Note 10)	3,051	1,165
Total Intragovernmental	$ 9,083	$ 5,914
Accounts Payable (Note 8)	723	647
Loan Guarantee Liability (Note 6)	36,103	34,958
Debentures Issued to Claimants (Note 9)	10	10
Other Liabilities (Note 10)	430	427
TOTAL LIABILITIES	**$ 46,349**	**$ 41,956**
NET POSITION		
Unexpended Appropriations (Note 16)	850	880
Cumulative Results of Operations	4,569	6,761
TOTAL NET POSITION	**5,419**	**7,641**
TOTAL LIABILITIES AND NET POSITION	**$ 51,768**	**$ 49,597**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET COST
For the Periods Ended September 30, 2011 and 2010
(Dollars in Millions)

	MMI/CMHI	GI/SRI	H4H	Total
FY 2011				
Intragovernmental				
Intragovernmental Gross Costs (Note 12)	$ 258	$ 176	$ 1	$ 435
Less: Intragovernmental Earned Revenue (Note 13)	1,565	540	-	2,105
Intragovernmental Net Costs	(1,307)	(364)	1	(1,670)
With The Public				
Gross Costs with the Public (Note 12)	$ 6,110	$ (862)	$ 14	$ 5,262
Less: Earned Revenue from the Public (Note 13)	22	$ 51	-	73
Net Costs with the Public	6,088	(913)	14	5,189
NET PROGRAM COST (SURPLUS)	**$ 4,781**	**$ (1,277)**	**$ 15**	**$ 3,519**

	MMI/CMHI	GI/SRI	H4H	Total
FY 2010				
Intragovernmental				
Intragovernmental Gross Costs (Note 12)	$ 160	$ 144	$ 2	$ 306
Less: Intragovernmental Earned Revenue (Note 13)	2,135	412	$ -	2,547
Intragovernmental Net Costs	(1,975)	(268)	$ 2	(2,241)
With The Public				
Gross Costs with the Public (Note 12)	$ (2,543)	$ 3,359	$ 10	$ 826
Less: Earned Revenue from the Public (Note 13)	63	70	$ -	133
Net Costs with the Public	(2,606)	3,289	10	693
NET PROGRAM COST (SURPLUS)	**$ (4,581)**	**$ 3,021**	**$ 12**	**$ (1,548)**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET POSITION
For the Periods Ended September 30, 2011 and 2010
(Dollars in Millions)

	FY 2011 Cumulative Results of Operations	FY 2011 Unexpended Appropriations	FY 2010 Cumulative Results of Operations	FY 2010 Unexpended Appropriations
BEGINNING BALANCES	**$ 6,761**	**$ 880**	**$ 3,261**	**$ 832**
Budgetary Financing Sources				
Appropriations Received (Note 16)	-	3,311	-	1,231
Other Adjustments (Note 16)	3	(25)	7	(47)
Appropriations Used (Note 16)	3,244	(3,244)	981	(981)
Transfers-Out (Note 15 and Note 16)	(492)	(72)	(559)	(155)
Other Financing Sources				
Transfers In/Out (Note 15)	(1,229)	-	1,504	-
Imputed Financing (Note 12)	18	-	19	-
Other	(217)	-	-	-
Total Financing Sources	**$ 1,327**	**$ (30)**	**$ 1,952**	**$ 48**
Net (Cost) Surplus of Operations	**(3,519)**	**-**	**1,548**	**-**
ENDING BALANCES	**$ 4,569**	**$ 850**	**$ 6,761**	**$ 880**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2011
(Dollars in Millions)

	FY 2011 Budgetary	FY 2011 Non-Budgetary	FY 2011 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	5,257	34,649	39,906
Unobligated balance brought forward, October 1, as adjusted	5,257	34,649	39,906
Recoveries of prior year unpaid obligations	84	26	110
Other changes in unobligated balance (+ or -)	(227)	(16)	(243)
Unobligated balance from prior year budget authority, net	5,114	34,659	39,773
Appropriations (discretionary and mandatory)	3,239	4	3,243
Borrowing authority (discretionary and mandatory)	-	3,838	3,838
Spending authority from offsetting collections (discretionary and mandatory)	8,165	25,316	33,481
Total budgetary resources	**16,518**	**63,817**	**80,335**
Status of Budgetary Resources:			
Obligations incurred	10,952	27,569	38,521
Unobligated balance, end of year:			
Apportioned	222	13,170	13,392
Unapportioned	5,344	23,078	28,422
Total unobligated balance, end of year	5,566	36,248	41,814
Total budgetary resources	**16,518**	**63,817**	**80,335**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	772	1,891	2,663
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(24)	-	(24)
Obligated balance, start of year (net), before adjustments (+ or -)	748	1,891	2,639
Obligated balance, start of year (net), as adjusted	748	1,891	2,639
Obligations incurred	10,952	27,569	38,521
Outlays (gross) (-)	(10,904)	(27,113)	(38,017)
Change in uncollected customer payments from Federal sources (+ or -)	4	(1)	3
Recoveries of prior year unpaid obligations (-)	(84)	(26)	(110)
Unpaid obligations, end of year (gross)	736	2,321	3,057
Uncollected customer payments from Federal sources, end of year	(20)	(1)	(21)
Obligated balance, end of year (net)	716	2,320	3,036
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	11,404	29,158	40,562
Actual offsetting collections (discretionary and mandatory) (-)	(8,169)	(27,869)	(36,038)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	4	(1)	3
Budget authority, net (discretionary and mandatory)	3,239	1,288	4,527
Outlays, gross (discretionary and mandatory)	10,904	27,113	38,017
Actual offsetting collections (discretionary and mandatory) (-)	(8,169)	(27,869)	(36,038)
Outlays, net (discretionary and mandatory)	2,735	(756)	1,979
Less Distributed offsetting receipts (-)	1,033	-	1,033
Agency outlays, net (discretionary and mandatory)	**1,702**	**(756)**	**946**

The accompanying notes are an integral part of these statements

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2010
(Dollars in Millions)

	FY 2010 Budgetary	FY 2010 Non-Budgetary	FY 2010 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	11,401	26,799	38,200
Recoveries of prior year unpaid obligations	58	70	128
Other changes in unobligated balance (+ or -)	(396)	(452)	(848)
Appropriations (discretionary and mandatory)	1,231	7	1,238
Borrowing authority (discretionary and mandatory)	10	790	800
Spending authority from offsetting collections (discretionary and mandatory)	3,970	28,184	32,154
Total budgetary resources	**16,274**	**55,398**	**71,672**
Status of Budgetary Resources:			
Obligations incurred	11,017	20,749	31,766
Unobligated balance, end of year:			
Apportioned	513	4,064	4,577
Unapportioned	4,744	30,585	35,329
Total unobligated balance, end of year	5,257	34,649	39,906
Total budgetary resources	**16,274**	**55,398**	**71,672**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	840	1,464	2,304
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(86)	(3)	(89)
Obligations incurred	11,017	20,749	31,766
Outlays (gross) (-)	(11,027)	(20,252)	(31,279)
Change in uncollected customer payments from Federal sources (+ or -)	62	3	65
Recoveries of prior year unpaid obligations (-)	(58)	(70)	(128)
Unpaid obligations, end of year (gross)	772	1,891	2,663
Uncollected customer payments from Federal sources, end of year	(24)	-	(24)
Obligated balance, end of year (net)	748	1,891	2,639
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	5,211	28,981	34,192
Actual offsetting collections (discretionary and mandatory) (-)	3,970	28,184	32,154
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	62	3	65
Outlays, gross (discretionary and mandatory)	11,027	20,252	31,279
Actual offsetting collections (discretionary and mandatory) (-)	(3,970)	(28,185)	(32,155)
Less Distributed offsetting receipts (-)	619	-	619
Agency outlays, net (discretionary and mandatory)	**6,438**	**(7,933)**	**(1,495)**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2011

Note 1. Significant Accounting Policies

Entity and Mission

The Federal Housing Administration (FHA) was established under the National Housing Act of 1934 and became a wholly owned government corporation in 1948 subject to the Government Corporation Control Act (31 U.S.C. § 9101 et seq.), as amended. While FHA was established as a separate Federal entity, it was subsequently merged into the Department of Housing and Urban Development (HUD) when that department was created in 1965. FHA does not maintain a separate staff or facilities; its operations are conducted, along with other Housing activities, by HUD organizations. FHA is headed by HUD's Assistant Secretary for Housing/Federal Housing Commissioner, who reports to the Secretary of HUD. FHA's activities are included in the Housing section of the HUD budget.

FHA administers a wide range of activities to make mortgage financing more accessible to the home-buying public and to increase the availability of affordable housing to families and individuals, particularly to the nation's poor and disadvantaged. FHA insures private lenders against loss on mortgages, which finance Single Family homes, Multifamily projects, health care facilities, property improvements, manufactured homes, and reverse mortgages, also referred to as Home Equity Conversion Mortgages (HECM). The objectives of the activities carried out by FHA relate directly to developing affordable housing.

FHA categorizes its insurance programs as Single Family (including Title 1), Multifamily and HECM. Single Family activities support initial or continued home ownership; Title I activities support manufactured housing and property improvement. Multifamily activities support high-density housing and medical facilities. HECM activities support reverse mortgages which allow homeowners 62 years of age or older to convert the equity in their homes into lump sum or monthly cash payments without having to repay the loan until the loan terminates.

FHA supports its insurance operations through five funds. The Mutual Mortgage Insurance fund (MMI), FHA's largest fund, provides basic Single Family mortgage insurance and is a mutual insurance fund, whereby mortgagors, upon non-claim termination of their mortgages, share surplus premiums paid into the MMI fund that are not required for operating expenses and losses or to build equity. The Cooperative Management Housing Insurance fund (CMHI), another mutual fund, provides mortgage insurance for management-type cooperatives. The General Insurance fund (GI), provides a large number of specialized mortgage insurance activities, including insurance of loans for property improvements, cooperatives, condominiums, housing for the elderly, land development, group practice medical facilities, nonprofit hospitals, and reverse mortgages. The Special Risk Insurance fund (SRI) provides mortgage insurance on behalf of mortgagors eligible for interest reduction payments who otherwise would not be eligible for mortgage insurance. Activities related to most Single Family programs, including HECM, endorsed in Fiscal Year 2009 and going forward, are in the MMI fund. The Single Family activities in the GI fund from Fiscal Year 2008 and prior remain in the GI fund. The HOPE for Homeowners (H4H) program began on October 1, 2008 for Fiscal Year 2009 as a result of *The Housing and Economic Recovery Act of 2008*. This legislation required FHA to modify existing programs and initiated the H4H program and fund.

In fiscal year 2010, FHA received appropriations for the Energy Innovation and Transformation Initiative programs. The Energy Innovation program is intended to catalyze innovations in the residential energy efficiency sector that have the ability to be replicated and to help create a standardized home energy efficient retrofit market. The appropriation for the Transformation Initiative is for combating mortgage fraud.

Basis of Accounting

The principal financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to Federal agencies as promulgated by the Federal Accounting Standards Advisory Board (FASAB). The recognition and measurement of budgetary resources and their status for purposes of preparing the Combined Statements of Budgetary Resources (SBR), is based on concepts and guidance provided by Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission, and Execution of the Budget* and the Federal Credit Reform Act of 1990. The format of the SBR is based on the SF 133, *Report on Budget Execution and Budgetary Resources*.

Basis of Consolidation

The accompanying principal financial statements include all Treasury Account Fund Symbols (TAFSs) designated to FHA, which consist of principal program funds, revolving funds, general funds and a deposit fund. All inter-fund accounts receivable, accounts payable, transfers in and transfers out within these TAFSs have been eliminated to prepare the consolidated balance sheets, statements of net cost, and statements of changes in net position. The SBR is prepared on a combined basis as required by OMB Circular A-136, *Financial Reporting Requirements, Revised*.

Fund Balance with U.S. Treasury

Fund balance with U.S. Treasury consists of amounts collected from premiums, interest earned from Treasury, recoveries and appropriations. The balance is available to fund payments for claims, property and operating expenses and of amounts collected but unavailable until authorizing legislation is enacted (see Notes 2 and 3).

Investments

FHA investments include investments in U.S. Treasury securities, Multifamily risk sharing debentures and investments in private-sector entities where FHA is a member with other parties under the Accelerated Claims Disposition Demonstration program (see Note 4).

Under current legislation, FHA invests available MMI/CMHI capital reserve fund resources in excess of its current needs in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of the amortized premium or discount. Amortization of the premium or discount is recognized monthly on investments in U.S. Treasury securities using the interest method in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 *Accounting for Selected Assets and Liabilities*, paragraph 71.

In connection with an Accelerated Claims Disposition Demonstration program (the 601 program), FHA transfers assigned mortgage notes to private sector entities in exchange for cash and equity interest. FHA uses the equity method of accounting to measure the value of its investments in these entities.

Multifamily Risk Sharing Debentures [Section 542(c)] is a program available to lenders where the lender shares the risk in a property by issuing debentures for the claim amount paid by FHA on defaulted insured loans.

Credit Reform Accounting

The Federal Credit Reform Act (FCRA) established the use of program, financing, general fund receipt and capital reserve accounts to separately account for transactions that are not controlled by the Congressional budget process. It also established the liquidating account for activity relating to any loan guarantees committed and direct loans obligated before October 1, 1991 (pre-Credit Reform). These accounts are classified as either Budgetary or Non-Budgetary in the Combined Statements of Budgetary Resources. The Budgetary accounts include the program, capital reserve and liquidating accounts. The Non-Budgetary accounts consist of the credit reform financing accounts.

In accordance with the SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees,* the program account receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. The program account also receives appropriations for administrative expenses. The financing account is a Non-Budgetary account that is used to record all of the cash flows resulting from Credit Reform direct loans, assigned loans, loan guarantees and related foreclosed property. It includes loan disbursements, loan repayments and fees, claim payments, recoveries on sold collateral, borrowing from the U.S. Treasury, interest, negative subsidy and the subsidy cost received from the program account.

The general fund receipt account is used for the receipt of amounts paid from the GI/SRI financing account when there is negative subsidy from the original estimate or a downward reestimate. The receipt account is a general fund receipt account and amounts are not earmarked for the FHA's credit programs. They are available for appropriations only in the sense that all general fund receipts are available for appropriations. Any assets in this account are non-entity assets and are offset by intragovernmental liabilities. At the beginning of the following fiscal year, the fund balance in the general fund receipt account is transferred to the U.S. Treasury general fund. Negative subsidy and downward reestimates in the MMI/CMHI fund are transferred to the Capital Reserve account.

The liquidating account is used to record all cash flows to and from FHA resulting from pre-Credit Reform direct loans or loan guarantees. Liquidating account collections in any year are available only for obligations incurred during that year or to repay debt. Unobligated balances remaining in the GI and SRI liquidating funds at year-end are transferred to the U.S. Treasury's general fund. Consequently, in the event that resources in the GI/SRI liquidating account are otherwise insufficient to cover the payments for obligations or commitments, the FCRA provides that the GI/SRI liquidating account can receive permanent indefinite authority to cover any resource shortages.

In FY 2011, FHA began reporting on a second general fund receipt account. This receipt account is used for the unobligated balance transferred from GI/SRI liquidating account and loan modifications. Similar to the general fund receipt account used for the GI/SRI negative subsidy and downward reestimates, the amounts in this account are not earmarked for FHA's credit programs and are returned to Treasury at the beginning of the next fiscal year. Any assets in this account are non-entity assets and are offset by intragovernmental liabilities.

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, purchase money mortgages (PMM), and notes related to partial claims. Under the requirements of the FCRA, PMM notes are considered to be direct loans while MNA notes are considered to be defaulted guaranteed loans. The PMM loans are generated from the sales on credit of FHA's foreclosed properties to qualified non-profit organizations. The MNA notes are created when FHA pays the lenders for claims on defaulted guaranteed loans and takes assignment of the defaulted loans for direct collections. In addition, Multifamily and Single Family performing notes insured pursuant to Section 221(g)(4) of the National Housing Act may be assigned automatically to FHA at a pre-determined point. Partial claims notes arise when FHA pays a loss mitigation amount to keep a borrower current on their loan. FHA, in turn, records a loan receivable which takes a second position to the primary mortgage.

In accordance with the FCRA and SFFAS No. 2, Credit Reform direct loans, defaulted guaranteed loans and related foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily estimated proceeds less selling and maintenance costs. The difference between the cost of these loans and property and the net present value is called the Allowance for Subsidy. Pre-Credit Reform loans receivable and related foreclosed property in inventory are recorded at net realizable value which is based on recovery rates net of any selling expenses (see Note 6).

Loan Guarantee Liability

The net potential future losses related to FHA's central business of providing mortgage insurance are reflected in the Loan Guarantee Liability in the consolidated balance sheets. As required by SFFAS No. 2, the Loan Guarantee Liability includes the Credit Reform related Liabilities for Loan Guarantees (LLG) and the pre-Credit Reform Loan Loss Reserve (LLR) (see Note 6).

The LLG is calculated as the net present value of anticipated cash outflows and cash inflows. Anticipated cash outflows include lender claims arising from borrower defaults, (i.e., claim payments), premium refunds, property costs to maintain foreclosed properties arising from future defaults and selling costs for the properties. Anticipated cash inflows include premium receipts, proceeds from asset sales and principal and interest on Secretary-held notes.

FHA records loss estimates for its Single Family LLR (includes MMI and GI/SRI) to provide for anticipated losses incurred (e.g., claims on insured mortgages where defaults have taken place but claims have not yet been filed). Using the net cash flows (cash inflows less cash outflows), FHA computes an estimate based on conditional claim rates and loss experience data, and adjusts the estimate to incorporate management assumptions about current economic factors.

FHA records loss estimates for its Multifamily LLR (includes CMHI and GI/SRI) to provide for anticipated outflows less anticipated inflows. Using the net present value of claims less premiums, fees, and recoveries, FHA computes an estimate based on conditional claim rates, prepayment rates, and recovery assumptions based on historical experience.

Use of Estimates

The preparation of the principal financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Amounts reported for net loans receivable and related foreclosed property and the Loan Guarantee Liability represent FHA's best estimates based on pertinent information available.

To estimate the Allowance for Subsidy associated with loans receivable and related to foreclosed property and the liability for loan guarantees (LLG), FHA uses cash flow model assumptions associated with loan guarantee cases subject to the Federal Credit Reform Act of 1990 (FCRA), as described in Note 6, to estimate the cash flows associated with future loan performance. To make reasonable projections of future loan performance, FHA develops assumptions, as described in Note 6, based on historical data, current and forecasted program and economic assumptions.

Certain programs have higher risks due to increased chances of fraudulent activities perpetrated against FHA. FHA accounts for these risks through the assumptions used in the liabilities for loan guarantee estimates. FHA develops the assumptions based on historical performance and management's judgments about future loan performance.

General Property, Plant and Equipment

FHA does not maintain separate facilities. HUD purchases and maintains all property, plant and equipment used by FHA, along with other Office of Housing activities.

Current HUD policy concerning SFFAS No. 10, *Accounting for Internal Use Software,* indicates that HUD will either own the software or the functionality provided by the software in the case of licensed or leased software. This includes "commercial off-the-shelf" (COTS) software, contractor-developed software, and internally developed software. FHA had several procurement actions in place and had incurred expenses for software development. FHA identified and transferred those expenses to HUD to comply with departmental policy.

Appropriations

FHA receives annual appropriations for certain operating expenses for its MMI/CMHI, GI/SRI, and H4H program activities, some of which are transferred to HUD. Additionally, FHA receives appropriations for GI/SRI positive subsidy, upward reestimates, and permanent indefinite authority to cover any shortage of resources in the liquidating account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards* and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf*, require that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. HUD allocates each responsibility segment's share of the program costs or resources provided by other Federal agencies. As a responsibility segment of HUD, FHA's portion of these costs was $18 million for fiscal year 2011 and $19 million for fiscal year 2010, and was included in FHA's financial statements as an imputed cost in the Consolidated Statements of Net Cost, and an imputed financing in the Consolidated Statements of Changes in Net Position.

Distributive Shares

As mutual funds, excess revenues in the MMI/CMHI Fund may be distributed to mortgagors at the discretion of the Secretary of HUD. Such distributions are determined based on the funds' financial positions and their projected revenues and costs. No distributive share distributions have been declared from the MMI fund since the enactment of the National Affordable Housing Act (NAHA) in 1990.

Liabilities Covered by Budgetary Resources

Liabilities of federal agencies are required to be classified as those covered and not covered by budgetary resources, as defined by OMB Circular A-136, and in accordance with SFFAS No. 1. In the event that available resources are insufficient to cover liabilities due at a point in time, FHA has authority to borrow monies from the U.S. Treasury (for post-1991 loan guarantees) or to draw on permanent indefinite appropriations (for pre-1992 loan guarantees) to satisfy the liabilities. Thus, all of FHA's liabilities are considered covered by budgetary resources.

Statement of Budgetary Resources

The Statement of Budgetary Resources has been prepared as a combined statement and as such, intra-entity transactions have not been eliminated. Budget authority is the authorization provided by law to enter into obligations to carry out the guaranteed and direct loan programs and their associated administrative costs, which would result in immediate or future outlays of federal funds. FHA's budgetary resources include current budgetary authority (i.e., appropriations and borrowing authority) and unobligated balances brought forward from multi-year and no-year budget authority received in prior years, and recoveries of prior year obligations. Budgetary resources also include spending authority from offsetting collections credited to an appropriation or fund account.

Unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not for new obligations, until that account is canceled. When accounts are canceled, five years after they expire, amounts are not available for obligations or expenditure for any purpose.

FHA funds its programs through borrowings from the U.S. Treasury and debentures issued to the public. These borrowings and debentures are authorized through a permanent indefinite authority at interest rates set each year by the U.S. Treasury and the prevailing market rates.

Note 2. Non-entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2011 and 2010 are as follows:

Note 2: Non-Entity Assets
(Dollars in millions)

	FY 2011	FY 2010
Intragovernmental:		
Fund Balance with Treasury	$ 1,292	$ 668
Investments in U.S. Treasury Securities	3	-
Total Intragovernmental	1,295	668
Other Assets	66	70
Total Non-Entity Assets	1,361	738
Total Entity Assets	50,407	48,859
Total Assets	**$ 51,768**	**$ 49,597**

FHA's non-entity assets consist of FHA's U.S. Treasury deposit of negative credit subsidy in the GI/SRI general fund receipt account and of escrow monies collected by FHA from the borrowers of its loans.

According to the FCRA, FHA transfers GI/SRI negative credit subsidy from new endorsements, downward credit subsidy reestimates, loan modifications, and unobligated balances from the liquidating account to the GI/SRI general fund receipt accounts. At the beginning of each fiscal year, fund balances in the GI/SRI general fund receipt accounts are transferred into the U.S. Treasury's general fund.

Other assets consisting of escrow monies collected from FHA borrowers are either deposited at the U.S. Treasury or minority-owned banks or invested in U.S. Treasury securities. Subsequently, FHA disburses these escrow monies to pay for property taxes, property insurance or maintenance expenses on behalf of the borrowers.

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2011 and 2010:

Note 3: Fund Balance with U.S. Treasury

(Dollars in millions)	FY 2011	FY 2010
Fund Balances:		
Revolving Funds	$ 39,386	$ 37,404
Appropriated Funds	795	790
Other Funds	1,825	884
Total	**$ 42,006**	**$ 39,078**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance		
Available	$ 13,392	$ 4,577
Unavailable	25,557	31,838
Obligated Balance Not Yet Disbursed	3,057	2,663
Total	**$ 42,006**	**$ 39,078**

Revolving Funds

FHA's revolving funds include the liquidating and financing accounts as required by the FCRA. These funds are created to finance a continuing cycle of business-like operations in which the fund charges for the sale of products or services. These funds also use the proceeds to finance spending, usually without requirement of annual appropriations.

Appropriated Funds

FHA's appropriated funds consist of annual or multi-year program accounts that expire at the end of the time period specified in the authorizing legislation. For the subsequent five fiscal years after expiration, the resources are available only to liquidate valid obligations incurred during the unexpired period. Adjustments are allowed to increase or decrease valid obligations incurred during the unexpired period that were not previously reported. At the end of the fifth expired year, the annual and multi-year program accounts are cancelled and any remaining resources are returned to the U.S. Treasury.

Other Funds

FHA's other funds include the general fund receipt accounts established under the FCRA. Additionally, the capital reserve account is included with these funds and is used to retain the MMI/CMHI negative subsidy and downward credit subsidy reestimates transferred from the financing account. If subsequent upward credit subsidy reestimates are calculated in the financing account or there is shortage of budgetary resources in the liquidating account, the capital reserve account will return the retained negative subsidy to the financing account or transfer the needed funds to the liquidating account, respectively.

Status of Fund Balance with U.S. Treasury

Unobligated Fund Balance with U.S. Treasury represents Fund Balance with U.S. Treasury that has not been obligated to purchase goods or services either because FHA has not received apportionment authority from OMB to use the resources (unavailable unobligated balance) or because FHA has not obligated the apportioned resources (available unobligated balance). Fund Balance with U.S. Treasury that is obligated, but not yet disbursed, consists of resources that have been obligated for goods or services but not yet disbursed either because the ordered goods or services have not been delivered or because FHA has not yet paid for goods or services received by the end of the fiscal year.

Note 4. Investments

Investment in U.S. Treasury Securities
As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2011 were as follows:

(Dollars in millions)

FY 2011	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 4,091	$ 23	$ 4,114	$ 5,106
GI/SRI Investments	3	-	3	3
Subtotal	4,094	23	4,117	5,109
MMI/CMHI Accrued Interest			18	18
Total	**$ 4,094**	**$ 23**	**$ 4,135**	**$ 5,127**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2010 were as follows:

FY 2010	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 4,086	$ 41	$ 4,127	$ 5,117
GI/SRI Investments	-	-	-	-
Subtotal	4,086	41	4,127	5,117
MMI/CMHI Accrued Interest			23	23
Total	**$ 4,086**	**$ 41**	**$ 4,150**	**$ 5,140**

Investments in Private-Sector Entities

Investments in Section 601 and Risk Sharing Debentures as of September 30, 2011 and 2010 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Returns of Investment	Redeemed	Ending Balance
FY 2011						
601 Program	$ 9	$ -	$ (1)	$ (2)	$ -	$ 6
Risk Sharing Debentures	127	1	-	-	(71)	57
Total	**$ 136**	**$ 1**	**$ (1)**	**$ (2)**	**$ (71)**	**$ 63**
FY 2010						
601 Program	$ 12	$ -	$ -	$ (3)	$ -	$ 9
Risk Sharing Debentures	133	38	-	-	(44)	127
Total	**$ 145**	**$ 38**	**$ -**	**$ (3)**	**$ (44)**	**$ 136**

The joint venture partner reporting period for the Section 601 Program investments was from December 1, 2009 to December 31, 2010. The condensed financial statements reported $41 million in assets, $41 million in liabilities and partner's capital, and $167 thousand in net gain for these investments.

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2011 and 2010 are as follows:

	Gross		Allowance		Net	
(Dollars in millions)	FY 2011	FY2010	FY 2011	FY2010	FY 2011	FY2010
With the Public:						
Receivables related to credit program assets	$ 16	$ 11	$ -	$ (3)	$ 16	$ 8
Premiums receivable	4	1	-	-	$ 4	$ 1
Generic Debt Receivables	80	103	(80)	(103)	$ -	$ -
Miscellaneous receivables	12	7	-	-	$ 12	$ 7
Total	**$ 112**	**$ 122**	**$ (80)**	**$ (106)**	**$ 32**	**$ 16**

Receivables Related to Credit Program Assets

These receivables include asset sale proceeds receivable and rents receivable from FHA's foreclosed properties.

Premiums Receivable

These amounts consist of the premiums due to FHA from the mortgagors at the end of the reporting period. The details of FHA premium structure are discussed in Note 13 – Earned Revenue/Premium Revenue.

Generic Debt Receivables

These amounts are mainly composed of receivables from various sources, the largest of which are Single Family Partial Claims, Single Family Indemnifications, and Single Family Restitutions.

Miscellaneous Receivables

Miscellaneous receivables include late charges and penalties receivable on premiums receivable, refunds receivable from overpayments of claims and distributive shares and other immaterial receivables.

Allowance for Loss

The allowance for loss for these receivables is calculated based on FHA's historical loss experience and management's judgment concerning current economic factors.

Note 6. Direct Loans and Loan Guarantees, Non-Federal Borrowers

Direct Loan and Loan Guarantee Programs Administered by FHA Include:

MMI/CMHI Direct Loan Program
GI/SRI Direct Loan Program
MMI/CMHI Loan Guarantee Program
GI/SRI Loan Guarantee Program
H4H Loan Guarantee Program

For the Loan Guarantee Program at FHA, in both the MMI/CMHI and GI/SRI funds there are Single Family and Multifamily activities. The H4H fund only contains Single Family activity.

To comply with the FHA Modernization Act of 2008, activities related to most Single Family programs, including HECM and Section 234(c), endorsed in Fiscal Year 2009 and going forward, are now in the MMI fund. The Single Family activities in the GI fund from Fiscal Year 2008 and prior remain in the GI fund. The following table illustrates how the primary Single Family program activities for FHA are now distributed between MMI/CMHI and GI/SRI funds based on the year of endorsement:

Fund	Loans Endorsed in Fiscal Years 2008 and Prior	Loans Endorsed in Fiscal Years 2009 and Onward
GI	234(c), HECM	N/A
MMI	203(b)	203(b), 234(c), HECM

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2011 and 2010 are as follows:

Direct Loan Program

(Dollars in Millions)

FY 2011	**Total**
Direct Loans	
Loan Receivables	16
Interest Receivables	10
Allowance	(11)
Total Direct Loans	**15**

(Dollars in Millions)

FY2010	**Total**
Direct Loans	
Loan Receivables	20
Interest Receivables	10
Allowance	(16)
Total Direct Loans	**14**

Defaulted Guaranteed Loans from Pre-1992 Guarantees (Allowance for Loss Method):

(Dollars in Millions)

FY 2011	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	17	3	20
Interest Receivables	-	1	1
Allowance for Loan Losses	(43)	(13)	(56)
Foreclosed Property	32	11	43
Subtotal	**6**	**2**	**8**
Multifamily			
Loan Receivables	-	2,459	2,459
Interest Receivables	-	215	215
Allowance for Loan Losses	-	(1,660)	(1,660)
Foreclosed Property	-	1	1
Subtotal	**-**	**1,015**	**1,015**
HECM			
Loan Receivables	-	5	5
Interest Receivables	-	1	1
Allowance for Loan Losses	-	(1)	(1)
Foreclosed Property	-	4	4
Subtotal	-	9	9
Total Guaranteed Loans	**6**	**1,026**	**1,032**

(Dollars in Millions)

FY2010	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	16	7	23
Interest Receivables	-	1	1
Allowance for Loan Losses	(9)	(5)	(14)
Foreclosed Property	16	2	18
Subtotal	**23**	**5**	**28**
Multifamily			
Loan Receivables	-	2,571	2,571
Interest Receivables	-	213	213
Allowance for Loan Losses	-	(1,825)	(1,825)
Foreclosed Property	-	-	-
Subtotal	**-**	**959**	**959**
HECM			
Loan Receivables	-	4	4
Interest Receivables	-	1	1
Allowance for Loan Losses	-	(1)	(1)
Foreclosed Property	-	2	2
Subtotal	**-**	**6**	**6**
Total Guaranteed Loans	**23**	**970**	**993**

*HECM loans, while not defaulted, have reached 98% of the maximum claim amount and have been assigned to FHA.

Defaulted Guaranteed Loans from Post-1991 Guarantees:

(Dollars in Millions)

FY 2011	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	1,116	43	1,159
Interest Receivables	-	2	2
Foreclosed Property	5,199	277	5,476
Allowance	(3,859)	(199)	(4,058)
Subtotal	**2,456**	**123**	**2,579**
Multifamily			
Loan Receivables	-	681	681
Interest Receivables	-	-	-
Foreclosed Property	-	-	-
Allowance	-	(448)	(448)
Subtotal	**-**	**233**	**233**
HECM			
Loan Receivables	26	1,395	1,421
Interest Receivables	5	643	648
Foreclosed Property	-	61	61
Allowance	(8)	(521)	(529)
Subtotal	**23**	**1,578**	**1,601**
Total Guaranteed Loans	**2,479**	**1,934**	**4,413**

(Dollars in Millions)

FY2010	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	728	39	767
Interest Receivables	-	2	2
Foreclosed Property	6,833	379	7,212
Allowance	(4,282)	(241)	(4,523)
Subtotal	**3,279**	**179**	**3,458**
Multifamily			
Loan Receivables	-	641	641
Interest Receivables	-	-	-
Foreclosed Property	-	-	-
Allowance	-	(353)	(353)
Subtotal	**-**	**288**	**288**
HECM			
Loan Receivables	-	1,103	1,103
Interest Receivables	-	524	524
Foreclosed Property	-	44	44
Allowance	-	(288)	(288)
Subtotal	**-**	**1,383**	**1,383**
Total Guaranteed Loans	**3,279**	**1,850**	**5,129**

*HECM loans, while not defaulted, have reached 98% of the maximum claim amount and have been assigned to FHA.

Guaranteed Loans Outstanding:

(Dollars in Millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding (FY 2011):		
MMI/CMHI		
Single Family Forward	1,062,363	1,002,724
Multifamily	407	384
MMI/CMHI Subtotal	**1,062,770**	**1,003,108**
GI/SRI		
Single Family Forward	20,678	17,538
Multifamily	83,556	76,058
GI/SRI Subtotal	**104,234**	**93,596**
H4H		
Single Family - 257	125	124
H4H Subtotal	**125**	**124**
Total	**1,167,129**	**1,096,828**
Guaranteed Loans Outstanding (FY 2010):		
MMI/CMHI		
Single Family Forward	925,016	878,209
Multifamily	420	403
MMI/CMHI Subtotal	**925,436**	**878,612**
GI/SRI		
Single Family Forward	22,931	20,028
Multifamily	76,709	69,294
GI/SRI Subtotal	**99,640**	**89,322**
H4H		
Single Family - 257	24	24
H4H Subtotal	**24**	**24**
Total	**1,025,100**	**967,958**

New Guaranteed Loans Disbursed:

(Dollars in Millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans,	Amount of Outstanding Principal
MMI/CMHI		
Single Family Forward	217,629	215,282
Multifamily	85	85
MMI/CMHI Subtotal	**217,714**	**215,367**
GI/SRI		
Single Family Forward	177	176
Multifamily	16,512	16,442
GI/SRI Subtotal	**16,689**	**16,618**
H4H		
Single Family - 257	101	100
H4H Subtotal	**101**	**100**
Total	**234,504**	**232,085**
New Guaranteed Loans Disbursed (FY 2010):		
MMI/CMHI		
Single Family Forward	296,418	293,710
Multifamily	68	68
MMI/CMHI Subtotal	**296,486**	**293,778**
GI/SRI		
Single Family Forward	230	228
Multifamily	14,760	14,711
GI/SRI Subtotal	**14,990**	**14,939**
H4H		
Single Family - 257	20	20
H4H Subtotal	**20**	**20**
Total	**311,496**	**308,737**

Home Equity Conversion Mortgage (HECM)

HECM (reverse mortgages) are not included in the previous tables due to the unique nature of the program. Since the inception of the program, FHA has insured 706,740 HECM loans with a maximum claim amount of $158 billion. Of these 723,588 HECM loans insured by FHA, 560,843 loans with a maximum claim amount of $132 billion are still active. As of September 30, 2011 the insurance-in-force (the outstanding balance of active loans) was $85 billion. The insurance in force includes balances drawn by the mortgagee; interest accrued on the balances drawn, service charges, and mortgage insurance premiums. The maximum claim amount is the dollar ceiling to which the outstanding loan balance can grow before being assigned to FHA.

Home Equity Conversion Mortgage Loans Outstanding (not included in the balances in the previous table)

(Dollars in Millions)

Loan Guarantee Programs			Current Year Endorsements		Cumulative Current Outstanding Balance		Cumulative Maximum Potential Liability	
FY 2011	MMI/CMHI		$	18,141	$	39,686	$	65,624
	GI/SRI			-		44,949		66,151
		Total	**$**	**18,141**	**$**	**84,635**	**$**	**131,775**
FY 2010	MMI/CMHI		$	21,023	$	28,351	$	49,388
	GI/SRI			-		44,906		69,407
		Total	**$**	**21,023**	**$**	**73,257**	**$**	**118,795**

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2011	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 18	$ -	$ -	$ 18
Multifamily	-	16	-	16
Subtotal	**$ 18**	**$ 16**	**$ -**	**$ 34**
LLG				
Single Family Forward	$ 26,305	$ 799	$ 19	$ 27,123
Multifamily	(12)	(1,055)	-	(1,067)
HECM	2,149	7,864	-	10,013
Subtotal	**$ 28,442**	**$ 7,608**	**$ 19**	**$ 36,069**
Loan Guarantee Liability Total	**$ 28,460**	**$ 7,624**	**$ 19**	**$ 36,103**

FY2010	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	10	$ 1	$ -	$ 11
Multifamily	$ -	$ 42	$ -	42
Subtotal	**$ 10**	**$ 43**	**$ -**	**$ 53**
LLG				
Single Family Forward	$ 23,362	$ 609	$ 5	$ 23,976
Multifamily	$ (7)	$ (429)	$ -	(436)
HECM	$ 2,673	$ 8,692	$ -	11,365
Subtotal	**$ 26,028**	**$ 8,872**	**$ 5**	**$ 34,905**
Loan Guarantee Liability Total	**$ 26,038**	**$ 8,915**	**$ 5**	**$ 34,958**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

FY 2011	MMI/CMHI	GI/SRI	H4H	Total
Single Family Forward				
Defaults	5,199	6	16	5,221
Fees and Other Collections	(14,103)	(8)	(6)	(14,117)
Other	2,170	-	1	2,171
Subtotal	**(6,734)**	**(2)**	**11**	**(6,725)**
Multifamily				
Defaults	2	424	-	426
Fees and Other Collections	(5)	(874)	-	(879)
Other	1	-	-	1
Subtotal	**(2)**	**(450)**	**-**	**(452)**
HECM				
Defaults	931	-	-	931
Fees and Other Collections	(933)	-	-	(933)
Subtotal	**(2)**	**-**	**-**	**(2)**
Total	**(6,738)**	**(452)**	**11**	**(7,179)**

FY 2010	MMI/CMHI	GI/SRI	H4H	Total
Single Family Forward				
Defaults	9,601	11	4	9,616
Fees and Other Collections	(15,522)	(12)	(1)	(15,535)
Other	3,376	1	-	3,377
Subtotal	**(2,545)**	**-**	**3**	**(2,542)**
Multifamily				
Defaults	2	428	-	430
Fees and Other Collections	(3)	(856)	-	(859)
Other	1	-	-	1
Subtotal	**-**	**(428)**	**-**	**(428)**
HECM				
Defaults	1,078	-	-	1,078
Fees and Other Collections	(1,184)	-	-	(1,184)
Subtotal	**(106)**	**-**	**-**	**(106)**
Total	**(2,651)**	**(428)**	**3**	**(3,076)**

Subsidy Expense for Modifications and Reestimates:

(Dollars in millions)

FY 2011	Total Modification	Technical Reestimate
MMI/CMHI	-	8,395
GI/SRI	(37)	(574)
Total	(37)	7,821
FY 2010		
MMI/CMHI	-	(2,161)
GI/SRI	(5)	3,195
Total	(5)	1,034

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)

	FY 2011	FY 2010
MMI/CMHI	1,657	(4,812)
GI/SRI	(1,063)	2,762
H4H	11	3
Total	605	(2,047)

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2011 Loan Guarantees:				
MMI/CMHI				
Single Family - Forward - (4/18/2011 - 9/30/2011)	2.10	(6.90)	1.02	(3.78)
Single Family - Forward (10/1/2010 - 4/17/2011)	2.61	(6.17)	0.98	(2.58)
Single Family - HECM	5.11	(5.12)	-	(0.01)
Single Family - Short Refi	-	-	-	-
Multifamily - Section 213 - (4/18/2011 - 9/30/2011)	2.63	(6.50)	1.02	(2.85)
Multifamily - Section 213 (10/1/2010 - 4/17/2011)	2.61	(6.17)	0.98	(2.58)
GI/SRI				
Multifamily - Section 221(d)(4) (1/1/2011 - 9/30/2011)	3.59	(5.50)	-	(1.91)
Multifamily - Section 221(d)(4) (10/1/2010 - 12/31/2010)	3.71	(5.49)	-	(1.78)
Multifamily - Section 207/223(f) (1/1/2011 - 9/30/2011)	1.95	(5.35)	-	(3.40)
Multifamily - Section 207/223(f) (10/1/2010 - 12/31/2010)	1.97	(5.32)	-	(3.35)
Multifamily - Section 223(a)(7) (1/1/2011 - 9/30/2011)	1.95	(5.35)	-	(3.40)
Multifamily - Section 223(a)(7) (10/1/2010 - 12/31/2010)	1.97	(5.32)	-	(3.35)
Multifamily - Section 232 (11/17/2010 - 9/30/2011)	4.49	(6.00)	-	(1.51)
Multifamily - Section 232 (10/1/2010 - 11/16/2010)	4.62	5.94	-	10.56
Section 242	1.81	(5.48)	-	(3.67)
H4H				
Single Family - Section 257	15.95	(6.14)	1.09	10.90

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2010 Loan Guarantees:				
MMI/CMHI				
Single Family - Forward (10/1/2009 - 4/4/2010)	3.22	(4.97)	1.13	(0.62)
Single Family - Forward (4/5/2010 - present)	3.23	(5.50)	1.14	(1.13)
Single Family - HECM	5.11	(5.61)	-	(0.50)
Multifamily - Section 213 (10/1/2009 - 4/4/2010)	3.22	(4.96)	1.12	(0.62)
Multifamily - Section 213 (4/5/2010 - present)	3.23	(5.50)	1.14	(1.13)
GI/SRI				
Multifamily - Section 221(d)(4)	4.23	(5.86)	-	(1.63)
Multifamily - Section 207/223(f)	1.45	(5.32)	-	(3.87)
Multifamily - Section 223(a)(7)	1.45	(5.32)	-	(3.87)
Multifamily - Section 232	3.67	(5.96)	-	(2.29)
Section 242	1.55	(5.83)	-	(4.28)
H4H				
Single Family - Section 257 (10/1/2009 - 12/31/2009)	24.26	(1.91)	0.37	22.72
Single Family - Section 257 (1/1/2010 - present)	22.26	(5.89)	0.54	16.91

Schedule for Reconciling Loan Guarantee Liability Balances:

	FY 2011		FY2010	
(Dollars in Millions)	LLR	LLG	LLR	LLG
Beginning Balance of the Loan Guarantee Liability	$ 53	$ 34,905	$ 136	$ 33,886
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	6,578	-	11,124
Fees and Other Collections	-	(15,929)	-	(17,578)
Other Subsidy Costs	-	2,172	-	3,378
Total of the above subsidy expense components	**-**	**(7,179)**	**-**	**(3,076)**
Adjustments:				
Fees Received		8,582		10,082
Foreclosed Property and Loans Acquired		5,082		6,814
Claim Payments to Lenders		(17,200)		(16,478)
Interest Accumulation on the Liability Balance		1,388		1,344
Other		11		16
Ending Balance before Reestimates	**53**	**25,589**	**136**	**32,588**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	(19)	(1,647)	(83)	(2,607)
Interest Expense Component	-	1,397	-	1,113
Adjustment of prior years' credit subsidy reestimates	-	10,730	-	3,811
Total Technical/Default Reestimate	**(19)**	**10,480**	**(83)**	**2,317**
Ending Balance of the Loan Guarantee Liability	**$ 34**	**$ 36,069**	**$ 53**	**$ 34,905**

Administrative Expense:

(Dollars in Millions)	FY 2011	FY2010
MMI/CMHI	663	543
GI/SRI	6	30
H4H	4	9
Total	**673**	**582**

Credit Reform Valuation Methodology

FHA values its Credit Reform LLG and related receivables from notes and properties in inventory at the net present value of their estimated future cash flows.

To apply the present value computations, FHA divides loans into cohorts and risk categories. Multifamily and Health Care cohorts are defined based on the year in which loan guarantee commitments are made. Single Family mortgages are grouped into cohorts based on loan endorsement dates for the GI/SRI and MMI fund. Within each cohort year, loans are subdivided by risk categories. Each risk category has characteristics that distinguish it from others, including risk profile, premium structure, and the type and quality of collateral underlying the loan. For activity related to fiscal years 1992-2008, the MMI fund has one risk category, and for activity related to fiscal years 2009 and onward, the MMI fund has two risk categories, with HECM loans considered a separate category from standard forward loans. The single family GI/SRI loans are grouped into four risk categories. There are thirteen different multifamily risk categories and six health care categories. Health Care programs are subsumed in the single, aggregate, multifamily category reported in this note.

The cash flow estimates that underlie present value calculations are determined using the significant assumptions detailed below.

Significant Assumptions – FHA developed economic and financial models in order to estimate the present value of future program cash flows. The models incorporate information on the cash flows' expected magnitude and timing. The models rely heavily on the following loan performance assumptions:

- Conditional Termination Rates: The estimated probability of an insurance policy claim or non-claim termination in each year of the loan guarantee's term given that a loan survives until that year.

- Claim Amount: The estimated amount of the claim payment relative to the unpaid principal balance at the time the claim occurs.

- Recovery Rates: The estimated percentage of a claim payment or defaulted loan balance that is recovered through disposition of a mortgage note or underlying property.

Additional information about loan performance assumptions is provided below:

Sources of data: FHA developed assumptions for claim rates, prepayment rates, claim amounts, and recoveries based on historical data obtained from its internal business systems.

Economic assumptions: Independent forecasts of economic conditions are used in conjunction with loan-level data to generate Single Family, Multifamily, and Health Care claim and prepayment rates. Sources of forecast data include IHS Global Insight and Moody's Analytics. OMB provides other economic assumptions used, such as discount rates.

Actuarial Review: An independent actuarial review of the MMI Fund each year produces conditional claim and prepayment rates and loss severity rates that are used as inputs to the Single Family LLG calculation, both for forward and (post-2008) HECM loans.

Reliance on historical performance: FHA relies on the historical performance of its insured portfolio to generate behavioral response functions that are applied to economic forecasts to generate future performance patterns for the outstanding portfolio. Changes in legislation, program requirements, tax treatment, and economic factors all influence loan performance. FHA assumes that its portfolio will continue to perform consistently with its historical experience, respecting differences due to current loan characteristics and forecasted economic conditions.

Current legislation and regulatory structure: FHA's future plans allowed under current legislative authority have been taken into account in formulating assumptions when relevant. In contrast, future changes in legislative authority may affect the cash flows associated with FHA insurance programs. Such changes cannot be reflected in LLG calculations because of uncertainty over their nature and outcome.

Discount rates: The disbursement-weighted interest rate on U.S. Treasury securities of maturity comparable to guaranteed loan term is the discount factor used in the present value calculation for cohorts 1992 to 2000. For the 2001 and future cohorts, the rate on U.S. Treasury securities of maturities comparable to cash flow timing for the loan guarantee is used in the present value calculation. This latter methodology is referred to as the basket-of-zeros discounting methodology. OMB provides these rates to all Federal agencies for use in preparing credit subsidy estimates and requires their use under OMB Circular A-11, Part 4, "Instructions on Budget Execution." The basket-of-zeros discount factors are also disbursement weighted.

Analysis of Change in the Liability for Loan Guarantees

FHA has estimated and reported on LLG calculations since fiscal year 1992. Over this time, FHA's reported LLG values have shown measurable year-to-year variance. That variance is caused by four factors: (1) adding a new year of insurance commitments each year; (2) an additional year of actual loan performance data used to calibrate forecasting models, (3) revisions to the methodologies employed to predict future loan performance, and (4) programmatic/policy changes that affect the characteristics of insured loans or potential credit losses.

Described below are the programs that comprise the majority of FHA's loan guarantee business. These descriptions highlight the factors that contributed to changing LLG estimates for FY 2011. Overall, FHA's liability decreased slightly from the fiscal year 2010 estimates.

Mutual Mortgage Insurance (MMI) – During fiscal year 2011, FHA experienced better than anticipated credit quality of borrowers, but worse than expected declines in home prices. Updated house-price forecasts call for continued weakness in the near term, but better long-term appreciation rates than were predicted last year. At the start of 2011, FHA raised insurance premiums for both forward and reverse (HECM) loans, and then raised premium rates for forward loans a second time at mid-year. Some forward loan claims that would normally have been paid in 2011 have been delayed because of problems major loan servicers are facing with verification that foreclosure processes have been properly documented and that agents initiating foreclosure had legal standing to do so. On net, the MMI LLG increased from $26,035 million at the end of fiscal year 2010 to $28,454 million at the end of fiscal year 2011.

GI/SRI Home Equity Conversion Mortgage (HECM) - HECM endorsements from fiscal years 1990-2008 remain in the GI/SRI Fund. The liability for these loans decreased from $8,692 million at the end of FY 2010 to $7,865 million at the end of FY 2011. This liability is driven more by long term house price appreciation forecasts than short term forecasts, and the long-term forecast used (Moody's Analytics, July 2011) is slightly more favorable this year in the major states where HECM loans are most concentrated, namely, California, Texas, and Florida. The HECM loans remaining in the GI/SRI fund also benefited from slower UPB (Unpaid Principal Balance) growth due to lower current and future (projected) interest rates for adjustable-rate mortgages. Over 99 percent of the remaining GI/SRI HECM loans have adjustable interest rates.

GI/SRI Section 223(f) - Section 223(f) of the National Housing Act permits FHA mortgage insurance for the refinance or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure up to 85 percent of the lesser of the project's appraised value or its replacement cost. Projects insured under the program must be at least three years old. The Section 223(f) program is the largest multifamily program in the GI/SRI fund with an insurance-in-force of $14 billion. The Section 223(f) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(f) liability decreased this year by $174 million, from ($106) million to ($280) million, and principally due to lower claim expectations.

GI/SRI Section 221(d)(4) - Section 221(d)(4) of the National Housing Act authorizes FHA mortgage insurance for the construction or substantial rehabilitation of multifamily rental properties with five or more units. Under this program, FHA may insure up to 90 percent of the total project cost. This is the second largest multifamily program in the GI/SRI fund with an insurance-in-force of $12 billion. The Section 221(d)(4) liability increased by $61 million this year, from ($71) million to ($10) million. This was principally due to lower premium revenue expectations resulting from increased projected prepayment speeds.

GI/SRI Section 232 Health Care New Construction - The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of $4.6 billion. The Section 232 NC liability increased by $6 million from ($22) million in FY 2010 to ($16) million in FY 2011 due to slightly diminished insurance-in-force and recovery rate expectations.

GI/SRI Section 232 Health Care Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of $13 billion. The Section 232 Refinance liability decreased by $98 million from ($45) million in FY 2010 to ($143) million in FY 2011 due to lower claim expectations and significantly increased insurance-in-force as a result of roughly $2.6 billion in FY 2011 endorsements.

GI/SRI Section 242 Hospitals - The Section 242 Hospitals program provides mortgage insurance for the construction, substantial rehabilitation, or refinance of hospitals and/or the purchase of major hospital equipment to either private, for-profit businesses or non-profit associations. FHA insures a maximum of 90 percent of the estimated replacement cost of the hospital, including the installed equipment. The Section 242 program has an insurance-in-force of $8.3 billion. The Section 242 liability decreased by $82 million from ($111) million in FY 2010 to ($193) million in FY 2011 due to higher premium revenue caused by decreased prepayment expectations.

Risks to LLG Calculations

LLG calculations for MMI loans use loan-performance projections based upon a single, base-case economic forecast. That forecast can be considered a median expectation, meaning there are equal probabilities of economic conditions being more or less favorable than what is used in the LLG calculation.

The current MMI Fund LLG calculation includes a provision for what could be a substantial influx of claims in FY 2012 resulting from large numbers of loans currently in the foreclosure process, and more loans that have gone through foreclosure auction but for which lenders have been reluctant to transfer properties to FHA so that they can file insurance claims. These issues are a result of foreclosure documentation problems in the mortgage servicing industry that surfaced in 2010 and that are still, in many cases, unresolved. The FY 2011 MMI Fund LLG assumes that nearly all of the post-foreclosure cases will result in claims during FY 2012. Thus, FHA does not believe that there is any negative risk to the LLG calculation from this situation.

Continued bottlenecks in processing foreclosure actions in judicial states, as a result simply of large volumes of cases, do not affect FHA’s estimates of the number of future claims, but they can affect timing and cost of those claims. Thus, to the extent that court backlogs persist for long periods of time there can be a risk of upward revisions to the LLG. Issues for FHA appear to be in a small number of States, with the most problematic being Florida. As of August 31, 2011, there were close to 22,000 open foreclosure actions on FHA loans in Florida, which is nearly twice that of the next State (Illinois). The share of cases in Florida that have been in-process for more than 18 months is now 44 percent. The only State with a worse backlog is New Jersey, where 53 percent of active foreclosures have been open for over 18 months. Nationwide, the share of in-foreclosure actions that have been open for more than 18 months has increased over the past year from under 8 percent to nearly 23 percent. FHA cannot foresee when this situation will improve, but foreclosure actions are being processed on a more normal schedule in most States. The actual number of FHA loans in foreclosure processing peaked in the second quarter of FY 2011 and has been on a gradual decline since then.

Risks to the multifamily LLG calculation come from many sources--changes in population growth and household formation, the supply of rental housing in each market where FHA has a presence, and local employment conditions. Risks also come from FHA's policy of insuring loans pre-construction in its 221(d)(4) program. LLG calculations are then subject to risk from the abilities of new projects to find viable markets when they do come on-line. New construction loans approved in 2008 – 2009 are just coming on-line and facing rent-up risk, while 2010 and 2011 commitments have not yet resulted in new units being available for rent.

For health care programs (Sections 232 and 242), LLG risk comes principally from health-care reimbursement rates from Medicare and Medicaid. It also emanates from the quality of business management at each facility, and from the supply of medical care in each community relative to demand and the abilities of facility management to adapt to changing technologies and the competitive landscape.

Pre-Credit Reform Valuation Methodology

FHA values its Pre-Credit Reform related notes and properties in inventory at net realizable value, determined on the basis of net cash flows. To value these items, FHA uses historical claim data, revenues from premiums and recoveries, and expenses of selling and maintaining property.

MMI Single Family LLR - For the single family portfolio, the remaining insurance-in-force for pre-credit reform loans is $4.5 billion. The aggregate liability for the remaining pre-credit reform loans in FY 2011 is $18 million, which is an $8 million increase from the $10 million estimate in FY 2010.

GI/SRI Multifamily & Healthcare LLR - For the multifamily and healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is $1.7 billion. The aggregate liability for the remaining pre-credit reform loans in FY 2011 is $5 million, which is a $25 million decrease from the $30 million estimate in FY 2010. The year-over-year decrease in aggregate liability is due to an $800 million decline in insurance-in-force.

GI/SRI Section 223(a)(7) - Section 223(a)(7) gives FHA authority to refinance FHA-insured loans. Under this program, the refinanced principal amount of the mortgage may be the lesser of the original amount of the existing mortgage or the remaining unpaid principal balance of the loan. Loans insured under any sections of the National Housing Act may be refinanced under 223(a)(7), including those already under 223(a)(7). The Section 223(a)(7) program has an insurance-in-force of $11.5 billion. The Section 223(a)(7) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(a)(7) liability decreased this year by $184 million, from ($89) million to ($273) million, principally due to lower claim expectations.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2011 and 2010:

(Dollars in millions)

	FY 2011	FY2010
Intragovernmental:		
Advances to HUD for Working Capital Fund Expenses	$ 3	$ 5
Total	**$ 3**	**$ 5**
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 66	$ 70
Deposits in Transit	3	6
Total	**$ 69**	**$ 76**

Advances to HUD for Working Capital Fund Expenses

The Working Capital Fund was established by HUD to consolidate, at the department level, the acquisition of certain property and equipment to be used by different organizations within HUD. Advances to HUD for Working Capital Fund expenses represent the amount of payments made by FHA to reimburse the HUD Working Capital Fund for its share of the fund's expenses prior to the receipt of goods or services from this fund.

Escrow Monies Deposited at Minority-Owned Banks

FHA holds in trust escrow monies received from the borrowers of its Multifamily mortgage notes to cover property repairs and renovations expenses. These escrow monies are deposited at the U.S. Treasury (see Note 2), invested in U.S. Treasury securities (see Note 4 - GI/SRI Investments) or deposited at minority-owned banks.

Deposits in Transit

Deposits in Transit is cash that has not been confirmed as being received by the U.S. Treasury. Once the U.S. Treasury has confirmed that this cash has been received, the cash will be moved from Deposits in Transit to Fund Balance with U.S. Treasury.

Note 8. Accounts Payable

Accounts Payable as of September 30, 2011 and 2010 are as follows:

(Dollars in millions)	FY 2011	FY2010
With the Public:		
Claims Payable	$ 474	$ 351
Premium Refunds Payable	142	$ 143
Single Family Property Disposition Payable	79	$ 128
Miscellaneous Payables	28	$ 25
Total	**$ 723**	**$ 647**

Claims Payable

Claims payable represents the amount of claims that have been processed by FHA, but the disbursement of payment to lenders has not taken place at the end of the reporting period.

Premium Refunds

Premium refunds payable are refunds of previously collected Single Family premiums that will be returned to the borrowers resulting from prepayment of the insured mortgages.

Single Family Property Disposition Payable

Single family property disposition payable includes management and marketing contracts and other property disposition expenses related to foreclosed property.

Miscellaneous Payables

Miscellaneous payables include interest enhancement payables, interest penalty payables for late payment of claims, generic debt payables and other payables related to various operating areas within FHA.

Note 9. Debt

The following tables describe the composition of Debt held by FHA as of September 30, 2011 and 2010:

(Dollars in millions)	FY2010			FY 2011	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt:					
Debentures Issued to Claimants	14	(4)	10	$ -	$ 10
Other Debt:					
Borrowings from U.S. Treasury	4,420	329	4,749	1,283	6,032
Total	**$ 4,434**	**$ 325**	**$ 4,759**	**$ 1,283**	**$ 6,042**

	FY 2011	FY2010
Classification of Debt:		
Intragovernmental Debt	$ 6,032	$ 4,749
Debt Held by the Public	10	10
Total	**$ 6,042**	**$ 4,759**

Debentures Issued to Public

The National Housing Act authorizes FHA, in certain cases, to issue debentures in lieu of cash to settle claims. FHA-issued debentures bear interest at rates established by the U.S. Treasury. Interest rates related to the outstanding debentures ranged from 4.00 percent to 13.375 percent in fiscal year 2011 and from 4.00 percent to 13.375 percent in fiscal year 2010. Lenders may redeem FHA debentures prior to maturity in order to pay mortgage insurance premiums to FHA, or they may be called with the approval of the Secretary of the U.S. Treasury.

The par value of debentures outstanding, not including accrued interest, as of September 30th was $10 million and $10 million in fiscal year 2010. The fair value for both fiscal years 2011 and 2010 is $21 million.

Borrowings from U.S. Treasury

In accordance with Credit Reform accounting, FHA borrows from the U.S. Treasury when cash is needed in its financing accounts. Usually, the need for cash arises when FHA has to transfer the negative credit subsidy amounts related to new loan disbursements and existing loan modifications from the financing accounts to the general fund receipt account (for cases in GI/SRI funds) or to the capital reserve account (for cases in MMI/CMHI funds). In some instances, borrowings are also needed to transfer the credit subsidy related to downward reestimates from the GI/SRI financing account to the GI/SRI receipt account or when available cash is less than claim payments due.

During fiscal year 2011, FHA’s U.S. Treasury borrowings carried interest rates ranging from 1.68 percent to 7.59 percent. In fiscal year 2010, they carried interest rates ranged from 1.68 percent to 7.59 percent. The maturity dates for these borrowings occur from September 2017 – September 2030. Loans may be repaid in whole or in part without penalty at any time prior to maturity.

Note 10. Other Liabilities

The following table describes the composition of Other Liabilities as of September 30, 2011 and 2010:

(Dollars in millions)

FY 2011		Current
Intragovernmental:		
Receipt Account Liability		3,051
Total	**$**	**3,051**
With the Public:		
Trust and Deposit Liabilities	$	111
Multifamily Notes Unearned Revenue		230
Disbursements in Transit		75
Miscellaneous Liabilities		14
Total	**$**	**430**

FY2010		Current
Intragovernmental:		
Receipt Account Liability	$	1,165
Total	**$**	**1,165**
With the Public:		
Trust and Deposit Liabilities	$	120
Multifamily Notes Unearned Revenue	$	227
Disbursements in Transit	$	74
Miscellaneous Liabilities	$	6
Total	**$**	**427**

Receipt Account Liability

The receipt account liability is created from negative credit subsidy from new endorsements, downward credit subsidy reestimates, loan modifications, and unobligated balances from the liquidating account in the GI/SRI receipt account.

Trust and Deposit Liabilities

Trust and deposit liabilities include mainly escrow monies received by FHA for the borrowers of its mortgage notes and earnest money received from potential purchasers of the FHA foreclosed properties. The escrow monies are eventually disbursed to pay for insurance, property taxes, and maintenance expenses on behalf of the borrowers. The earnest money becomes part of the sale proceeds or is returned to any unsuccessful bidders.

Disbursements in Transit

Disbursements in Transit is cash that has not been confirmed as being disbursed by the U.S. Treasury. Once the U.S. Treasury has confirmed that this cash has been disbursed, the cash will be removed from Disbursements in Transit and taken out of Fund Balance with U.S. Treasury.

Multifamily Notes Unearned Revenue

Multifamily Notes Unearned Revenue primarily includes the deferred interest revenue on Multifamily notes that are based on work out agreements with the owners. The workout agreements defer payments from the owners for a specified time but, the interest due on the notes is still accruing and will also be deferred until payments resume.

Miscellaneous Liabilities

Miscellaneous liabilities mainly include unearned premium revenue and may include loss contingencies that are recognized by FHA for past events that warrant a probable, or likely, future outflow of measurable economic resources.

Note 11. Commitments and Contingencies

Litigation

FHA is party in various legal actions and claims brought by or against it. In the opinion of management and general counsel, the ultimate resolution of these legal actions will not have an effect on FHA's consolidated financial statements as of September 30, 2011. As a result, no contingent liability has been recorded.

As of September 30, 2011, the Government National Mortgage Association ("Ginnie Mae") held defaulted FHA-insured mortgage loans. These loans, acquired from defaulted mortgage-backed securities issuers, have an unpaid principal balance of $5.2 billion. "Ginnie Mae" may submit requests for claim payments to FHA for some or all of these loans. Subject to all existing claim verification controls, FHA would pay such claims to Ginnie Mae, another component of HUD, upon conveyance of the foreclosed property to FHA. Any liability for such claims, and offsetting recoveries, has been reflected in the Liability for Loan Guarantees on the accompanying financial statements based on the default status of the insured loans.

Note 12. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2011 and 2010 are as follows:

(Dollars in millions)	FY 2011			FY 2010		
	MMI/CMHI	GI/SRI	H4H	MMI/CMHI	GI/SRI	H4H
Intragovernmental:						
Interest Expense	$ 236	$ 176	$ -	$ 140	$ 144	$ -
Imputed Cost	18	-	-	$ 19	$ -	$ -
Other Expenses	4	-	1	$ 1	$ -	$ 2
Total	**$ 258**	**$ 176**	**$ 1**	**$ 160**	**$ 144**	**$ 2**
With the Public:						
Salary and Administrative Expense	$ 659	$ 6	$ 3	$ 542	$ 30	$ 7
Subsidy Expense	1,657	(1,063)	11	$ (4,812)	$ 2,762	$ 3
Interest Expense	2,690	(32)	-	$ 595	$ 695	$ -
Interest Accumulation Expense	1,023	365	-	$ 1,076	$ 268	$ -
Bad Debt Expense	13	(173)	-	(7)	$ (342)	$ -
Loan Loss Reserve	7	(27)	-	$ (4)	$ (79)	$ -
Other Expenses	61	62	-	$ 67	$ 25	$ -
Total	**$ 6,110**	**$ (862)**	**$ 14**	**$ (2,543)**	**$ 3,359**	**$ 10**

Interest Expense

Intragovernmental interest expense includes interest expense on borrowings from the U.S. Treasury in the financing account. Interest expense is calculated annually for each cohort using the interest rates provided by the U.S Treasury. Interest expense with the public consists of interest expense on debentures issued to claimants to settle claim payments and interest expense on the annual credit subsidy reestimates.

Interest Accumulation Expense

Interest accumulation expense is the net of interest expense on borrowing and interest revenue in the financing accounts for MMI/CMHI and GI/SRI.

Imputed Costs/Imputed Financing

Imputed costs represent FHA's share of the departmental imputed cost calculated and allocated to FHA by the HUD CFO office. Federal agencies are required to report imputed costs under SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf*. The HUD CFO receives its imputed cost data from the Office of Personnel Management (OPM) for pension costs, federal employee health benefits (FEHB) and life insurance costs. It also receives Federal Employees' Compensation Act (FECA) costs from the Department of Labor (DOL). Subsequently, using its internally developed allocation basis, HUD CFO allocates the imputed cost data to each of its reporting offices. The imputed costs reported by FHA in its Statements of Net Cost are equal to the amounts of imputed financing in its Statements of Changes in Net Position.

Salary and Administrative Expenses

Salary and administrative expenses include FHA's reimbursement to HUD for FHA personnel costs and FHA's payments to third party contractors for administrative contract expenses. Beginning in fiscal year 2010 and going forward, FHA is only using the MMI annual program fund to record salaries and related expenses other than those relating to the H4H program.

Subsidy Expense

Subsidy expense, positive and negative, consists of credit subsidy expense from new endorsements, modifications, and annual credit subsidy reestimates and the subsidy expense incurred by the Church Arson program. Credit subsidy expense is the estimated long-term cost to the U.S. Government of a direct loan or loan guarantee, calculated on a net present value basis of the estimated future cash flows associated with the direct loan or loan guarantee.

Bad Debt Expense

Bad debt expense represents the provision for loss recorded for uncollectible amounts related to FHA's pre-1992 accounts receivable and credit program assets. FHA calculates its bad debt expense based on the estimated change of these assets' historical loss experience and FHA management's judgment concerning current economic factors.

Loan Loss Reserve Expense

Loan loss reserve expense is recorded to account for the change in the balance of the loan loss reserve liabilities associated with FHA's pre-1992 loan guarantees. The loan loss reserve is provided for the estimated losses incurred by FHA to pay claims on its pre-1992 insured mortgages when defaults have taken place but the claims have not yet been filed with FHA.

Other Expenses

Other expenses with the public include only those associated with the FHA pre-1992 loan guarantees. They consist of net losses or gains on sales of FHA credit program assets, insurance claim expenses, fee expenses, and other miscellaneous expenses incurred to carry out FHA operations. Other intragovernmental expenses include FHA's share of HUD expenses incurred in the Working Capital Fund and expenses from intra-agency agreements.

Note 13. Earned Revenue

Earned revenues generated by FHA for the period ended September 30, 2011 and 2010 are as follows:

(Dollars in millions)	FY 2011		FY2010	
	MMI/CMHI	GI/SRI	MMI/CMHI	GI/SRI
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 1,259	$ 540	$ 1,215	$ 412
Interest Revenue from MMI/CMHI Investments	173	-	$ 366	$ -
Gain on Sale of MMI/CMHI Investments	133	-	$ 554	$ -
Total Intragovernmental	**$ 1,565**	**$ 540**	**$ 2,135**	**$ 412**
With the Public:				
Insurance Premium Revenue	$ 1	$ 12	$ 28	$ 16
Income from Notes and Properties	21	34	35	54
Other Revenue	-	5	-	-
Total With the Public	**$ 22**	**$ 51**	**$ 63**	**$ 70**

Interest Revenue

Intragovernmental interest revenue includes interest revenue from deposits at the U.S. Treasury and investments in U.S. Treasury securities. FHA's U.S. Treasury deposits are generated from post-1991 loan guarantees and direct loans in the financing accounts. FHA's investments in U.S. Treasury securities consist of investments of surplus resources in the MMI/CMHI Capital Reserve account and of escrow monies collected from borrowers in the GI/SRI liquidating accounts.

Interest revenue with the public is generated mainly from FHA's acquisition of pre-1992 performing MNA notes as a result of claim payments to lenders for defaulted guaranteed loans. Interest revenue associated with the post-1991 MNA notes is included in the Allowance for Subsidy (AFS) balance.

Gain on Sale of MMI/CMHI Investments

This gain occurred as a result of the sale of investments before maturity in the MMI/CMHI Capital Reserve account because the sales price of the investments was greater than the book value of the investments at the time of the sale.

Premium Revenue

According to the FCRA accounting, FHA's premium revenue includes only premiums associated with the pre-1992 loan guarantee business. Premiums for post-1991 guarantee loans are included in the balance of the LLG. The FHA premium structure includes both up-front premiums and annual periodic premiums.

Up-front Premiums

The up-front premium rates vary according to the mortgage type and the year of origination. The FHA up-front premium rates in fiscal year 2011 were:

Upfront Premium Rates

Single Family	1.00%
Multifamily	0.25%, 0.45 %, 0.50%, 0.57% , 0.80% or 1.00%
HECM Standard	2.00% (Based on Maximum Claim Amount)
HECM Saver	.01% (Based on Maximum Claim Amount)

Annual Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums. These rates also vary by mortgage type and program. The FHA annual periodic premium rates in fiscal year 2011 were:

Annual Periodic Premium Rates

Single Family	0.85% or 0.90%
Single Family	1.10% or 1.15% (as of April 18th)
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%
HECM (Standard & Saver)	1.25%

For Title I, the maximum insurance premium paid for guaranteed cases endorsed in years 1992 through 2001 is equal to 0.50 percent of the loan amount multiplied by the number of years of the loan term. The annual insurance premium for a Title I Property Improvement loan is 0.50 percent of the loan amount until the maximum insurance charge is paid. The annual insurance premium of a Title I Manufactured Housing loan is calculated in tiers by loan term until the maximum insurance charge is paid. For guaranteed cases endorsed in fiscal year 2011, the Title I annual insurance premium is 1.00 percent of the loan amount until maturity.

Income from Notes and Property

Income from Notes and Property includes revenue associated with FHA pre-1992 loan guarantees. This income includes revenue from Notes and Properties held, sold, and gains associated with the sale.

Other Revenue

Other revenue includes revenue associated with FHA pre-1992 loan guarantees. FHA's other revenue consists of late charges and penalty revenue, fee income, and miscellaneous income generated from FHA operations.

Note 14. Gross Cost and Earned Revenue by Budget Functional Classification

FHA cost and earned revenue reported on the Statements of Net Cost is categorized under the budget functional classification (BFC) for Mortgage Credit (371). All FHA U.S. Treasury account symbols found under the department code "86" for Department of Housing and Urban Development appear with the Mortgage Credit BFC.

Note 15. Transfers

Transfers in/out incurred by FHA for the period ended September 30, 2011 and 2010 are as follows:

(Dollars in millions)

Budgetary Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (492)	$ -	$ (492)
HUD	-	(72)	(72)
FY 2011 Total	**$ (492)**	**$ (72)**	**$ (564)**

Other Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (1,796)	$ -	$ (1,796)
HUD	567	-	567
FY 2011 Total	**$ (1,229)**	**$ -**	**$ (1,229)**

(Dollars in millions)

Budgetary Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (559)	$ (83)	$ (642)
HUD	$ -	(72)	$ (72)
FY2010 Total	**$ (559)**	**$ (155)**	**$ (714)**

Other Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ 1,020	$ -	$ 1,020
HUD	484	-	484
FY2010 Total	**$ 1,504**	**$ -**	**$ 1,504**

Transfers Out to U.S. Treasury

Transfers out to U.S. Treasury consist of negative subsidy from new endorsements, modifications and downward credit subsidy reestimates in the GI/SRI general fund receipt account.

Transfers In/Out From HUD

FHA does not receive an appropriation for salaries and expense; instead the FHA amounts are appropriated directly to HUD. In order to recognize these costs in FHA's Statement of Net Cost, a Transfer In from HUD is recorded based on amounts computed by HUD. FHA continues to make a non-expenditure Transfer Out to HUD for Working Capital Fund expenses.

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2011 and 2010 are as follows:

(Dollars in millions)

FY 2011	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 468	$ 9	$ -	$ (12)	$ -	$ 465
Working Capital and Contract Expenses	314	207	(25)	(106)	(72)	318
Reestimates	-	3,024	-	(3,024)	-	-
GI/SRI Liquidating	98	71	-	(102)	-	67
Total	**$ 880**	**$ 3,311**	**$ (25)**	**$ (3,244)**	**$ (72)**	**$ 850**

FY2010	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 478	$ 9	$ -	$ (19)	$ -	$ 468
Working Capital and Contract Expenses	272	259	(47)	(96)	(72)	316
Reestimates	-	863	-	(863)	-	-
GI/SRI Liquidating	82	100	-	(3)	(83)	96
Total	**$ 832**	**$ 1,231**	**$ (47)**	**$ (981)**	**$ (155)**	**$ 880**

As required under FCRA, FHA receives appropriations to cover expenses or fund shortages related to its loan guarantee and direct loan operations.

FHA receives appropriations in the program accounts for administrative and contract expenses. The GI/SRI and H4H no-year program accounts also receive appropriations for positive credit subsidy and upward reestimates. Additionally, FHA obtains permanent indefinite appropriations to cover any shortfalls for its GI/SRI pre-1992 loan guarantee operations.

When appropriations are first received, they are reported as unexpended appropriations. As these appropriations are expended, appropriations used are increased and unexpended appropriations are decreased. Additionally, unexpended appropriations are decreased when: administrative expenses and working capital funds are transferred out to HUD; appropriations are rescinded; or other miscellaneous adjustments are required.

Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2010 have been reconciled to the fiscal year 2010 actual amounts included in the Program and Financing Schedules presented in the Budget of the United States Government. There were no significant reconciling items. Information from the fiscal year 2011 Statement of Budgetary Resources will be presented in the fiscal year 2013 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2013 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2011 and 2010 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders	FY 2011	FY2010
MMI/CMHI	$ 1,495	$ 1,139
GI/SRI	403	454
H4H	1	1
EI	12	
TI	12	
Undelivered Orders Subtotal	**$ 1,923**	**$ 1,594**
Accounts Payable		
MMI/CMHI	$ 813	$ 719
GI/SRI	321	350
H4H	-	-
EI	-	
TI	-	
Accounts Payable Subtotal	**$ 1,134**	**$ 1,069**
Total	**$ 3,057**	**$ 2,663**

Note 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2011 and 2010:

(Dollars in Millions)

FY 2011	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 7,745	$ 784	$ 2	$ 8,531
Notes	123	438	-	561
Property	6,158	310	-	6,468
Interest Earned from U.S. Treasury	1,588	540	-	2,128
Subsidy	6,739	1	11	6,751
Reestimates	8,449	3,024	-	11,473
Other	48	77	1	126
Total	**$ 30,850**	**$ 5,174**	**$ 14**	**$ 36,038**

FY2010	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 9,282	$ 768	$ 1	$ 10,051
Notes	9	490	-	499
Property	5,038	269	-	5,307
Interest Earned from U.S. Treasury	2,238	412	-	2,650
Subsidy	2,651	15	3	2,669
Reestimates	9,894	863	-	10,757
Other	48	165	9	222
Total	**$ 29,160**	**$ 2,982**	**$ 13**	**$ 32,155**

Note 19. Budgetary Resources – Non-expenditure Transfers

The following table presents the composition of FHA's non-expenditure transfers for the period ended September 30, 2011 and 2010:

(Dollars in Millions)

FY 2011	MMI/CMHI	EI	Total
Transfers:			
Working Capital and Contract Expenses	$ (72)	$ -	$ (72)

(Dollars in Millions)

FY2010	MMI/CMHI	EI	Total
Transfers			
Working Capital and Contract Expenses	$ (71)	$ (1)	$ (72)

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2011 and 2010:

(Dollars in Millions)

FY 2011	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 15,130	$ 1,840	$ -	$ -	$ 16,970
Property Disposition	1,505	89	-	-	1,594
Interest on Borrowings	236	177	-	-	413
Subsidy	6,740	511	11	-	7,262
Downward Reestimates	847	542	-	-	1,389
Upward Reestimates	7,601	3,024	-	-	10,625
Admin, Contract and Working Capital	113	-	-	29	142
Other	(1)	127	-	-	126
Total	**$ 32,171**	**$ 6,310**	**$ 11**	**$ 29**	**$ 38,521**

FY2010	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 14,017	$ 2,007	$ -	$ -	$ 16,024
Property Disposition	808	21	-	-	829
Interest on Borrowings	112	6	-	-	118
Subsidy	2,651	521	3	-	3,175
Downward Reestimates	26	164	-	-	190
Upward Reestimates	9,868	863	-	-	10,731
Admin, Contract and Working Capital	139	151	-	-	290
Other	257	150	2	-	409
Total	**$ 27,878**	**$ 3,883**	**$ 5**	**$ -**	**$ 31,766**

Note 21. Reconciliation of Net Cost of Operations to Budget

This note (formerly the Statement of Financing) links the proprietary data to the budgetary data. Most transactions are recorded in both proprietary and budgetary accounts. However, because different accounting bases are used for budgetary and proprietary accounting, some transactions may appear in only one set of accounts. The Reconciliation of Net Cost of Operations to Budget is as follows for the period ended September 30, 2011 and 2010:

(Dollars in Millions)	FY 2011	FY 2010
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred	$ 38,521	$ 31,766
Spending Authority from Offsetting Collections and Recoveries	(33,481)	(32,217)
Offsetting Receipts	(1,033)	(619)
Transfers In / Out	(1,229)	1,504
Imputed Financing from Costs Absorbed by Others	18	19
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ 2,796**	**$ 453**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS		
Undelivered Orders and Adjustments	$ (327)	$ (468)
Revenue and Other Resources	34,926	30,073
Purchase of Assets	(11,781)	(21,497)
Appropriation for prior year Re-estimate	(10,625)	(10,731)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$ 12,193**	**$ (2,623)**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ 14,989**	**$ (2,170)**
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Upward Re-estimate of Credit Subsidy Expense	$ 14,973	$ 8,183
Downward Re-estimate of Credit Subsidy Expense	(4,494)	(5,865)
Changes in Loan Loss Reserve Expense	(28)	(83)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	(159)	(349)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(7,228)	(3,100)
Gains or Losses on Sales of Credit Program Assets	85	46
Other	(14,619)	1,790
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ (11,470)**	**$ 622**
NET COST (SURPLUS) OF OPERATIONS	**$ 3,519**	**$ (1,548)**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows on September 30, 2011 and 2010:

(Dollars in Millions)

FY 2011	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Other Assets	Total
U.S. Treasury	$ 42,006	$ 4,135	$ -	$ 46,141
HUD	-	-	3	3
Total	**$ 42,006**	**$ 4,135**	**$ 3**	**$ 46,144**

FY2010	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Other Assets	Total
U.S. Treasury	$ 39,078	$ 4,150	$ -	$ 43,228
HUD	-	-	5	5
Total	**$ 39,078**	**$ 4,150**	**$ 5**	**$ 43,233**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2011 and 2010:

(Dollars in Millions)

FY 2011	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 6,032	$ 3,051	$ 9,083
Total	**$ -**	**$ 6,032**	**$ 3,051**	**$ 9,083**

FY2010	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 4,749	$ 1,165	$ 5,914
Total	**$ -**	**$ 4,749**	**$ 1,165**	**$ 5,914**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2011:

	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 4,375	$ 35	$ 57	$ 790	$ 5,257
Unobligated balance brought forward, October 1, as adjusted	4,375	35	57	790	5,257
Recoveries of prior year unpaid obligations	-	8	5	71	84
Other changes in unobligated balance (+ or -)	(4,375)	4,368	(18)	(202)	(227)
Unobligated balance from prior year budget authority, net	-	4,411	45	658	5,114
Appropriations (discretionary and mandatory)	-	135	3,033	71	3,239
Spending authority from offsetting collections (discretionary and mandatory)	4,685	3,226	-	254	8,165
Total budgetary resources	**$ 4,685**	**$ 7,772**	**$ 3,078**	**$ 983**	**$ 16,518**
Status of Budgetary Resources:					
Obligations incurred	-	7,714	3,026	213	10,953
Unobligated balance, end of year:					
Apportioned	-	22	17	183	222
Unapportioned	4,685	36	35	587	5,343
Total unobligated balance, end of year	4,685	58	52	770	5,565
Total budgetary resources	**$ 4,685**	**$ 7,772**	**$ 3,078**	**$ 983**	**$ 16,518**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	132	27	613	772
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(23)	-	-	(1)	(24)
Obligated balance, start of year (net), before adjustments (+ or -)	(23)	132	27	612	748
Adjustment to obligated balance, start of year (net) (+ or -)	-	-	-	-	-
Obligated balance, start of year (net), as adjusted	(23)	132	27	612	748
Obligations incurred	-	7,714	3,026	213	10,953
Outlays (gross) (-)	-	(7,693)	(3,031)	(180)	(10,904)
Change in uncollected customer payments from Federal sources (+ or -)	4	-	-	-	4
Recoveries of prior year unpaid obligations (-)	-	(8)	(5)	(71)	(84)
Unpaid obligations, end of year (gross)	-	145	16	576	737
Uncollected customer payments from Federal sources, end of year	(19)	-	-	(1)	(20)
Obligated balance, end of year (net)	**$ (19)**	**$ 145**	**$ 16**	**$ 575**	**$ 717**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	4,685	3,361	3,033	325	11,404
Actual offsetting collections (discretionary and mandatory) (-)	(7,915)	-	-	(254)	(8,169)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	4	-	-	-	4
Budget authority, net (discretionary and mandatory)	(3,226)	3,361	3,033	71	3,239
Outlays, gross (discretionary and mandatory)	-	7,693	3,031	180	10,904
Actual offsetting collections (discretionary and mandatory) (-)	(7,915)	-	-	(254)	(8,169)
Outlays, net (discretionary and mandatory)	(7,915)	7,693	3,031	(74)	2,735
Distributed offsetting receipts (-)	-	-	-	1,033	1,033
Agency outlays, net (discretionary and mandatory)	**$ (7,915)**	**$ 7,693**	**$ 3,031**	**$ (1,107)**	**$ 1,702**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2010:

	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	10,604.00	28	$ 51	$ 681	$ 11,364
Adjustment to unobligated balance brought forward, October 1 (+ or -)	-	-	-	$ -	$ -
Unobligated balance brought forward, October 1, as adjusted	10,604	28	51	$ 681	$ 11,364
Recoveries of prior year unpaid obligations	-	2	12	$ 33	$ 47
Other changes in unobligated balance (+ or -)	(9,868)	9,868	-	$ (213)	$ (187)
Unobligated balance from prior year budget authority, net	737	9,898	63	501	$ 11,198
Appropriations (discretionary and mandatory)	-	117	871	171	$ 1,159
Borrowing authority (discretionary and mandatory)	-	-	-	$ 9	$ 10
Spending authority from offsetting collections (discretionary and mandatory)	3,638	-	-	$ 269	$ 3,907
Total budgetary resources	**$ 4,375**	**$ 10,015**	**$ 934**	**$ 950**	**$ 16,274**
Status of Budgetary Resources:					
Obligations incurred	-	9,980	877	160	$ 11,017
Unobligated balance, end of year:	-				
Apportioned	-	5	9	499	$ 513
Unapportioned	4,375	30	48	291	$ 4,744
Total unobligated balance, end of year	4,375	35	57	790	$ 5,257
Total budgetary resources	**$ 4,375**	**$ 10,015**	**$ 934**	**$ 950**	**$ 16,274**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	81	76	672	$ 829
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(84)	-	-	(1)	$ (85)
Obligated balance, start of year (net), before adjustments (+ or -)	(84)	81	68	679	$ 744
Obligated balance, start of year (net), as adjusted	(84)	81	76	671	$ 744
Obligations incurred	-	9,980	877	160	$ 11,017
Outlays (gross) (-)		(9,928)	(914)	(185)	(11,027.00)
Change in uncollected customer payments from Federal sources (+ or -)	61	-	-	-	$ 61
Recoveries of prior year unpaid obligations (-)	-	(2)	(12)	(33)	$ (47)
Unpaid obligations, end of year (gross)	-	132	27	613	$ 772
Uncollected customer payments from Federal sources, end of year	(23)	-	-	(1)	$ (24)
Obligated balance, end of year (net)	**$ (23)**	**$ 132**	**$ 27**	**$ 612**	**$ 748**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	3,639	117	871	450	$ 5,077
Actual offsetting collections (discretionary and mandatory) (-)	(3,700)	-	-	(270)	$ (3,970)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	61	-	-	-	$ 61
Budget authority, net (discretionary and mandatory)	-	117	871	180	$ 1,168
Outlays, gross (discretionary and mandatory)	-	9,928	914	185	$ 11,027
Actual offsetting collections (discretionary and mandatory) (-)	(3,700)	-	-	(270)	$ (3,970)
Outlays, net (discretionary and mandatory)	(3,700)	9,928	914	(85)	$ 7,057
Distributed offsetting receipts (-)	-	-	-	619	$ 619
Agency outlays, net (discretionary and mandatory)	**$ (3,700)**	**$ 9,928**	**$ 914**	**$ (704)**	**$ 6,438**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2011:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 27,321	$ 7,319	$ 9	$ 34,649
Unobligated balance brought forward, October 1, as adjusted	27,321	7,319	9	34,649
Recoveries of prior year unpaid obligations	18	8	-	26
Other changes in unobligated balance (+ or -)	-	(16)	-	(16)
Unobligated balance from prior year budget authority, net	27,338	7,311	10	34,659
Appropriations (discretionary and mandatory)	-	3	1	4
Borrowing authority (discretionary and mandatory)	3,010	828	-	3,838
Spending authority from offsetting collections (discretionary and mandatory)	21,098	4,204	14	25,316
Total budgetary resources	**$ 51,446**	**$ 12,346**	**$ 25**	**$ 63,817**
Status of Budgetary Resources:				
Obligations incurred	24,402	3,165	1	27,568
Unobligated balance, end of year:				
Apportioned	12,488	671	11	13,170
Unapportioned	14,556	8,510	13	23,079
Total unobligated balance, end of year	27,044	9,181	24	36,249
Total budgetary resources	**$ 51,446**	**$ 12,346**	**$ 25**	**$ 63,817**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	1,558	333	-	1,891
Obligated balance, start of year (net), before adjustments (+ or -)	1,558	333	-	1,891
Obligated balance, start of year (net), as adjusted	1,558	333	-	1,891
Obligations incurred	24,402	3,165	1	27,568
Outlays (gross) (-)	(23,935)	(3,178)	-	(27,113)
Change in uncollected customer payments from Federal sources (+ or -)	-	(1)	-	(1)
Recoveries of prior year unpaid obligations (-)	(18)	(8)	-	(26)
Unpaid obligations, end of year (gross)	2,007	313	-	2,320
Uncollected customer payments from Federal sources, end of year	-	(1)	-	(1)
Obligated balance, end of year (net)	**$ 2,007**	**$ 314**	**$ (2)**	**$ 2,319**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	24,108	5,035	15	29,158
Actual offsetting collections (discretionary and mandatory) (-)	(22,913)	(4,941)	(15)	(27,869)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	-	(1)	-	(1)
Budget authority, net (discretionary and mandatory)	1,195	93	-	1,288
Outlays, gross (discretionary and mandatory)	23,935	3,178	-	27,113
Actual offsetting collections (discretionary and mandatory) (-)	(22,913)	(4,941)	(15)	(27,869)
Outlays, net (discretionary and mandatory)	1,022	(1,763)	(15)	(756)
Agency outlays, net (discretionary and mandatory)	**$ 1,022**	**$ (1,763)**	**$ (15)**	**$ (756)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2010:

	MMI/CMHI Financing	GI/SRI Financing	Other	Budgetary Total Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 19,936	$ 6,859	$ 4	26,799
Unobligated balance brought forward, October 1, as adjusted	11,147	6,859	$ 11,152	29,158
Recoveries of prior year unpaid obligations	62	8	$ -	70
Other changes in unobligated balance (+ or -)	8,788		$ (11,154)	(2,359)
Unobligated balance from prior year budget authority, net	19,998	$ 6,867	$ 4	26,869
Appropriations (discretionary and mandatory)	-	7	$ -	7
Borrowing authority (discretionary and mandatory)	-	790	$ 1	791
Spending authority from offsetting collections (discretionary and mandatory)	25,177	2,548	$ 5	27,731
Total budgetary resources	**$ 45,175**	**$ 10,212**	**$ 11**	**$ 55,398**
Status of Budgetary Resources:				
Obligations incurred	$ 17,854	$ 2,893	$ 2	20,749
Apportioned	3,998	57	$ 9	4,064
Unapportioned	23,323	7,262	$ -	30,585
Total unobligated balance, end of year	27,321	7,319	$ 9	34,649
Total budgetary resources	**$ 45,175**	**$ 10,212**	**$ 11**	**$ 55,398**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	$ 1,209	$ 255	$ -	1,464
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	-	(2)	$ -	(2)
Obligated balance, start of year (net), before adjustments (+ or -)	$ 1,209	253	$ -	1,462
Obligated balance, start of year (net), as adjusted	1,209	253	$ -	1,462
Obligations incurred	17,854	2,893	$ 2	20,749
Outlays (gross) (-)	(17,444)	(2,807)	$ (1)	(20,252)
Change in uncollected customer payments from Federal sources (+ or -)	2	2	$ -	4
Recoveries of prior year unpaid obligations (-)	(62)	(8)	$ -	(70)
Unpaid obligations, end of year (gross)	1,558	333	$ (2)	1,889
Uncollected customer payments from Federal sources, end of year	-	-	$ 2	2
Obligated balance, end of year (net)	**$ 1,558**	**$ 333**	**$ -**	**$ 1,891**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	25,178	3,345		28,529
Actual offsetting collections (discretionary and mandatory) (-)	(25,440)	(2,740)	$ (5)	(28,185)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	2	2	$ -	4
Budget authority, net (discretionary and mandatory)	(260)	608	$ -	348
Outlays, gross (discretionary and mandatory)	17,444	$ 2,807	$ 1	20,252
Actual offsetting collections (discretionary and mandatory) (-)	(25,440)	(2,740)	$ (5)	(28,185)
Outlays, net (discretionary and mandatory)	(7,995)	66	$ (4)	(7,933)
Distributed offsetting receipts (-)	-	-	$ -	-
Agency outlays, net (discretionary and mandatory)	**$ (7,995)**	**$ 66**	**$ (4)**	**$ (7,933)**

AUDITOR'S REPORT

This report is a condensed version of a more detailed report issued separately in November 2011 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2011 and 2010" (2012-FO-0002). The report is available at HUD, OIG's internet site at: http://www.hudoig.gov/pdf/Internal/2012/ig12f0002.pdf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Issue Date November 7, 2011
Audit Case Number 2012-FO-0002

TO: Carol Galante, Acting Assistant Secretary for Housing - FHA Commissioner, H

FROM Thomas R. McEnanly, Director, Financial Audits Division, GAF

SUBJECT: Audit of the Federal Housing Administration's Financial Statement for Fiscal Years 2011 and 2010

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Clifton Gunderson LLP (CG) to audit the fiscal years 2011 and 2010 financial statements of the Federal Housing Administration (FHA). The contract required that the audit be performed according to Generally Accepted Government Auditing Standards (GAGAS).

CG is responsible for the attached auditors' report dated November 3, 2011 and the conclusions expressed in the report. Accordingly, we do not express an opinion on FHA's financial statements or conclusions on FHA's internal controls or compliance with laws and regulations and government-wide policies. Within 60 days of this report, CG expects to issue a separate letter to management dated November 3, 2011 regarding other matters that came to its attention during the audit.

This report includes both the Independent Auditors' Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. FHA plans to separately publish an annual report for fiscal year 2011 that conforms to FASAB standards.

The report contains one significant deficiency in FHA's internal control and two reportable instances of non compliance with laws and regulations. The report contains three new recommendations. Within 120 days of the report issue date, FHA is required to provide its final management decision which includes the corrective action plan for each recommendation. As part of the audit resolution process, we will record three new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking system (ARCATS). We will also endeavor to work with FHA to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plan will be reviewed and evaluated with concurrence from the OIG.

We appreciate the courtesies and cooperation extended to the CG and OIG audit staffs during the conduct of the audit.

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Clifton Gunderson LLP
Certified Public Accountants & Consultants

INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Department of Housing and Urban Development

Acting Commissioner
Federal Housing Administration

In our audit of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), for fiscal year (FY) 2011, we found:

- The consolidated balance sheets of FHA as of September 30, 2011 and 2010, and the related consolidated statements of net cost, changes in net position, and the combined statement of budgetary resources (hereinafter referred to as "Principal Financial Statements") are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America
- No material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations
- One significant deficiency, entitled "Identified information technology control deficiencies are not being effectively analyzed and resolved"
- Two reportable instances of noncompliance with laws and regulations related to FHA's financial management systems and the capital requirements for the Mutual Mortgage Insurance Fund (MMI Fund).

The following sections (including Appendices A through C) discuss in more detail: (1) these conclusions and our conclusions relating to supplemental information presented in the Annual Management Report, (2) management's responsibilities, (3) our objectives, scope and methodology, (4) management's response and our evaluation of their response, and (5) the current status of prior year findings and recommendations.

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Opinion on the Principal Financial Statements

The Principal Financial Statements present fairly, in all material respects, the financial position of FHA as of September 30, 2011 and 2010, and its net cost, changes in net position, and combined budgetary resources for the years then ended.

As discussed in the footnotes to the Principal Financial Statements, the Loan Guarantee Liability (LGL) is an actuarially determined estimate of the net present value of future claims, net of premiums and recoveries, from loans insured as of the end of the fiscal year. This estimate is developed using econometric models that integrate historical data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. Deviations from these forecasts or historical performance relationships could have a material impact on this estimate.

The MMI Fund includes a Capital Reserve account from which increases in funding to cover accrued claim losses are drawn. As of September 30, 2011, this Capital Reserve account had $4.1 billion available to cover further increases in the LGL. The Credit Reform Act of 1990 provides for permanent, indefinite budget authority should future increases in the LGL exceed funds available in the Capital Reserve account.

Consideration of Internal Control over Financial Reporting and Compliance

In planning and performing our audit, we considered FHA's internal control over financial reporting and compliance (internal control) as a basis for designing our auditing procedures and to comply with Office of Management and Budget (OMB) audit guidance for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of FHA's internal control over financial reporting and compliance or on management's assertion on internal control included in Management's Discussion and Analysis (MD&A). Accordingly, we do not express an opinion on the effectiveness of FHA's internal control over financial reporting or on management's assertion on internal control included in the MD&A.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting and compliance was for the limited purpose described above and would not necessarily identify all deficiencies in internal control over financial reporting and compliance that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified one deficiency in internal control over financial reporting, described below, that we consider to be a significant deficiency. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Identified information technology control deficiencies are not being effectively analyzed and resolved

FHA's financial reporting process receives transaction information from numerous business applications that are owned by the Office of Single Family Housing or the Office of Multifamily Housing. Those applications support both HUD and FHA business and financial operations. The technical infrastructure and general support of FHA and HUD systems are provided by HUD's Office of the Chief Information Officer (OCIO). The policies and procedures governing these applications are the responsibility of OCIO. HUD policy assigns responsibility for implementing those policies and procedures to the system owners. FHA has designated senior managers in each of the Housing program offices to serve as system owners of FHA applications.

In prior audit reports and management letters, we have reported numerous weaknesses in security and access controls, as well as in configuration management and contingency planning. Likewise, HUD's Office of the Inspector General has reported such weaknesses at the HUD level. This year, we found the following weaknesses.

Security Management

- HUD's Information Technology Security Policies and Procedures have not been updated to comply with the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53 Revision 3, *Recommended Security Controls for Federal Information Systems and Organizations* as required by Federal Information Processing Standard (FIPS) 200, *Minimum Security Requirements for Federal Information and Information Systems*
- The System Security Plans for FHA applications and general support systems are not being reviewed and updated in accordance with HUD policy and NIST standards
- Vulnerability scanning practices do not comply with written HUD policy and the identified vulnerabilities are not being effectively tracked and remediated
- Specialized security training required by HUD policy and NIST standards is not being monitored and enforced
- Agreements for external information systems and interface control documentation are not being maintained in accordance with HUD policy and NIST standards

Access Control

- Management of user accounts is not being performed in accordance with HUD policy and NIST standards
- Password and security parameter settings are not being consistently applied in accordance with HUD policy
- Remote access authentication does not meet HUD policy and is not in compliance with NIST standards
- Inactive user accounts are not always deactivated as required by HUD policy and in compliance with NIST standards

Configuration Management

- Standard baseline configuration policies for FHA's general support systems are not fully documented and implemented in accordance with HUD policy and NIST standards

Contingency Planning

- Systems supporting critical operations are not consistently identified and tested in accordance with HUD policy and in compliance with NIST standards
- Contingency plans for certain systems were incomplete or not updated in accordance with HUD policy and NIST standards

Most of these weaknesses have been observed and reported in prior audits. FHA tracks actions to improve controls using corrective action plans (CAPs) and plans of action and milestones (POA&Ms). While these plans often result in improvements to the specific application weaknesses reported, such remediation does not always occur. Furthermore, we find the same type of weaknesses when we examine different applications. This indicates that the root causes of the deficiencies are not being effectively addressed for all systems. Relying on numerous system owners to implement HUD's information technology (IT) policies and procedures requires strong oversight of those policies and procedures.

FHA's ability to improve application controls is complicated by HUD's complex IT environment. FHA's financial management infrastructure is comprised of numerous aging information systems developed over the last thirty years that are connected to each other, customers, and the general ledger through hundreds of electronic interfaces. This complex and outdated IT environment provides numerous challenges in maintaining the integrity of the environment as a whole, as well as appropriate accessibility levels and security controls across the many applications.

Recommendations

We recommend that the Deputy Assistant Secretary for Finance and Budget:

1a. Work with OCIO to develop a process to analyze identified systems control weaknesses for their root causes. (New)

1b. Work with OCIO to strengthen the POA&M process by ensuring that the status of plans is reviewed regularly by FHA and HUD management with the authority to take action or accept the risks related to the weakness. (New)

1c. Develop and implement procedures for FHA senior management to acknowledge and accept system risks that cannot be mitigated within the fiscal year. (New)

Due to the sensitive nature of the specific matters noted, additional detail and the related detailed recommendations for this finding are being provided to FHA and HUD management in a separate limited distribution report.

We noted other non-reportable matters involving FHA's internal control and its operations that we communicated in a separate letter to FHA management.

Compliance with Laws and Regulations

Our tests of FHA's compliance with selected provisions of laws and regulations for FY2011 disclosed two instances of noncompliance that are reportable under United States generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to express an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Financial Management Systems: FHA's financial management infrastructure is comprised of numerous aging information systems developed over the last thirty years that are connected to each other, customers, and the general ledger through hundreds of electronic interfaces. The current IT environment has a mix of old and new software languages – from COBOL to Cold Fusion.

This complex and outdated infrastructure is becoming increasingly difficult and costly to maintain. System performance issues are difficult to analyze with a mix of old and new software and hardware. The complex environment requires multiple contractors to support the systems. Furthermore, the environment limits FHA's ability to 1) effectively adapt and efficiently scale its operations to regulatory and market changes, 2) incorporate data management practices that improve the reliability and accuracy of information, and 3) enhance data rationalization and enterprise integration for greater operational efficiency.

These limitations present a risk to FHA's ability to continue to operate in an effective and efficient manner and for its financial management system "to support the most current Federal business practices and systems requirements" as required by the Office of Management and Budget (OMB) Circular No. A-127, *Financial Management Systems* and the *Federal Managers Financial Integrity Act of 1982.* FHA has also implemented numerous expensive and manual compensating controls to ensure the reliability of its day-to-day financial transaction processing and reporting.

FHA is currently undergoing a major systems modernization process that is designed to improve efficiency and enhance management analysis and reporting while migrating business processes to more modern platforms.

Capital Ratio: The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's MMI Fund maintain a minimum level of capital sufficient to sustain a moderate recession. This capital requirement, termed the Capital Ratio, is defined as capital resources (assets minus current liabilities) less the liability for future claim costs (net of future premiums and recoveries), divided by the value of amortized insurance-in-force. The Act required FHA to maintain a minimum Capital Ratio of two percent and conduct an annual independent actuarial study to, among other things, calculate this ratio. The Housing and Economic Recovery Act of 2008

requires that the Secretary submit a report annually to the Congress describing the results of the study, assess the financial status of the MMI Fund, recommend program adjustments, and to evaluate the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the MMI Fund. As of the date of our audit, this report had not yet been submitted to Congress, but preliminary FHA data indicates that this ratio remains substantially below the required two percent through FY2011.

Status of Prior Year Control Deficiencies and Noncompliance Issues

As required by United States generally accepted government auditing standards and OMB audit guidance, we reviewed the status of FHA's corrective actions with respect to the recommendations related to the significant deficiencies included in the FY2010 Independent Auditor's Report dated November 3, 2010. Appendix C provides the status of the prior year recommendations.

Consistency of Other Information

FHA's MD&A and required supplementary information contain a wide range of information, some of which is not directly related to the financial statements. We reviewed this information for consistency with the financial statements and discussed the methods of measurement and presentation with FHA officials. Based on this limited work, we found no material inconsistencies with the financial statements; accounting principles generally accepted in the United States, or OMB guidance. However, we do not express an opinion on this information.

Objectives, Scope and Methodology

FHA management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, (2) establishing, maintaining and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers Financial Integrity Act of 1982 (FMFIA) are met, and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly in all material respects, in conformity with accounting principles generally accepted in the United States of America. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (3) performing limited testing with respect to other information appearing in the Annual Report.

In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; (2) assessed the accounting principles used and significant estimates made by management; (3) evaluated the overall presentation of the financial statements; (4) obtained an understanding of FHA and its operations, including its internal control over financial reporting (including safeguarding of assets) and compliance with laws, regulations (including execution of transactions in accordance with budget authority); (5) tested relevant internal controls over financial reporting and compliance; (6) considered the design of the process for evaluating and reporting on internal control and financial management systems under FMFIA; and (7) tested compliance with selected provisions of certain laws and regulations.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error, fraud, losses or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, we caution that our internal control testing may not be sufficient for other purposes.

We did not test compliance with all laws and regulations applicable to FHA. We limited our tests of compliance to selected provisions of those laws and regulations that have a direct and material effect on the financial statements and those required by OMB audit guidance that we deemed applicable to FHA's financial statements for the fiscal year ended September 30, 2011. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB audit guidance. We believe that our audits provide a reasonable basis for our opinion.

FHA Comments and Our Evaluation

FHA management concurred with the significant deficiency and the related recommendations, and disagreed with our assessment that FHA's financial management systems do not comply with federal standards. The full text of FHA management's response is included in Appendix A. We did not perform audit procedures on management's written response and accordingly, we express no opinion on it. Our assessment of management's response is included in Appendix B.

Distribution

This report is intended solely for the information and use of the management of FHA and HUD, the HUD Office of Inspector General, OMB, the Government Accountability Office, and the United States Congress, and is not intended to be, and should not be, used by anyone other than these specified parties.

Clifton Gunderson LLP

Arlington, Virginia
November 3, 2011

Appendix A
Management's Response

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

NOV 3 2011

MEMORANDUM FOR: Clifton Gunderson LLP

FROM: George Tomchick III, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Fiscal Year 2011 FHA Audit Report

Thank you for providing us the opportunity to respond to FHA's Independent Auditor's Report. I am pleased to present Federal Housing Administration's (FHA) response to this report.

General Comments

FHA is pleased that Clifton Gunderson recognized the progress and efforts made in resolving prior year findings. FHA will continue to improve and address the concerns identified.

Compliance with Laws and Regulations

FHA disagrees with the auditor's assertion that its systems are not compliant with OMB Circular A-127, *Financial Management Systems*. FHA has conducted its annual review of financial management systems, in compliance with Section 8(E) of Circular A-127. Based on these reviews, FHA has determined that its systems are routinely providing reliable and timely financial information for management of day-to-day operations as well as reliable financial statements, effective internal controls and compliance with legal and regulatory requirements.

FHA agrees with our auditors that our financial management infrastructure is comprised of numerous information systems, many aging, that are connected to each other, customers, and the general ledger through numerous electronic interfaces. FHA agrees that these systems must be evaluated for their ability to "continue to operate in an effective and efficient manner" and to meet changing business conditions. FHA has concluded that its systems currently meet these requirements. At some point as yet undetermined, FHA will likely need to replace some or all of its systems to continue to meet the requirements of Circular A-127. However, FHA assesses the current risk that its systems will not meet these requirements as low. Using the compliance framework of Circular A-127, Section 8(a), a low risk places FHA's systems in the 'nominal' risk category. FHA is therefore currently achieving substantial compliance.

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Report on Internal Controls – Significant Deficiency

1. Identified control deficiencies are not being effectively analyzed and resolved resulting in risks to the security of FHA's applications.

FHA concurs with the finding and recommendations identified. FHA and OCIO will work together to address these recommendations.

Appendix B
Clifton Gunderson's Assessment of Management's Response

We obtained and reviewed FHA management's response to the findings and recommendations made in connection with our audit of FHA's 2011 Principal Financial Statements, which is included as Appendix A. We did not perform audit procedures on FHA's written response to the findings and recommendations and accordingly, we express no opinion on it. Our assessment of management's response is discussed below.

Assessment of management's response to significant deficiency:

As indicated in Appendix A, FHA management concurred with our finding and recommendations but did not provide specific information regarding planned corrective actions or information needed to assess whether management will be able to effectively implement the recommendations.

Assessment of management's response to noncompliance with OMB Circular No. A-127, *Financial Management Systems,* and the *Federal Managers Financial Integrity Act of 1982*:

As indicated in Appendix A, FHA management disagrees with our assessment of the compliance of their financial management system with federal standards. Management agrees with our description of the financial management infrastructure and that it poses a risk to effective and efficient operations but they assess that risk as low at this time. We believe that the risk could have a potentially severe impact and, therefore, requires additional risk management planning.

Assessment of management's response to noncompliance with the *Cranston-Gonzales National Affordable Housing Act of 1990*:

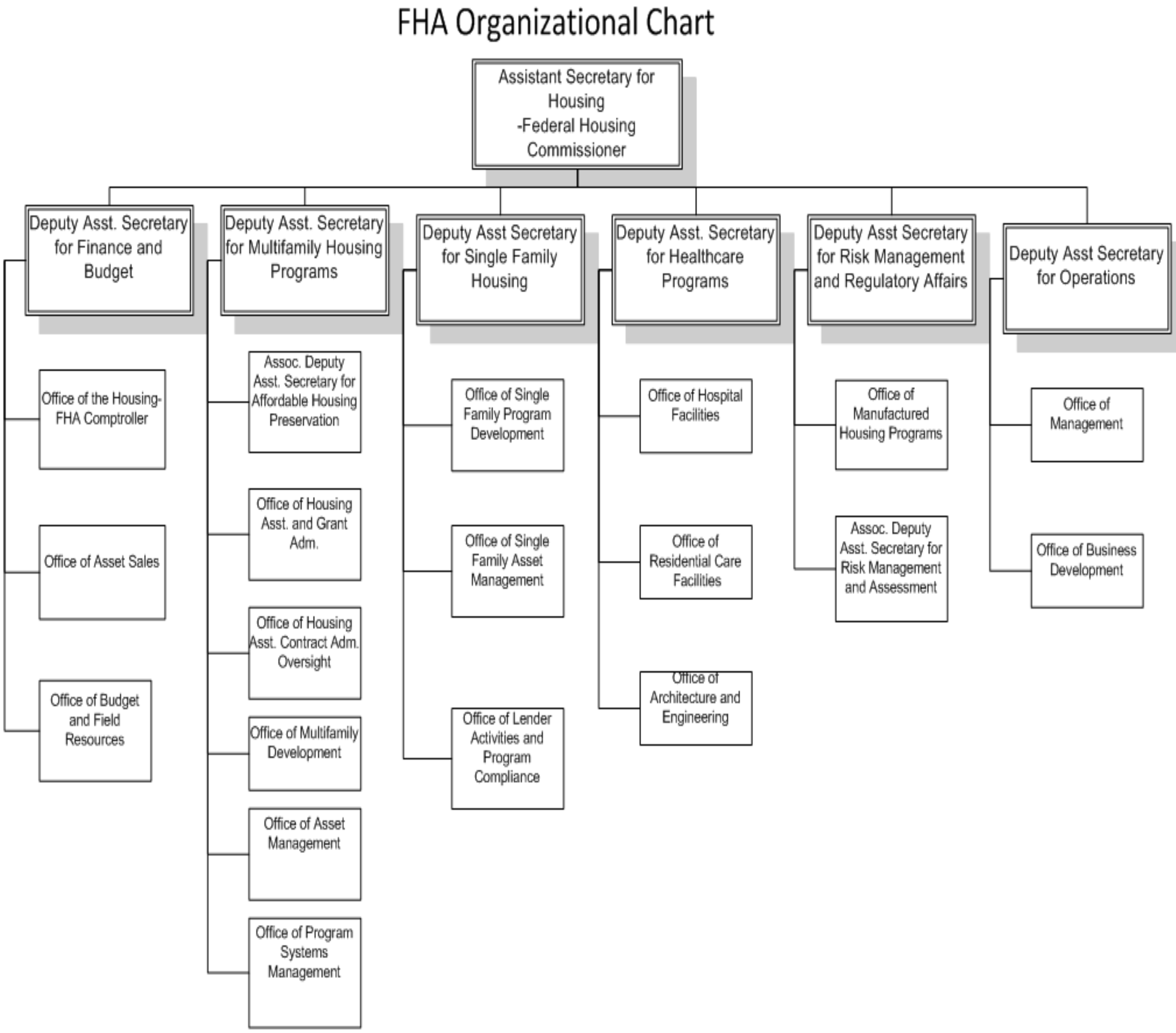
FHA management did not specifically respond to this finding. However, management is well aware of this issue.

Appendix C
Status of Prior Year Recommendations

Our assessment of the current status of the recommendations related to significant deficiencies identified in the prior year audit is presented below:

FY 2010 Recommendation	*Type*	*Fiscal Year 2011 Status*
1a. The Chair, FHA Transformation, should further refine the risk management plan for the FHA Infrastructure Transformation Initiative to include formal risk mitigation strategies, key metrics, milestones, and monitoring and reporting requirements. The risk management plan should also include any potential risks associated with achievement of the strategic objectives related to the modernization plan. (New)	Significant Deficiency 2010	Resolved
1b. Continue developing the initiative specific risk assessment plans and ensure they address the risks inherent in the comprehensive nature of the modernization project. (Updated)	Significant Deficiency 2010	Resolved
1c. Define a project governance structure and key success factors (KSFs) for monitoring the consultants and measuring the success and achievement of the KSFs for the systems transformation project over the next phase as well as the next three years. (New)	Significant Deficiency 2010	Resolved
1d. Perform a formal documented risk assessment on the sustainability and scalability of the current systems and processes during the modernization project. Based on the risk assessment, develop a risk management plan incorporating the risk identified for the sustainability of the legacy environment over the next five years. (New)	Significant Deficiency 2010	Partially resolved (See Management Letter)
2a. FHA's Deputy Assistant Secretary for Finance and Budget and Deputy Assistant Secretary for Risk Management and Regulatory Affairs should document their specific review and acceptance of the key assumptions, including key variables, in conjunction with their acceptance of the actuarial study. (New)	Significant Deficiency 2010	Resolved
2b. Document the final overall management conclusion on whether the analyses performed suggest whether adjustments to the model, calculated assumptions, or projected cash flows are warranted, and if so, how those adjustments are determined and their resulting value. (Updated)	Significant Deficiency 2010	Resolved
2c. Review and monitor the potential impact of delayed claims and the growth in loss mitigation programs on the counterintuitive model results to ensure the	Significant Deficiency 2010	Resolved

FY 2010 Recommendation	***Type***	***Fiscal Year 2011 Status***
anticipated variable relationships will continue. (New)		
2d. Analyze the risk of redefaults and claims on loans that have undergone loss mitigation. (New)	Significant Deficiency 2010	Resolved
2e. Investigate potential enhancements to the actuarial model to better communicate the precision of its estimates. (New)	Significant Deficiency 2010	Partially resolved (See Management Letter)
2f. Ensure the Annual Report and financial statements effectively present critical factors that may impact current estimates and management's views on the probability of significant changes in these factors. (New)	Significant Deficiency 2010	Resolved



The web address for this report can be found at:

http://portal.hud.gov/hudportal/documents/huddoc?id=FHAFY11AnnualMgmntRpt.pdf

November 2011
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