FHA

FEDERAL HOUSING ADMINISTRATION

Fiscal Year

2010

ANNUAL MANAGEMENT REPORT


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A MESSAGE FROM THE COMMISSIONER

TO THE CONGRESS OF THE UNITED STATES, MEMBERS OF THE HOUSING INDUSTRY, AMERICA'S HOMEOWNERS AND TENANTS, AND THE PUBLIC:

FHA continues to support our Nation's housing recovery by assisting responsible borrowers who need a helping hand and by encouraging the return of private capital to the housing market. We have instituted significant reforms over the last fiscal year that have put FHA on stronger financial footing during these difficult economic times and will ensure that it remains strong and available to future generations. But the job is far from over. Last November, we reported in our independent actuarial study that increasing rates of default and foreclosure caused the capital reserve ratio in FHA's Mutual Mortgage Insurance (MMI) Fund to fall below its statutorily required 2 percent threshold. Nevertheless, projections indicated that the ratio would remain positive, and reserves were sufficient to cover any anticipated future losses over the next 30 years under most economic scenarios.

Secretary Donovan and this Administration are committed to restoring FHA's capital reserves by more rigorously managing risks and continuing to take all necessary steps to ensure that the Fund remains on sound financial footing. Over the past year, this Administration has implemented the most sweeping combination of reforms to FHA's credit policies, risk management, lender enforcement and consumer protections in its history. These reforms have strengthened our financial condition and minimized risk to taxpayers.

We hired the first Chief Risk Officer in the organization's history in October 2009, and are in the process of institutionalizing a robust risk management capability, expanding our capacity to assess financial and operational risk, perform more sophisticated data analyses, and respond quickly to changes in the market. FHA has made great strides in mitigating risk by tightening its credit policies in both the single family and multifamily mortgage insurance programs.

In April, we published Final Rule (FR5356-F-02), "Federal Housing Administration: Continuation of FHA Reform – Strengthening Risk Management Through Responsible FHA-Approved Lenders," eliminating FHA approval for loan correspondents, increasing net worth requirements for lenders and strengthening FHA's counterparty risk management capabilities.

We have also stepped up our single family enforcement – we suspended some well-known FHA-approved lenders, withdrew FHA approval from over 1,500 others, and imposed over $4.27 million in civil money penalties and administrative payments on non-compliant lenders. We are sending a clear message that FHA will not do business with lenders who do not operate ethically and transparently, and are holding lenders accountable by publicly reporting lender performance rankings. We have also streamlined our lender approval process so that lenders are liable for oversight of their mortgage brokers, and strengthened our lender approval requirements to ensure our resources are entrusted to lenders who are sufficiently capitalized.

We have changed our single-family credit score and down payment requirements to ensure FHA provides access to borrowers who have historically performed well. Specifically, FHA implemented a "2-step" FICO floor for FHA purchase borrowers, which will reduce both the claim rate on new insurance as well as the loss rate experienced on claims that are paid. A minimum down payment of 10 percent is now required of purchase borrowers with FICO scores below 580. Applications with credit scores below 500 are no longer eligible for FHA insurance. Finally, we have raised annual mortgage insurance premiums and correspondingly lowered upfront premiums to help restore our capital reserves without overburdening homebuyers.

As we manage risks, we continue to commit ourselves to providing help for homeowners who are struggling to keep their homes. We have extended loss mitigation options to homeowners facing imminent default and have helped more than a half-million FHA borrowers act before missing a mortgage payment, improving their chances of saving their homes. In addition, on September 7, we launched the FHA Short Refinance option, which will help responsible homeowners who are current on their mortgages but owe more than their homes are worth.

Also effective September 7, we implemented changes to multifamily insurance programs that will enhance risk management measures and will increase oversight of multifamily lenders and underwriters. These changes, including updated underwriting policies, will help increase lender and underwriter quality, and align loan application, review and approval standards. The changes are just one component of a new Multifamily framework. They reflect many of the lending industry's best practices and standards that have evolved in the multifamily market and are a much needed step to insure that FHA Multifamily programs are sound.

Secretary Donovan and I remain committed to comprehensive FHA reform legislation that enhances FHA's lender enforcement capabilities and the risk management efforts critical to our ability to monitor lender performance and ensure compliance.

Again, the job is far from finished. During these economically troubled times, our focus is to protect the taxpayer and continue providing affordable rental opportunities and homeownership options needed to keep our mortgage markets afloat. But collectively, these steps have helped to ensure that FHA can and will continue to play its critically needed role in the Nation's housing market, during good times and bad.

David H. Stevens
Assistant Secretary for Housing-
FHA Commissioner

This report is divided into four sections:

- *A **Message from the Commissioner*** is a letter from the 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 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 2010 financial statements, internal controls and compliance with laws and regulations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS


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INTRODUCTION

The Federal Housing Administration (FHA), is the largest government insurer of mortgages in the world. A part of the United States Department of Housing and Urban Development (HUD), FHA provides mortgage insurance on single-family, multifamily, manufactured homes and healthcare loans made by FHA-approved lenders throughout the United States (U.S.) and its territories. While borrowers must meet certain requirements established by FHA to qualify for the insurance, lenders bear less risk because FHA will pay the lender if a borrower defaults on his or her loan. FHA has insured over 39 million home mortgages and 52 thousand multifamily project mortgages since 1934. 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.

In general, the widespread availability of FHA mortgage insurance encourages the provision of mortgage credit by lenders and provides liquidity and stability for the mortgage market. FHA serves borrowers that the conventional market does not adequately provide for, including first-time homebuyers, minorities, low-income families and residents of underserved communities. In addition, FHA remains active and available in all markets during times of economic disruption. This can be seen now as FHA volume has grown significantly during the mortgage crisis as a result of reduced or constrained activity by private mortgage insurers and private lenders. FHA's overall outstanding insurance-in-force exceeded $1 trillion by the end of fiscal year 2010. This proactive role entails commensurate risk. FHA must now balance its role in supporting the mortgage markets with its statutory mandate to operate on a sound basis.

To address current and difficult conditions in the housing market, FHA 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
- Tightened underwriting procedures and requirements
- Expanded loss mitigation programs
- Hired a Risk Officer and created a risk management office within FHA
- Introduced 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 how FHA continues to provide access to homeownership for underserved communities while supporting the nation's housing market recovery.

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. FHA continues to play a critical role in supporting mortgage markets consistent with the overall recovery plan devised by the current Administration and Congress to stimulate the economy, stabilize neighborhoods heavily impacted by foreclosures, prevent homelessness, 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.

During fiscal year 2010, FHA continued its investment in technology, staffing and training to maintain a sustainable environment for its mortgage insurance programs under Single Family and Title I Manufactured Housing and Property Improvement, Multifamily and Healthcare. These programs are administered through seven functional areas under the direction of the Federal Housing Commissioner. All functional areas collaborate in supporting FHA's goals and mission. The adjacent organizational chart depicts FHA's current functional areas (Figure 1).

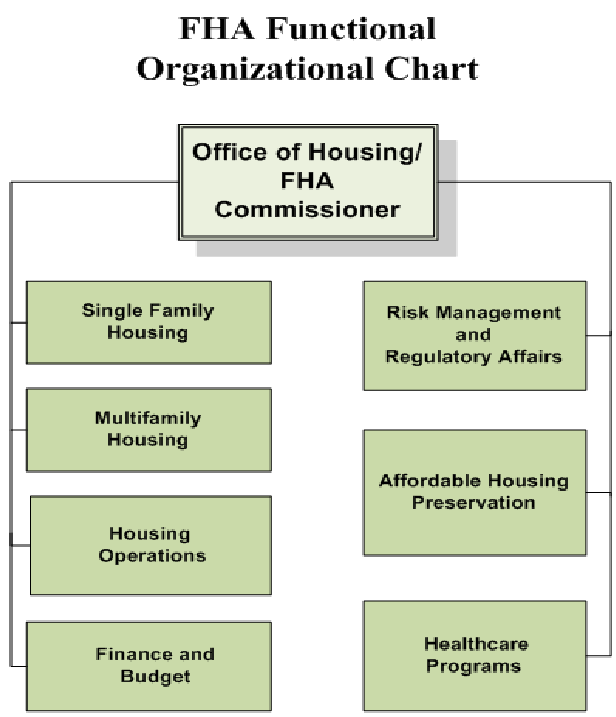


Figure 1

FHA works with Congress and the Administration to provide effective programs and sound pricing. During fiscal year 2010, FHA made enhancements to the Home Affordable Modification Program (HAMP) and FHA refinance programs to better assist homeowners affected by the crisis. These program modifications expand flexibility for mortgage servicers and originators to assist more unemployed/under-employed borrowers and homeowners with negative equity in their homes. These efforts reflect FHA's commitment to examining every possible action to help support the recovery and the Administration's goal of stabilizing housing markets.

Summary of Recent Legislative and Regulatory Changes

- American Recovery and Reinvestment Act of 2009 (ARRA)
  - Provides for affordable housing modification program
- Helping Families Save Their Homes Act of 2009
  - Assists FHA mortgagors in default to modify their mortgage to an affordable payment
  - Improves the FHA's HOPE for Homeowners program
- Real Estate Settlement Procedures Act (RESPA) update of regulations in 2009
  - Updated to standardize the Good Faith Estimate to provide better information on loan costs
- General and Special Risk Insurance Funds Availability Act
  - Provides FHA commitment authority funding for loans that are obligations of the General and Special Risk Insurance Funds
- H.R. 5981
  - Provides FHA increased flexibility in charging and establishing mortgage insurance premiums on Single Family mortgages insured under the Mutual Mortgage Insurance Fund

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.

FHA PROGRAMS AND INSURANCE IN FORCE

FHA Insurance Funds

FHA programs are operated primarily through four insurance funds: *Mutual Mortgage Insurance (MMI), General Insurance (GI), Special Risk Insurance (SRI)* and *Hope for Homeowners (H4H).* These funds are supported by premiums, fees, interest income, recoveries, Congressional appropriations, borrowings from the U.S. Treasury, and other miscellaneous sources.

The Single Family Forward Mortgage Loan portfolio comprises loans that meet FHA credit qualifications for properties between one and four units. The Home Equity Conversion Mortgages (HECM) portion of the Single Family portfolio is FHA's reverse mortgage program, which enables borrowers to withdraw a lump sum payment of mortgage proceeds, fixed monthly amounts, a line of credit or a combination thereof. Single Family loans are primarily financed through the MMI fund and the Single Family Forward mortgage portfolio within this fund is self sustaining. The Single Family H4H portfolio is primarily financed through the Hope for Homeowners fund. The Multifamily loan portfolio comprises properties consisting of five or more units. Multifamily loans are primarily financed through the General Insurance Fund (GI) and Special Risk Insurance Fund (SRI). Healthcare facilities are financed under the GI Fund.

The total mortgage Insurance-In-Force (IIF) in the FHA Insurance Funds was $1,041.2 billion, an increase of $284.0 billion or 37.5 percent, compared to fiscal year 2009. Specifically, the MMI Fund increased by $232.3 billion, the GI Fund increased by $52.2 billion and the SRI Fund decreased by $0.5 billion. Since its inception, the H4H fund, the smallest of the four, insured $23.7 million.

Figure 2

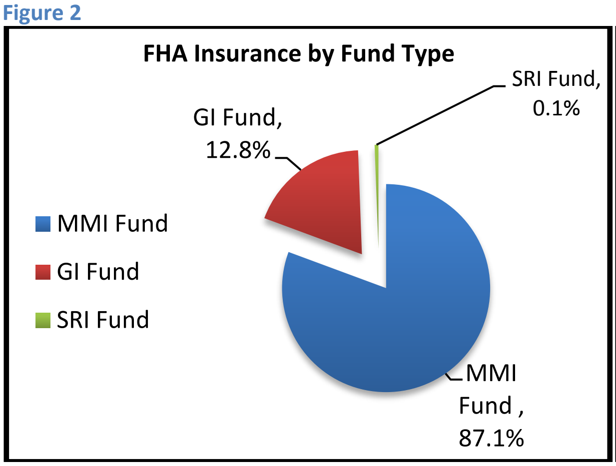
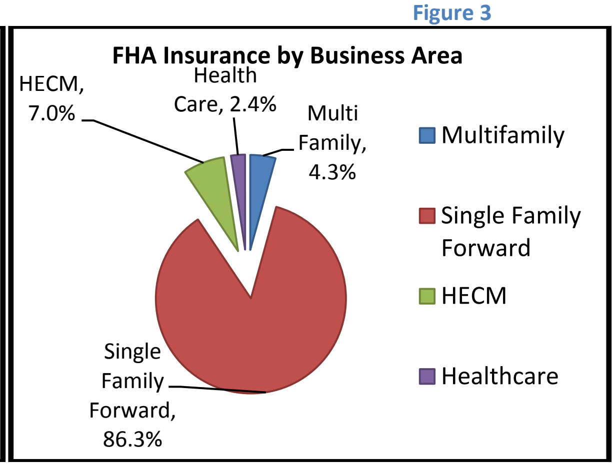


Figure 3



FHA's Single Family Forward mortgage insurance business, including Title I, comprised 86.3 percent of the total IIF and HECM insurance covered 7 percent. The Multifamily insurance business comprised 4.3 percent of the total IIF, while Healthcare insurance business comprised 2.4 percent (Figure 3).

Office of Single Family Housing

Single Family Housing Helping Homeowners Stay in Their Homes

A single mother of three in Daingerfield, Texas was unable to pay her mortgage. Her 2-year old had been in a terrible automobile accident, and there were high medical bills. Her lender said she was qualified for a Special Forbearance to help her get the loan current, but they wanted $1,200 upfront for attorney fees and other costs. She could only afford $500. After contacting the National Servicing Center (NSC), the representative was able to get the lender to waive the attorney fees and costs; thereby keeping the family in their home during the child's recovery.

Single Family Housing Programs

FHA encourages homeownership by making loans readily available to low- and moderate-income homebuyers through its FHA Single Family Housing mortgage insurance programs. Since its inception, FHA's Single Family housing programs have made substantial contributions to the national homeownership rate and its programs are the most visible evidence of FHA's success in maintaining homeownership opportunities for all Americans. Through these programs, FHA targets households that otherwise would have difficulty obtaining mortgages. During fiscal year 2010, its forward mortgage programs insured 1,661,917 loans, including 1,106,128 initial purchase endorsements and 879,573 initial purchase endorsements made to first-time homebuyers, of which 268,238 loans were made to minority first-time homebuyers.

Three of Single Family Housing's more popular programs, Mortgage Insurance for One to Four Family Homes, Mortgage Insurance for Condominiums, and Insurance for Home Equity Conversion Mortgages (HECMs), are described below.

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

Section 203(b) is the largest of FHA's Single Family programs covering 93.7 percent of total Single Family Insurance-In-Force for homes with up to four housing units. FHA established this program to support a stable mortgage finance market and to serve otherwise underserved borrowers. These mortgages are attractive to lenders because they can be packaged into mortgage-backed securities, guaranteed by the Government National Mortgage Association (Ginnie Mae), and backed by the full faith and credit of the U.S. Government. During fiscal year 2010, FHA insured 1,546,551 Section 203(b) mortgages that included 799,800 to first-time homebuyers and 244,583 to minority first-time homebuyers.

Mortgage Insurance for Condominiums

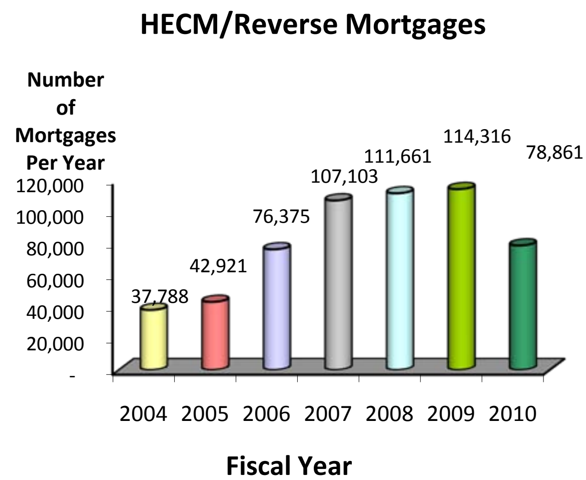
Section 234(c) provides mortgage insurance for individual condominium units and covers 5.4 percent of FHA's total Single Family Insurance-In-Force. During fiscal year 2010, FHA insured mortgages for 93,128 condominium units. The origination and underwriting processes for Section 234(c) loans were simplified under the Housing and Economic Recovery Act (HERA). HERA also contains a provision that moves Section 234(c) loans from the GI Fund to the MMI Fund for fiscal year 2009 endorsements and beyond. HUD now insures individual condominium loans under section 203(b) pursuant to amendments made in HERA. This represents a much more flexible way of insuring units in existing conventional projects, which is an important homeownership market for FHA. Prior to the statutory changes, FHA insured individual condominium loans under section 234(c). That program was restricted by HERA to provide individual take out loans only for units insured under a blanket FHA insured condominium mortgage, a multifamily housing program which has limited to no activity.

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

FHA was the first entity to promote and insure reverse mortgages on a national scale. The HECM program provides eligible homeowners access to the equity in their property with flexible terms. The program is limited to homeowners 62 years of age and older and is designed for those with limited income. Homeowners may opt for a lump sum payment of the mortgage proceeds, monthly payments, line of credit, or a combination thereof. The HECM program has undergone changes over the past year and starting October 4, 2010 offers two distinct sets of borrowing options namely, the traditional HECM option and HECM Saver. The HECM Saver allows for a smaller withdrawal of equity accompanied by a lower monthly and no upfront Mortgage Insurance Premium (MIP). This new option, available for borrowers looking for less money, will help lower the risk to the FHA Insurance Fund.

Since its inception, FHA has endorsed 650,591 HECM loans. The number of reverse mortgages insured by FHA increased from fiscal years 2004 – 2009; however, endorsements decreased in fiscal year 2010 to 78,861 loans (Figure 4). The Housing and Economic Recovery Act contains a provision that moves HECM from the GI Fund to the MMI Fund for fiscal year 2009 endorsements and beyond.

Figure 4



Additional details on these and other Single Family loan programs are available at http://www.hud.gov/offices/hsg/sfh/ins/singlefamily.cfm

Management Initiatives and Program Improvements

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

- *Expansion of Loss Mitigation Tools.* FHA assists homeowners facing financial difficulties to remain in their homes through its loss mitigation programs. The continued weakness in the housing market and reduction in bank lending has increased the demand for loss mitigation actions, and FHA has expanded its tools to meet that need. Effective September 2009, FHA prescribed a re-amortization mortgage term of 360 months coupled with an interest rate cap that cannot exceed 50 basis points or more over the current market rate as defined by the Freddie Mac Weekly Primary Mortgage Market Survey Rate. These new requirements now assure that borrowers receive the best available payment reduction when eligible for a FHA Loan Modification. As a result, annual participation in FHA's loss mitigation program increased from 68,003 cases in fiscal year 2003 to 199,222 in fiscal year 2010.

  To further assist borrowers avoid foreclosure, in January 2010 under the Helping Families Save their Home Act of 2009, FHA announced the availability of the Forbearance and FHA Home Affordable Modification Program (FHA-HAMP) loss mitigation tools. The latter of the two tools, FHA-HAMP, helps FHA-insured borrowers reduce their mortgage payments by combining a Loan Modification with a Partial Claim. By emphasizing the use of loss mitigation at the time of initial default, or determination that a default is imminent, the servicer increases the likelihood that the default will be cured and the borrower will be able to retain homeownership. FHA defined a borrower facing imminent default to be a FHA borrower that is current or less than 30 days past due on the mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent borrowers from making the next payment on the mortgage. Hardships such as a reduction in or loss of income, death in family, serious or chronic illness, and permanent or short-term disability, contribute to a borrower's potential of facing imminent default.

- *HOPE for Homeowners (H4H).* H4H was authorized by Title IV of HERA and is administered by the Secretary of HUD. The goal of the program is to help distressed homeowners refinance their mortgages into safe and sustainable FHA-insured mortgages by writing down the principal amount of the loan to an affordable level. However, since the program was not cost-effective to lenders, they were reluctant to commit the resources necessary to participate in the program. As a result, the H4H program was amended twice by Congress (under the Helping Families Save Their Homes Act) to address the challenges faced during the initial implementation. Additionally, FHA issued Mortgagee Letter 09-43 on October 20, 2009 to implement the Congressional amendments.

- *Energy Efficient Mortgages (EEM)*. Introduced in 2008, Section 2123 of the HERA increased the maximum additional amount that can be added to a FHA insured mortgage for energy efficient improvements, also known as the Green Initiative. Since the increase, FHA has endorsed 2,495 loans in the amount of $484,225,733.

Risk Management

- *Lender Enforcement Activities on Risk and Fraud.* In order to avoid losses that may occur due to abusive lender practices and risky origination and underwriting by unscrupulous lenders, FHA has implemented certain rules and requirements for the lenders:

  - Lender Approval and Recertification. Helping Families Save Their Homes Act of 2009 provided much needed support in the ability to combat mortgage fraud and enhance oversight of FHA approved lenders. The Act strengthened the eligibility requirements for participation in FHA programs, required mortgagees to utilize their HUD-registered business name for their business operations and marketing, mandated that mortgagees notify HUD of any sanctions or license revocations for their institution or its employees, and greatly enhanced the enforcement authority of the HUD Mortgagee Review Board. These changes contribute significantly to FHA's ability to engage in partnerships with responsible business partners and to take action to remove those partners that act irresponsibly. During fiscal year 2010, FHA has withdrawn approval for 1,334 lenders that failed to adhere to FHA's origination, underwriting, servicing or recertification requirements.

    On June 11, 2010, FHA issued guidance which provided an overview of key provisions of HUD's recently issued FHA Reform – Strengthening Risk Management through Responsible FHA-Approved Lenders. This rule:

    1. Increased the net worth requirements of FHA-approved lenders, which ensures that FHA lenders are sufficiently capitalized.
    2. Eliminated FHA approval of loan correspondents (mortgage brokers). FHA-approved lenders that choose to work with mortgage brokers will assume complete responsibility and accountability for the origination and underwriting of FHA–insured loans.
    3. Finally, this Final Rule updates FHA's regulations to incorporate criteria specified in the Helping Families Save Their Home Act of 2009 (HFSH Act) designed to ensure that only entities of integrity are involved in the origination of FHA insured loans.

    Additionally, as a result of the Secure and Fair Enforcement Act (S.A.F.E) registration requirement, FHA will have the ability to evaluate new applicants and lenders seeking recertification against a nationwide database to ensure those originating FHA loans are properly licensed in the states in which they operate.

> "FHA assists homeowners facing financial difficulties to remain in their homes through its loss mitigation programs. The current housing challenge under the current economy has increased the demand for loss mitigation actions and FHA has expanded its tools to meet that need."
>
> Vicki Bott,
> DAS, Single Family Housing

- Lender Monitoring and Enforcement. Monitoring reviews of HUD approved lenders are conducted to ensure that FHA-insured mortgages are originated and serviced in compliance with the Department's requirements. FHA has placed a heightened focus on servicing with emphasis on foreclosure prevention efforts, increasing loss mitigation activities and reducing losses to the FHA insurance fund. As a result, during the third quarter of fiscal year 2010, five of FHA's largest servicing lenders were selected and reviewed to ensure they were in compliance with servicing requirements. This type of review will assist in ensuring that emerging market risks are effectively managed and mitigated in an effort to restore the insurance fund reserve ratio to its congressionally-mandated requirement. FHA's lender monitoring efforts are geared towards aggressively detecting abusive and fraudulent lending practices.

- Credit Watch Termination. FHA continues to aggressively exercise its authority to terminate lenders' origination authority through its Credit Watch Termination Initiative. As part of the new Counterparty Risk Strategy, FHA expanded its Credit Watch Termination Initiative to include not only the originator of the loans but also the lender that made the underwriting decision. Under this initiative, HUD may terminate a Direct Endorsement lender's approval to underwrite FHA-insured loans in an area where the mortgagee's default and claim rate exceeds the established Credit Watch Termination thresholds.

- 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 initiative is the procurement of risk mitigation and fraud detection and prevention services under the broader FHA Transformation Initiative.
    1. Counterparty Risk Management – This initiative will aggregate information from various systems and databases into a single platform. It will facilitate data sharing and information exchange across process areas and throughout FHA. It will calculate risk metrics applicable to the broad area of lender activity across FHA and specifically within respective program offices.
    2. Master Data Management and Business Intelligence (MDM/BI) – This initiative will consist of acquiring robust, scalable, analytical consulting services to establish and maintain a lifecycle for business intelligence implementation within the FHA environment and enhance capabilities to manage loan-level risk, fraud detection and pre-loan endorsement risk mitigation.
    3. Loan File Review – The focus of this initiative is to assist with evaluating the impacts of updating process changes related to improving targeting methodology for loan–level Post Endorsement Technical Reviews and pre-claim file review services.

- *Post Endorsement Risk Management*. To further improve its risk management, FHA uses monitoring tools such as a Risk-Based Targeting Model (RBTM), Post Endorsement Technical Review Process (PETR) and Appraiser Watch to better monitor program performance and enhance oversight of lenders, Management & Marketing (M&M) contractors, and appraisers. In addition, FHA revised its delinquency rate reporting standards and took corrective action against problem lenders, underwriters and appraisers. During fiscal year 2010, FHA removed 92 appraisers from the FHA roster and took action against an additional 1,525 appraisers based on extensive risk analysis.

Single Family Asset Management

FHA acquires single family properties through conveyance claims. HUD utilizes Management and Marketing (M&M) Contractors to sell Single Family REO properties to owner-occupants and to investors. In fiscal year 2010, HUD restructured M&M contracts to segregate M&M duties between property preservation, property sales, and mortgagee compliance with conveyance requirements. Previously, the responsibility for all of the administrative, program support, management and marketing services was performed by one M&M contractor for each contract area. Under the M&M III, HUD developed a new disposition structure to streamline the operations, capitalize on the expertise of its contractors, and provide flexibility to meet changing market conditions in the Real Estate Owned (REO) industry. The performance under the restructured M&M III will reduce risk to HUD, increase net returns, decrease holding times, 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.
- Creation of an Oversight Monitor (OM), focused on overall portfolio analysis, monitoring, and oversight of the disposition processes.
- 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 property.

Concurrently, a new REO case management system and centralized property bidding/listing site has been initiated. FHA anticipates that these changes will enhance the oversight of the conveyance and REO processes.

In fiscal year 2010, HUD acquired 98,349 REO properties with an acquisition cost of $11.4 billion and sold 87,709 for $5.7 billion, resulting in a net increase of 10,640 properties in inventory. The average loss on each property was $76,000.

Single Family Notes Inventory

Secretary-held notes, including HECM, increased 25.0 percent in fiscal year 2010 to $172.6 billion from $138.1 billion in fiscal year 2009 due to an increase in claims. 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. During fiscal year 2010, Single Family Notes Partial Claims increased by 10.5 percent from 80,598 notes in 2009 to 89,034 in fiscal year 2010. Single Family Notes assigned through HECM comprised $171.1 billion of the total Secretary-held mortgage notes inventory at the end of fiscal year 2010.

Single Family Loan Sale

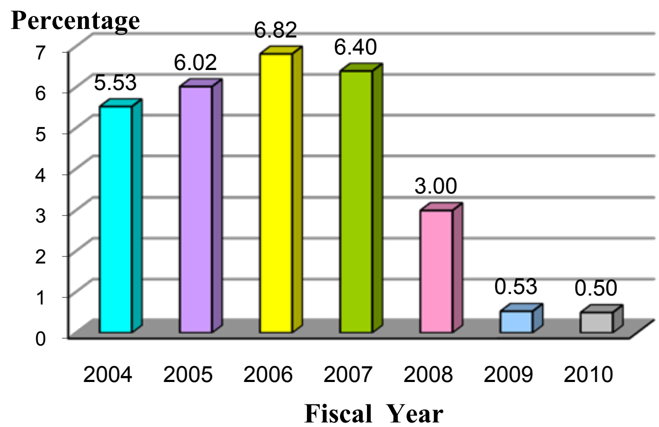
In FY 2010, the Department established the Mortgage Acquisition and Recovery Initiative Pilot (MARI) to provide another disposition alternative for defaulted single family assets. The goals of the initiative are to preserve home ownership and maximize returns to the FHA insurance funds. The first offering in the Pilot was conducted in September 2010. In this offering the Department accepted bids on pools of defaulted mortgages, which would be delivered in two monthly settlements. The first settlement took place in September and the final settlement on October 27, 2010. 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 January, 2011.

MMI Capital Ratio

The MMI Fund encompasses nearly all of FHA's single family business, with 97.8 percent of total single family Insurance-in-Force. One measure of the fund's financial soundness is the MMI capital ratio, which is defined in section 205 of the National Housing Act. This 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, after booking the present value of all expected future revenues and net claim expenses, and then adding that to current balance sheet positions. The Act requires that the estimate of economic net worth used in the capital ratio calculation be based on an annual, independent actuarial analysis of the future performance of insured loans. It further mandates that the MMI Fund maintain a capital ratio of at least 2 percent.

Figure 5

MMI Capital Ratio



Note: The FY 2004 – FY 2008 ratios are based on unamortized IIF and do not include HECM loans. The FY 2009 and 2010 ratio calculations use amortized IIF and include HECM loans endorsed starting in FY 2009.

Projections of additional significant house price declines into fiscal year 2011 reduced the economic net worth of the MMI Fund again this year. The estimated capital ratio falls slightly, from 0.53 at the end of fiscal year 2009 to 0.50 percent today.

The low capital ratio 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. In contrast, the fiscal years 2009 and 2010 loans are expected to produce net revenues that can be used to offset losses from earlier years.

FHA has sufficient liquid resources available to pay for all expected net future losses on currently insured loans. The additional cushion available should economic conditions be worse than projected is, however, very small. At the same time, the capital ratio is based on a point in time which assumes that

FHA stops insuring new loans at the start of fiscal year 2011. In actuality, FHA will not stop insuring loans, and new insurance is projected to generate net revenues for the Fund. The independent actuarial study predicts that, absent any changes made by FHA, the capital ratio will return to 2.0 by fiscal year 2015.

One additional change that began in fiscal year 2009 is that FHA reverse-mortgage insurance is now a part of the MMI Fund group of programs. Because reverse mortgages are fundamentally distinct from all other single-family loans, FHA has contracted for a separate independent actuarial study of that program. Combined results of the forward-loan and reverse-loan actuarial studies are used to form a final estimate of economic net worth and to calculate the capital ratio for the entire MMI Fund.

In addition, FHA started in fiscal year 2009 to use the amortized value of the insured loans (outstanding balances) to calculate the forward-loans portion of the capital ratio. Reverse mortgages still use the Maximum Claim Amount as the measure for Insurance-In-Force.

Office of Multifamily Housing

Housing Facility Opens for Displaced Hurricane Katrina Seniors

Forty low-income seniors displaced by Hurricane Katrina receive a grand welcome home celebration in New Orleans, Louisiana at the Terraces on Tulane, a 200-unit senior housing apartment complex. The new facility includes state-of-the-art security and comprehensive care for residents.

Multifamily Housing Programs

Multifamily housing programs 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 2010, Multifamily Housing initially endorsed 963 FHA-insured Apartments and Healthcare loans totaling $11 billion through 52 lenders. In addition, Multifamily endorsed 48 Risk Sharing loans totaling $314.6 million (Table 1).

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 100 percent of the replacement cost in contrast to the Section 221(d)4 program, where for-profit owners can be insured up to 90 percent of the project's estimated replacement cost. While both programs offer only 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 (GNMA) 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.

"Multifamily Housing Programs provide vital liquidity to the multifamily credit market, and create or preserve critically needed sustainable affordable rental housing opportunities for families, the elderly and disabled."

Carol Galante
DAS, Multifamily Housing

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 2010		
	Dollars (millions)	**Percentage**	**# of Mortgages**
Sections 221(d)(3) and 221(d)(4):New Construction and Substantial Rehabilitation Program	$ 3,767.1	33.4%	205
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing Multifamily Housing Projects	$ 6,489.6	57.5%	693
Section 232 Health Care Facilities processed by Multifamily Hubs	$ 707.9	6.2%	61
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	$ 314.6	2.8%	48
Other Programs	$ 13.1	0.1%	4

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

Multifamily Housing Development

The Office of Multifamily Housing Development provides direction and oversight for FHA mortgage insurance and risk sharing loan origination. During fiscal year 2010, the Office of Multifamily Housing Development endorsed 950 loans. These loans provided the public with a variety of shelter options that included 939 rental projects, and 11 cooperatives. Multifamily Housing Development initial endorsements of FHA insured and Risk Sharing Apartment loans totaled $10.6 billion covering 162,807 units and exceeded the fiscal year 2009 level of $4.9 billion and 79,656 units.

Because of the significant difficulties in the housing market during fiscal year 2010, the dollar volume for FHA endorsements increased by 116.3 percent and units by 104.4 percent, which represented significant market support in the face of a major economic downturn. Additionally, Multifamily supports special initiatives directed to elderly and underserved areas having high concentrations of low income or minority families. Several of these initiative activities are highlighted below.

Table 2: Special Initiative Loan

Special Initiative Loan	Number of Loans
Low Income Housing Tax Credits (LIHTC)	98
Refinance on Section 202 Elderly Housing	70
Decoupling of Interest Reduction Payment (IRP) Contracts	14

Management Initiatives and Program Improvements

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

- *Multifamily Accelerated Processing (MAP*). MAP is the primary tool used by the Office of Multifamily Housing 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, 92 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 HUD endorses. 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 2010, LQMD completed reviews of 40 MAP cases. The MAP Guide is in the process of being revised to include various underwriting changes and 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 2010, the Office of Multifamily Housing began 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 process;

    - 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.

Risk Management

In an effort to improve its overall risk management, the Office of Multifamily Housing 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 by the end of fiscal year 2010 or early fiscal year 2011.

During fiscal year 2010, Multifamily introduced 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.

Multifamily Asset Management

At the end of fiscal year 2010, FHA's Multifamily portfolio insured 12,519 mortgages that covered 1.5 million units, with a total outstanding principal balance of over $69.7 billion. In addition, FHA held 2,763 notes in inventory, with a total outstanding principal balance of $3.2 billion; however, the majority of these notes are subordinate liens. Multifamily notes inventory decreased by 1.8 percent, from 2,814 notes in fiscal year 2009 to 2,763 in fiscal year 2010. During fiscal year 2010, 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 three competitive Multifamily and Health Care Loan Sales during fiscal year 2010 that sold 44 Multifamily and 7 Health Care first and second lien mortgage notes to successful bidders. The gross proceeds from these sales was $271.2 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 2010, the lead-based paint compliance rate reached 97.3 percent with 3,950 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.

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 supportable by comparable market rents affordable to tenants. OAHP also provides assistance for oversight and preservation of a wide spectrum of affordable housing programs.

Mark-to-Market (M2M) Program

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 2010, OAHP completed restructuring on 98 properties, covering 8,997 units under the M2M program, of which 64 properties or 65.3 percent resulted in reduced rents and Section 8 savings. Out of the 98 properties, 26 resulted in full debt restructuring, contributing to the long-term preservation of 2,661 units, of which 1,035 represented an annual Section 8 loss of $56.6 million. Additionally, 52 properties consisting of 4,740 units charged reduced rents only, representing an annual Section 8 savings of over $46.3 million. In total, 5,775 units received reduced rents, resulting in an annual net loss (non-incurrence of cost) to FHA of over $10.3 million.

Office of Healthcare Programs

OHP Facilitates Re-opening of Town Long-Term Care Facility

Construction begins for re-opening the Key West Convalescent Center (the only long-term care facility in Key West, Florida). The facility began accepting patients in October 2010.

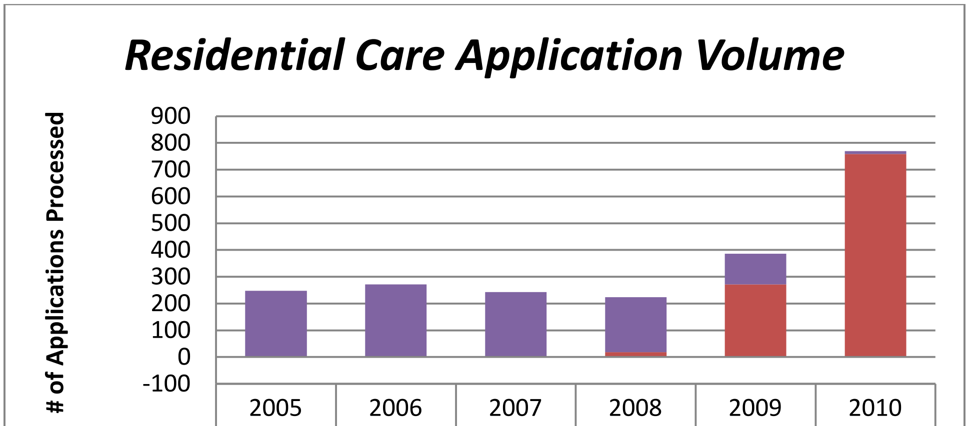
Healthcare Programs

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. The transfer of the program from the Office of Multifamily Housing to OHP was completed in April 2009; however, applications and loans in the pipeline continue to be processed through the Office of Multifamily Housing. During fiscal year 2010, OHP endorsed 309 loans totaling $2.6 billion for 35,789 units. In fiscal year 2010, the portfolio contained 2,501 loans with an unpaid principal balance of $16.6 billion. Since 2008, industry demand for the program has grown from 224 initial applications processed to 768 in 2010 (Figure 6).

Figure 6



	2005	2006	2007	2008	2009	2010
MultiFamily	248	271	243	206	114	10
OHP				18	271	758
% Increase		9.27%	-10.33%	-7.82%	71.88%	99.48%

Note: Fiscal year 2005 – 2007 applications were processed by Multifamily Housing only.

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 101 active hospital loans with unpaid principal balances totaling over $8.2 billion. In fiscal year 2010, FHA issued insurance commitments totaling $1.7 billion for 17 hospitals in 12 states and Puerto Rico. The unpaid principal balance of insured loans has more than doubled from $4 billion in fiscal year 2004 to $8.2 billion in fiscal year 2010. 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. Another factor was the implementation of the Section 223(f) program, in July 2009, permitting hospitals to refinance current debt and waiving the construction project requirement. Other factors contributing to the growth include the significant decrease in application processing time, marketing efforts for the program, and the overall market conditions.

Risk Management

With an outstanding portfolio balance of $24 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.

In 2010, the credit subsidy rate for the Hospital program was -4.28% and the credit subsidy rate for the Residential Care Facilities program was -0.53% for new construction and -2.29% for refinances. The overall claim rate net of recoveries for both programs was less than one percent.

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.

Highline Medical Center Opens State-of-the-Art Patient Tower and Emergency Room

On April 10, 2010, Highline Medical Center completed its New Birch Wing addition and Emergency Room in Burien, Washington. The project was financed with a $118 million Section 242 FHA-insured loan, which will save Highline approximately $24 million in interest expense over the life of the loan. Highline Medical Center's construction project supported approximately 771 Full Time Equivalents (FTE) in its community and provided an economic stimulus of $186.8 million during the construction period. The completed project supports approximately 157 FTEs and provides an annual economic benefit of $31.1 million.

PERFORMANCE GOALS AND OBJECTIVES

Performance Goals and Objectives

The Government Performance and Results Act (GPRA) and the Government Management Reform Act (GMRA) mandates that Federal agencies improve their financial and program accountability. GPRA requires Federal agencies to develop multi-year strategic plans, set program goals, measure performance against the goals, and publicly report the findings. GMRA mandates improvements and reforms to promote better accountability and financial management of the Federal government.

Fiscal year 2010 has been a year of transition for performance goals and strategic planning. Early in the year, agencies worked with the Office of Management and Budget (OMB) to develop High Priority Performance Goals for the fiscal year 2011 Budget. The focus of the High Priority Performance Goals was to develop a limited number of ambitious, but realistic goals to define HUD's role in addressing the economic and housing crisis.

Fiscal Year 2011 High Priority Performance Goals

HUD identified four high priority performance goals to focus on during fiscal years 2010 and 2011. FHA supports the first high priority performance goal of Foreclosure Prevention. FHA plans to assist homeowners to 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.

Fiscal Year 2010 – 2015 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 HUD Strategic Plan and will contribute to achieving each of the goals and sub goals that are listed below. However, full reporting on progress toward these goals will not begin until fiscal year 2011.

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

- Stem the foreclosure crisis
- Protect and educate consumers when they buy, refinance, or rent a home
- Create financially sustainable homeownership opportunities

- Establish an accountable and sustainable housing finance system

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

- Expand the supply of affordable rental homes where they are most needed
- Preserve the affordability and improve the quality of federally assisted and private unassisted affordable rental homes
- 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

- Utilize HUD assistance to improve educational outcomes and early learning and development
- Utilize HUD assistance to increase economic security and self-sufficiency
- 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

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

Strategic Goal 5: Transform the Way HUD Does Business

ANALYSIS OF FINANCIAL STATEMENTS

This section presents a summary analysis of the 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*. FHA's management is responsible for the integrity and objectivity of the financial information presented in the statements. This is the 18th consecutive year FHA has received an unqualified audit opinion on its financial statements.

Overview of Financial Position

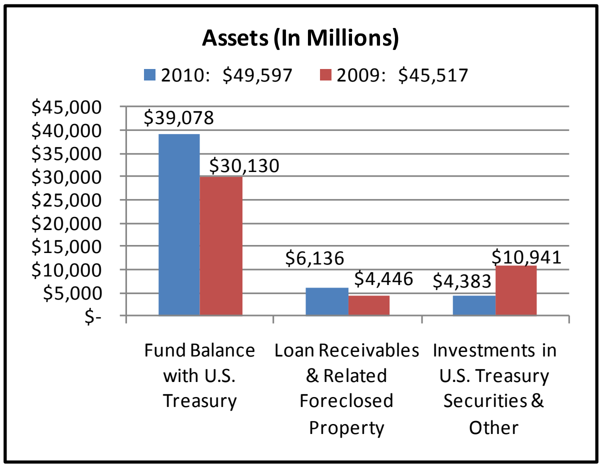
A summary of FHA's change in financial position from fiscal year 2009 to fiscal year 2010 is presented in the table below. The financial data included in this table represents the assets available to use against the amounts owed (liabilities) and the amounts that comprise the difference (net position).

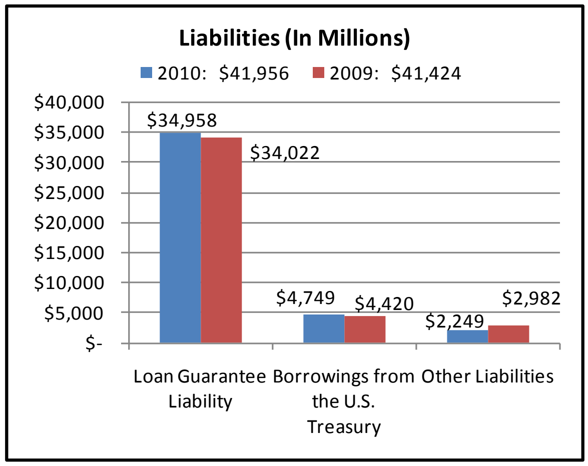
Changes in Financial Position
(In Millions)

Net Financial Condition	FY 2010	FY 2009	Difference	% Change
Fund Balance with U.S. Treasury	$ 39,078	$ 30,130	$ 8,948	30%
Investments in U.S. Treasury Securities	4,150	10,635	(6,485)	-61%
Loan Receivables & Related Foreclosed Property	6,136	4,446	1,690	38%
Other Receivables and Assets	233	306	(73)	-24%
Total Assets	**$ 49,597**	**$ 45,517**	**$ 4,080**	**9%**
Loan Guarantee Liability	34,958	34,022	936	3%
Borrowings from the U.S. Treasury	4,749	4,420	329	7%
Other Liabilities to Federal Agencies	1,165	1,913	(748)	-39%
Payables to the Public	647	639	8	1%
Other Liabilities to Public and Debentures	437	430	7	2%
Total Liabilities	**$ 41,956**	**$ 41,424**	**$ 532**	**1%**
Unexpended Appropriations	880	832	48	6%
Cumulative Results of Operations	6,761	3,261	3,500	107%
Total Net Position	**$ 7,641**	**$ 4,093**	**$ 3,548**	**87%**

Assets and Liabilities

FHA maintains a highly liquid balance sheet with the majority of its assets consisting 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 assets 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 and fee 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 earned and gains on investments in the MMI capital reserve account and interest earned on cash balances in the financing accounts. Interest earned on the investments totaled $366 million and the gain on sale of investments totaled $554 million. While it is FHA's intent to hold the investments in the MMI capital reserve account to maturity, investments were sold prior to maturity in order to transfer cash from the capital reserve account to the financing account for the MMI reestimate. The investments were sold for more than their book value which resulted in a gain. FHA also earns interest on the cash balances in the financing accounts. This amount totaled $1,627 million in fiscal year 2010.

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.

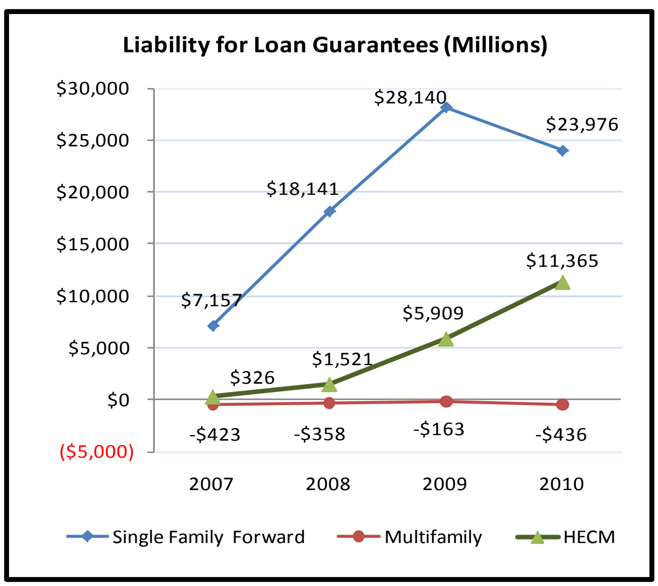
Post-1991 LLG

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 2010	FY 2009	Difference	% Change
Single Family Forward	$ 23,976	$ 28,140	$ (4,164)	-15%
HECM	11,365	5,909	5,456	92%
Multifamily	(436)	(163)	(273)	-167%
Total	**$ 34,905**	**$ 33,886**	**$ 1,019**	**3%**

The $4,164 million single family forward LLG decrease can be attributed to the better than anticipated credit quality of borrowers and an improved house price appreciation forecast in the short term. The more optimistic forecast lowered expected claims, increased expected prepayments and increased the expected return on credit program assets.

The $5,456 million HECM LLG increase is primarily due to a decline in expected long term house price appreciation for HECM properties and new estimates of current and future tax and insurance default cases. The forecast for HECM properties is driven by longer term forecasts which are less optimistic than previous estimates. The new estimates of current and future tax and insurance default cases increase the unpaid balance of these loans which also increases the liability.



The $273 million multifamily LLG decrease can be attributed to a decrease in the number of eligible loans actually participating in Mark to Market restructuring.

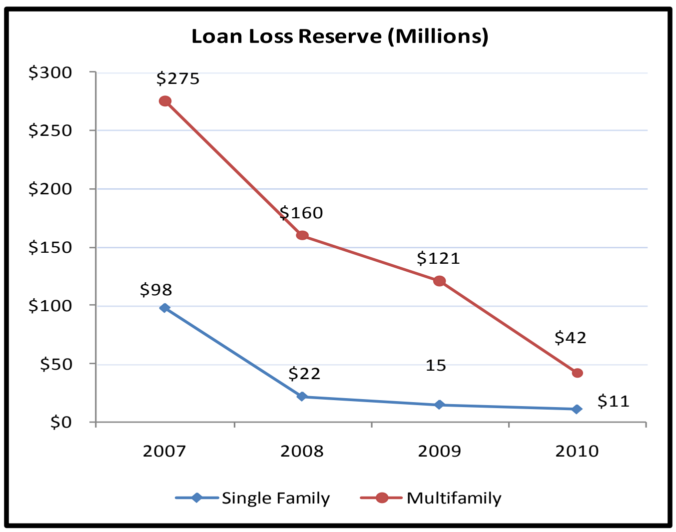
Pre-1992 Loan Loss Reserve (LLR)

The liability associated with pre-Credit Reform endorsements is computed by estimating the 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 and multifamily mortgages and Title I loans. FHA records a loss reserve allowance 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 2010	FY 2009	Difference	% Change
Single Family	$ 11	$ 15	$ (4)	-27%
Multifamily	42	121	(79)	-65%
Total	**$ 53**	**$ 136**	**$ (83)**	**-61%**

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 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 $83 million from $136 million in fiscal year 2009 to $53 million in fiscal year 2010. The majority of the decrease can be attributed to a decrease in the Mark-to-Market program.

Net Cost/ (Surplus)

FHA's program revenues exceeded costs in fiscal year 2010, resulting in a net surplus. 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, at the time the loan is disbursed by the lender, of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements. Payments made to FHA, including premiums, penalties, and recoveries are also included in the calculation.

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

	FY 2010	FY 2009	Difference	% Change
Program Cost	$ 1,132	$ 14,689	$ (13,557)	-92%
Less: Program Revenues	2,680	2,266	414	18%
Net Cost (Surplus)	**$ (1,548)**	**$ 12,423**	**$ (13,971)**	**-112%**

FHA had a net program surplus in 2010. This is primarily due to the interest earnings on investments and on the cash balances in the financings account and the gain of the sale of investments held in the MMI capital reserve account. The year over year program cost difference is primarily due to a $9,989 million decrease in subsidy cost between the fiscal year 2010 and fiscal year 2009 reestimates of credit subsidy expense.

Budgetary Resources

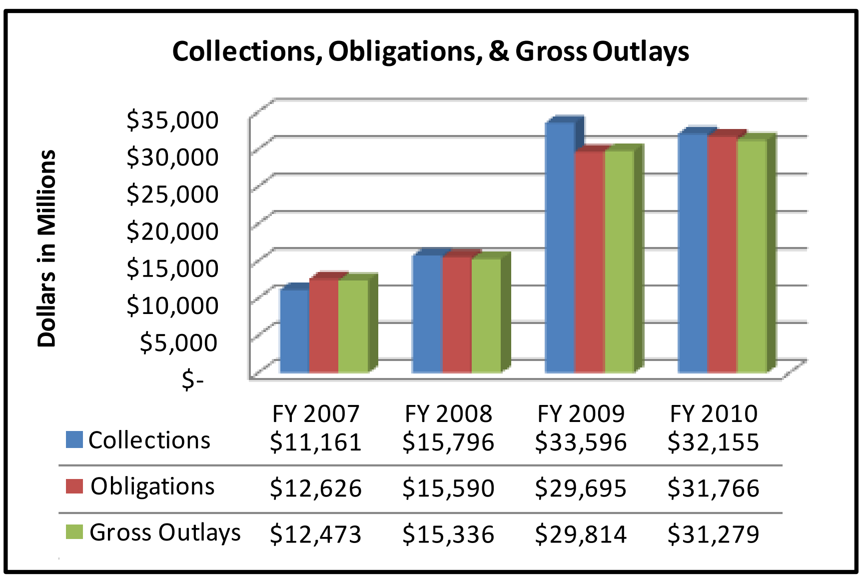
FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances carried forward.

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 salaries and working capital fund expenses.

Budgetary Resources
(Dollars in millions)

	FY 2010	FY 2009	Difference	% Change
Offsetting Collections	$ 32,155	$ 33,596	$ (1,441)	-4%
Unobligated Balance Carried Forward	38,200	27,695	10,505	38%
Appropriations	1,238	7,554	(6,316)	-84%
Borrowing Authority	800	470	330	70%
Recoveries, Transfers, and Other	(721)	(1,420)	699	49%
Total Budgetary Resources	**$ 71,672**	**$ 67,895**	**$ 3,777**	**6%**

These resources were used to cover the fiscal year 2010 obligations totaling $31,766 million. These obligations included: 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 2008 and 2009 Financial Statements identified several significant deficiencies in systems. The auditors recommended that FHA continue "to enhance and modernize its information systems" and that "the FHA Commissioner, Assistant Secretary for Housing, coordinate with the HUD Secretary and the HUD Chief Information Officer (CIO) to conduct a risk assessment of the various system initiatives and required corrective actions in connection with the Office of the Chief Information Officer (OCIO) Strategic Plan and document how HUD's/FHA's information technology (IT) resources will be appropriately allocated in fiscal year 2009 to address the Department's and FHA highest system priorities."

In their fiscal year 2009 report, the independent auditors noted that during the past decade FHA has experienced both large declines in mortgage insurance business and, more recently, large increases. FHA is currently insuring mortgages in all programs at historically unprecedented levels. FHA's 42 financial and management systems were developed independently over the last thirty years and do not have the capabilities provided by modern technologies to respond efficiently and flexibly to these extraordinary changes in the mortgage insurance markets. Unprecedented changes in the Single Family mortgage market and their impact on the performance of the FHA insurance funds have also focused FHA's concerns on improving and modernizing controls for risk and fraud.

In response to these conditions, FHA has:

- Worked with HUD OCIO to continue monitoring and managing the current systems capacity requirements and needs in the face of a rapid increase in business
- Developed prioritized plans for system integration and modernization of the most critically stressed systems
- Planned and initiated system changes to improve controls over risk and fraud in FHA's Single Family insurance programs

<u>Capacity Monitoring and Management</u>

FHA has planned and acted to respond to rapidly changing needs in the mortgage market over the past three years. Beginning in 2008, rapidly increasing activity in the Single Family mortgage insurance program challenged the capacity of FHA's information technology systems. Based upon operating experience at that time, FHA's and HUD's management responded with immediate steps to increase capacity in the information technology systems directly affected. During the course of the year, regularly scheduled equipment upgrades were completed for workstations in the Home Ownership

Centers of Denver, Philadelphia, Santa Ana and Atlanta. In 2010, FHA continued to update and increase the capacity in information technology systems to keep pace with national needs. Among other improvements in 2010, FHA and HUD have: (1) increased data storage capacity in 2010 by adding 200 terabytes of storage, (2) invested in personnel productivity tools such as Webcast, SharePoint, Web 2.0 and social networking capabilities in an effort to enhance outreach and communication, improve project oversight and collaboration, and effectively communicate across HUD and with its stakeholders.

Prioritized plans for System Integration and Modernization

In 2008, FHA commissioned a long term study of risks in IT infrastructure capacity and other institutional capabilities, including personnel, relating to the Single Family program ("Risk Capacity Study: Single Family Housing Application and Endorsement Processes", February 2, 2009"). Capacity improvements were implemented in parallel with study progress.

FHA's experience during 2008 and early 2009 demonstrated that FHA's IT infrastructure, software applications and business processes needed to be transformed in order to provide the agility and capacity needed by the rapidly changing housing and health care markets. In February, 2009, FHA initiated work on a comprehensive planning effort for the transformation of information technology systems and program business processes to respond to the challenge.

The strategic planning effort initiated in February, 2009, yielded the Housing/FHA IT Strategy and Improvement Plan, delivered to Congress in August, 2009. This Plan has set the stage for FHA information system technology improvements for the future. The Plan identified FHA systems as potentially the biggest constraint on FHA's ability to quickly and effectively adjust to rapidly changing needs in the nation's housing and health care environments. The IT Plan scored and ranked IT and process initiatives across multiple lines of business within FHA's Single Family, Multifamily, and Healthcare Facilities for targeted execution. In addition, the IT plan provided both low and high cost estimates for all potential initiatives, and an overall final project plan for sequenced execution. Given the passage of HUD's fiscal year 2010 Appropriation, which includes specific funds for FHA Transformation, FHA is now focusing on executing the priority elements identified in the Plan.

FHA is currently working to execute the Plan with three guiding principles, (1) deliver value added solutions that minimize risk to the vitality of the FHA, (2) scope Transformation Initiatives into manageable increments to ensure success, and (3) establish milestones and deliver on commitments. With these core principles in mind, FHA Transformation is comprised of 5 focus areas that address both immediate and longer-term business requirements:

- The Risk and Fraud Initiative
- Multifamily Business Process Reengineering (BPR) and subsequent execution
- The Automated Underwriting System Initiative
- The FHA Infrastructure Initiative
- Operationalizing the LEAN Healthcare Initiative

Fiscal Year 2010 Material Weaknesses

There were no material weaknesses identified for fiscal year 2010.

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

An internal control certification statement is provided by the Department's Assistant Secretaries in support of an overall statement from the Secretary. Housing complies with Sections 2 and 4 of the Federal Managers' Financial Integrity Act. Housing provides reasonable assurances that FHA's system of internal controls meets Federal standards.

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, 2010 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2010

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, 2010 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

David H. Stevens

Assistant Secretary for Housing,
Federal Housing Commissioner

Improper Payments Information Act of 2002

In accordance with the Improper Payments Information Act, enacted on November 26, 2002, and the OMB Memorandum M-03-13, dated May 21, 2003 (now subsumed into OMB Circular A-123 as Appendix C), FHA complied with the requirements and determined which of its program activities required review this year. Pursuant to the Act, FHA has determined the total dollar amount of each disbursement system for ten months (July 1, 2009 through April 30, 2010) and compared them to the $40 million threshold. During this period, the disbursements from the three systems listed below exceeded the threshold.

- Single Family Insurance Claims System (SFIC)
- Multifamily Insurance Claims (MFIC)
- Single Family Acquired Asset Management System (SAMS)

During fiscal year 2010, limited risk assessments were conducted on all the systems to assure that there were no changes that might be vulnerable to improper payments. Our risk assessment revealed that there were no significant changes to process by which the disbursements were processed, leading to the conclusion that systems are still not susceptible to improper payments. FHA has performed random statistical sampling and analyses of MFIC and SAMS together with statistical testing of claim disbursements of the Single Family Insurance Claims (SFIC) in the fiscal year 2010. The transactions reviewed corroborated with our previous findings of no significant risk of improper payments for the fiscal year 2010. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A, concluded that each of these systems has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2010 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

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FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2010 and 2009
(Dollars in Millions)

	FY 2010	FY 2009
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 39,078	$ 30,130
Investments (Note 4)	4,150	10,635
Other Assets (Note 7)	5	16
Total Intragovernmental	43,233	40,781
Investments (Note 4)	136	145
Accounts Receivable, Net (Note 5)	16	16
Loans Receivable and Related Foreclosed Property, Net (Note 6)	6,136	4,446
Other Assets (Note 7)	76	129
TOTAL ASSETS	**$ 49,597**	**$ 45,517**
LIABILITIES		
Intragovernmental		
Borrowings from U.S. Treasury (Note 9)	$ 4,749	$ 4,420
Other Liabilities (Note 10)	1,165	1,913
Total Intragovernmental	5,914	6,333
Accounts Payable (Note 8)	647	639
Loan Guarantee Liability (Note 6)	34,958	34,022
Debentures Issued to Claimants (Note 9)	10	14
Other Liabilities (Note 10)	427	416
TOTAL LIABILITIES	**41,956**	**41,424**
NET POSITION		
Unexpended Appropriations (Note 16)	880	832
Cumulative Results of Operations	6,761	3,261
TOTAL NET POSITION	**7,641**	**4,093**
TOTAL LIABILITIES AND NET POSITION	**$ 49,597**	**$ 45,517**

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, 2010 and 2009
(Dollars in Millions)

	MMI/CMHI	GI/SRI	H4H	Total
FY 2010				
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)
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)**

	MMI/CMHI	GI/SRI	H4H	Total
FY 2009				
Intragovernmental Gross Costs (Note 12)	$ 167	$ 131	$ 5	$ 303
Less: Intragovernmental Earned Revenue (Note 13)	1,756	392	-	2,148
Intragovernmental Net Costs	(1,589)	(261)	5	(1,845)
Gross Costs with the Public (Note 12)	9,072	5,302	12	14,386
Less: Earned Revenue from the Public (Note 13)	47	71	-	118
Net Costs with the Public	9,025	5,231	12	14,268
NET PROGRAM COST (SURPLUS)	**$ 7,436**	**$ 4,970**	**$ 17**	**$ 12,423**

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, 2010 and 2009
(Dollars in Millions)

	FY 2010 Cumulative Results of Operations	FY 2010 Unexpended Appropriations	FY 2009 Cumulative Results of Operations	FY 2009 Unexpended Appropriations
BEGINNING BALANCES	**$ 3,261**	**$ 832**	**$ 10,347**	**$ 411**
BUDGETARY FINANCING SOURCES				
Appropriations Received (Note 16)	-	1,231	-	7,554
Other Adjustments (Note 16)	7	(47)	-	(59)
Appropriations Used (Note 16)	981	(981)	6,929	(6,929)
Transfers-Out (Note 15 and Note 16)	(559)	(155)	(347)	(145)
OTHER FINANCING SOURCES				
Transfers In/Out (Note 15)	1,504	-	(1,260)	-
Imputed Financing (Note 12)	19	-	15	-
TOTAL FINANCING SOURCES	**$ 1,952**	**$ 48**	**$ 5,337**	**$ 421**
NET (COST) SURPLUS OF OPERATIONS	**1,548**	**-**	**(12,423)**	**-**
ENDING BALANCES	**$ 6,761**	**$ 880**	**$ 3,261**	**$ 832**

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
Budget Authority:			
Appropriations	1,231	7	1,238
Borrowing authority	10	790	800
Spending authority from offsetting collections (gross):			
Earned			
Collected (Note 18)	3,970	28,185	32,155
Change in receivables from Federal sources	(62)	(3)	(65)
Change in unfilled customer order w/o advance	-	(1)	(1)
Nonexpenditure transfers, net (Note 19)	(72)	-	(72)
Permanently not available	(262)	(449)	(711)
TOTAL BUDGETARY RESOURCES	**$ 16,274**	**$ 55,398**	**$ 71,672**
STATUS OF BUDGETARY RESOURCES			
Obligations incurred, Direct (Note 20)	$ 11,017	$ 20,749	$ 31,766
Unobligated balance-Apportioned	513	4,064	4,577
Unobligated balance-Not available	4,744	30,585	35,329
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 16,274**	**$ 55,398**	**$ 71,672**
Change in Obligated Balances			
Obligated balance, net:			
Unpaid obligations, brought forward, October 1	$ 840	$ 1,464	$ 2,304
Uncollected customer payments from Federal sources, brought forward, October 1	(86)	(3)	(89)
Total, unpaid obligated balance, brought forward, net	754	1,461	2,215
Obligations incurred (Note 20)	11,017	20,749	31,766
Gross outlays	(11,027)	(20,252)	(31,279)
Recoveries of prior-year unpaid obligations, actual	(58)	(70)	(128)
Change in uncollected customer payments-Federal sources	62	3	65
Total, unpaid obligated balance, net, end of period	748	1,891	2,639
Obligated balance, net, end of period:			
Unpaid obligations (Note 17)	772	1,891	2,663
Uncollected customer payments from Federal sources	(24)	-	(24)
Total, unpaid obligated balance, net, end of period	748	1,891	2,639
Net outlays:			
Gross outlays	$ 11,027	$ 20,252	$ 31,279
Offsetting collections (Note 18)	(3,970)	(28,185)	(32,155)
Less: Distributed offsetting receipts	619	-	619
NET OUTLAYS	**$ 6,438**	**$ (7,933)**	**$ (1,495)**

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, 2009
(Dollars in Millions)

	FY 2009 Budgetary	FY 2009 Non-Budgetary	FY 2009 Total
BUDGETARY RESOURCES			
Unobligated Balance, brought forward, October 1	$ 19,547	$ 8,148	$ 27,695
Recoveries of prior year unpaid obligations	26	10	36
Budget Authority:			
Appropriations	7,554	-	7,554
Borrowing authority	-	470	470
Spending authority from offsetting collections (gross):			
Earned			
Collected (Note 18)	2,363	31,233	33,596
Change in receivables from Federal sources	(152)	1	(151)
Change in unfilled customer order w/o advance	-	-	-
Nonexpenditure transfers, net (Note 19)	(58)	-	(58)
Permanently not available	(364)	(883)	(1,247)
TOTAL BUDGETARY RESOURCES	**$ 28,916**	**$ 38,979**	**$ 67,895**
STATUS OF BUDGETARY RESOURCES			
Obligations incurred, Direct (Note 20)	$ 17,515	$ 12,180	$ 29,695
Unobligated balance-Apportioned	575	5,875	6,450
Unobligated balance-Not available	10,826	20,924	31,750
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 28,916**	**$ 38,979**	**$ 67,895**
Change in Obligated Balances			
Obligated balance, net:			
Unpaid obligations, brought forward, October 1	$ 863	$ 1,596	$ 2,459
Uncollected customer payments from Federal sources, brought forward, October 1	(238)	(2)	(240)
Total, unpaid obligated balance, brought forward, net	625	1,594	2,219
Obligations incurred (Note 20)	17,515	12,180	29,695
Gross outlays	(17,512)	(12,302)	(29,814)
Recoveries of prior-year unpaid obligations, actual	(26)	(10)	(36)
Change in uncollected customer payments-Federal sources	152	(1)	151
Total, unpaid obligated balance, net, end of period	754	1,461	2,215
Obligated balance, net, end of period:			
Unpaid obligations (Note 17)	840	1,464	2,304
Uncollected customer payments from Federal sources	(86)	(3)	(89)
Total, unpaid obligated balance, net, end of period	754	1,461	2,215
Net outlays:			
Gross outlays	$ 17,512	$ 12,302	$ 29,814
Offsetting collections (Note 18)	(2,363)	(31,233)	(33,596)
Less: Distributed offsetting receipts	183	-	183
NET OUTLAYS	**$ 14,966**	**$ (18,931)**	**$ (3,965)**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2010

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, 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.

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*.

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 effective interest rate method.

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 Statement of Federal Financial Accounting Standards (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.

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. With the Energy Innovation appropriation of $50 million, Congress directed HUD to target $25 million to the single family market and $25 million to the multifamily market. The entire appropriation for the Transformation Initiative, $20 million, is for combating mortgage fraud.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, requires 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 $19 million for fiscal year 2010 and $15 million for fiscal year 2009, 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, *Selected Assets and Liabilities*. 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, 2010 and 2009 are as follows:

(Dollars in Millions)	FY 2010	FY 2009
Intragovernmental:		
Fund Balance with U.S. Treasury	$ 668	$ 202
Investments in U.S. Treasury Securities	-	4
Total Intragovernmental	668	206
Other Assets	70	92
Total Non-entity Assets	738	298
Total Entity Assets	48,859	45,219
Total Assets	**$ 49,597**	**$ 45,517**

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 negative credit subsidy from new endorsements and downward credit subsidy reestimates from the GI/SRI financing account to the GI/SRI general fund receipt account. At the beginning of each fiscal year, fund balance in the GI/SRI general fund receipt account is 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, 2010 and 2009:

(Dollars in Millions)	FY 2010	FY 2009
Fund Balances:		
Revolving Funds	$ 37,404	$ 29,141
Appropriated Funds	790	750
Other Funds	884	239
Total	**$ 39,078**	**$ 30,130**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance:		
Available	$ 4,577	$ 6,450
Unavailable	31,838	21,376
Obligated Balance not yet Disbursed	2,663	2,304
Total	**$ 39,078**	**$ 30,130**

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, included with these funds is the capital reserve account that 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, 2010 were as follows:

(Dollars in Millions)	Cost	Amortized (Premium)/ Discount, Net	Investment, 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**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2009 were as follows:

(Dollars in Millions)	Cost	Amortized (Premium)/ Discount, Net	Investment, Net	Market Value
MMI/CMHI Investments	$ 10,464	$ 83	$ 10,547	$ 11,860
GI/SRI Investments	4	-	4	4
Subtotal	$ 10,468	$ 83	$ 10,551	$ 11,864
MMI/CMHI Accrued Interest	-	-	$ 84	$ 84
Total	**$ 10,468**	**$ 83**	**$ 10,635**	**$ 11,948**

Investments in Private-Sector Entities

Investments in Section 601 and Risk Sharing Debentures as of September 30, 2010 and 2009 were as follows:

(Dollars in Millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Return of Investment	Redeemed	Ending Balance
FY 2010						
601 Program	$ 12	$ -	$ -	$ (3)	$ -	$ 9
Risk Sharing Debentures	133	38	-	-	(44)	127
Total	**$ 145**	**$ 38**	**$ -**	**$ (3)**	**$ (44)**	**$ 136**
FY 2009						
601 Program	$ 18	$ -	$ (4)	$ (2)	$ -	$ 12
Risk Sharing Debentures	30	137	-	-	(34)	133
Total	**$ 48**	**$ 137**	**$ (4)**	**$ (2)**	**$ (34)**	**$ 145**

The reporting period for the Section 601 Program investments was from December 1, 2008 to December 31, 2009. The condensed, audited financial statements reported $51 million in assets, $51 million in liabilities and partner's capital, and $1.5 million in net loss for these investments.

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2010 and 2009 are as follows:

	Gross		Allowance		Net	
(Dollars in Millions)	FY 2010	FY 2009	FY 2010	FY 2009	FY 2010	FY 2009
With the Public:						
Receivables Related to Credit Program Assets	$ 11	$ 17	$ (3)	$ (7)	$ 8	$ 10
Premiums Receivable	1	2	-	-	1	2
Generic Debt Receivables	103	75	(103)	(75)	-	-
Miscellaneous Receivables	7	4	-	-	7	4
Total	**$ 122**	**$ 98**	**$ (106)**	**$ (82)**	**$ 16**	**$ 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 up-front and periodic 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, 2010 and 2009 are as follows:

Direct Loan Program

(Dollars in Millions)

FY 2010		**Total**
Direct Loans		
Loans Receivable	$	20
Interest Receivable		10
Allowance		(16)
Total Direct Loans	**$**	**14**

FY 2009		**Total**
Direct Loans		
Loans Receivable	$	13
Interest Receivable		5
Allowance		(13)
Total Direct Loans	**$**	**5**

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

(Dollars in Millions)

FY 2010	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loans Receivable	$ 16	$ 7	$ 23
Interest Receivable	-	1	1
Allowance for Loan Losses	(9)	(5)	(14)
Foreclosed Property	16	2	18
Subtotal	**$ 23**	**$ 5**	**$ 28**
Multifamily			
Loans Receivable	$ -	$ 2,571	$ 2,571
Interest Receivable	-	213	213
Allowance for Loan Losses	-	(1,825)	(1,825)
Subtotal	**$ -**	**$ 959**	**$ 959**
HECM*			
Loans Receivable	$ -	$ 4	$ 4
Interest Receivable	-	1	1
Allowance for Loan Losses	-	(1)	(1)
Foreclosed Property	-	2	2
Subtotal	**$ -**	**$ 6**	**$ 6**
Total Guaranteed Loans	**$ 23**	**$ 970**	**$ 993**

(Dollars in Millions)

FY 2009	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loans Receivable	$ 19	$ 8	$ 27
Interest Receivable	3	3	6
Allowance for Loan Losses	(12)	(7)	(19)
Foreclosed Property	16	2	18
Subtotal	**$ 26**	**$ 6**	**$ 32**
Multifamily			
Loans Receivable	$ -	$ 2,668	$ 2,668
Interest Receivable	-	199	199
Allowance for Loan Losses	-	(2,162)	(2,162)
Subtotal	**$ -**	**$ 705**	**$ 705**
HECM*			
Loans Receivable	$ -	$ 5	$ 5
Interest Receivable	-	2	2
Allowance for Loan Losses	-	(1)	(1)
Foreclosed Property	-	2	2
Subtotal	**$ -**	**$ 8**	**$ 8**
Total Guaranteed Loans	**$ 26**	**$ 719**	**$ 745**

*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 2010	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loans Receivable	$ 728	$ 39	$ 767
Interest Receivable	-	2	2
Foreclosed Property	6,833	379	7,212
Allowance for Subsidy Cost	(4,282)	(241)	(4,523)
Subtotal	**$ 3,279**	**$ 179**	**$ 3,458**
Multifamily			
Loans Receivable	$ -	$ 641	$ 641
Allowance for Subsidy Cost	-	(353)	(353)
Subtotal	**$ -**	**$ 288**	**$ 288**
HECM*			
Loans Receivable	$ -	$ 1,103	$ 1,103
Interest Receivable	-	524	524
Foreclosed Property	-	44	44
Allowance for Subsidy Cost	-	(288)	(288)
Subtotal	**$ -**	**$ 1,383**	**$ 1,383**
Total Guaranteed Loans	**$ 3,279**	**$ 1,850**	**$ 5,129**

(Dollars in Millions)

FY 2009	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loans Receivable	$ 560	$ 31	$ 591
Interest Receivable	-	1	1
Foreclosed Property	4,875	281	5,156
Allowance for Subsidy Cost	(3,165)	(187)	(3,352)
Subtotal	**$ 2,270**	**$ 126**	**$ 2,396**
Multifamily			
Loans Receivable	$ -	$ 594	$ 594
Allowance for Subsidy Cost	-	(292)	(292)
Subtotal	**$ -**	**$ 302**	**$ 302**
HECM*			
Loans Receivable	$ -	$ 772	$ 772
Interest Receivable	-	418	418
Foreclosed Property	-	31	31
Allowance for Subsidy Cost	-	(223)	(223)
Subtotal	**$ -**	**$ 998**	**$ 998**
Total Guaranteed Loans	**$ 2,270**	**$ 1,426**	**$ 3,696**

*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 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**
FY 2010 Total	**$1,025,100**	**$ 967,958**
Guaranteed Loans Outstanding (FY 2009):		
MMI/CMHI		
Single Family Forward	$ 711,426	$ 674,263
Multifamily	401	375
MMI/CMHI Subtotal	**$ 711,827**	**$ 674,638**
GI/SRI		
Single Family Forward	25,898	23,088
Multifamily	66,463	59,515
GI/SRI Subtotal	**$ 92,361**	**$ 82,603**
H4H		
Single Family - 257	4	4
H4H Subtotal	**$ 4**	**$ 4**
FY 2009 Total	**$ 804,192**	**$ 757,245**

New Guaranteed Loans Disbursed:

(Dollars in Millions) Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
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**
FY 2010 Total	**$ 311,496**	**$ 308,737**
New Guaranteed Loans Disbursed (FY 2009):		
MMI/CMHI		
Single Family Forward	$ 330,342	$ 328,054
Multifamily	43	43
MMI/CMHI Subtotal	**$ 330,385**	**$ 328,097**
GI/SRI		
Single Family Forward	234	232
Multifamily	6,708	6,690
GI/SRI Subtotal	**$ 6,942**	**$ 6,922**
H4H		
Single Family - 257	4	4
H4H Subtotal	**$ 4**	**$ 4**
FY 2009 Total	**$ 337,331**	**$ 335,023**

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 650,591HECM loans with a maximum claim amount of $144 billion. Of these 650,591 HECM loans insured by FHA, 510,144 loans with a maximum claim amount of $119 billion are still active. As of September 30, 2010 the insurance-in-force (the outstanding balance of active loans) was $73 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)

			Cumulative	
Loan Guarantee Programs		**Current Year Endorsements**	**Outstanding Balance**	**Potential Liability**
FY 2010	MMI/CMHI	$ 21,023	$ 28,351	$ 49,388
	GI/SRI	-	44,906	69,407
	Total	**$ 21,023**	**$ 73,257**	**$ 118,795**
FY 2009	MMI/CMHI	$ 30,080	$ 15,524	$ 29,442
	GI/SRI	-	44,353	73,058
	Total	**$ 30,080**	**$ 59,877**	**$ 102,500**

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2010	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**

FY 2009	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 14	$ 1	$ -	$ 15
Multifamily	-	121	-	121
Subtotal	**$ 14**	**$ 122**	**$ -**	**$ 136**
LLG				
Single Family Forward	$ 27,301	$ 838	$ 1	$ 28,140
Multifamily	(5)	(158)	-	(163)
HECM	1,156	4,753	-	5,909
Subtotal	**$ 28,452**	**$ 5,433**	**$ 1**	**$ 33,886**
Loan Guarantee Liability Total	**$ 28,466**	**$ 5,555**	**$ 1**	**$ 34,022**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

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)**

FY 2009	**MMI/CMHI**	**GI/SRI**	**H4H**	**Total**
Single Family Forward				
Defaults	$ 9,990	$ 10	$ 1	$ 10,001
Fees and Other Collections	(13,637)	(12)	-	(13,649)
Other	3,496	1	-	3,497
Subtotal	**$ (151)**	**$ (1)**	**$ 1**	**$ (151)**
Multifamily				
Defaults	$ 1	$ 193	$ -	$ 194
Fees and Other Collections	(2)	(338)	-	(340)
Other	-	-	-	-
Subtotal	**$ (1)**	**$ (145)**	**$ -**	**$ (146)**
HECM				
Defaults	$ 1,043	$ -	$ -	$ 1,043
Fees and Other Collections	(1,457)	-	-	(1,457)
Subtotal	**$ (414)**	**$ -**	**$ -**	**$ (414)**
Total	**$ (566)**	**$ (146)**	**$ 1**	**$ (711)**

Subsidy Expense for Modifications and Reestimates:

(Dollars in millions)

FY 2010		Total Modifications		Technical Reestimate
MMI/CMHI	$	-	$	(2,161)
GI/SRI		(5)		3,195
Total	**$**	**(5)**	**$**	**1,034**
FY 2009				
MMI/CMHI	$	(362)	$	7,275
GI/SRI		(6)		3,139
Total	**$**	**(368)**	**$**	**10,414**

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)

		FY 2010		FY 2009
MMI/CMHI	$	(4,812)	$	6,347
GI/SRI		2,762		2,987
H4H		3		1
Total	**$**	**(2,047)**	**$**	**9,335**

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(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 - 9/30/2010)	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 - 9/30/2010)	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 - 9/30/2010)	22.26	(5.89)	0.54	16.91

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2009 Loan Guarantees:				
MMI/CMHI				
Single Family - Forward (10/1/2008 - 6/30/2009)	3.03	(4.13)	1.06	(0.04)
Single Family - Forward (7/1/2009 - 9/30/2009)	3.04	(4.13)	1.03	(0.06)
Single Family - HECM	3.45	(4.82)	-	(1.37)
Multifamily - Section 213 ((10/1/2008 - 6/30/2009)	3.03	(4.13)	1.06	(0.04)
Multifamily - Section 213 (7/1/2009 - 9/30/2009)	3.04	(4.13)	1.03	(0.06)
GI/SRI				
Multifamily - Section 221(d)(4)	4.14	(5.24)	-	(1.10)
Multifamily - Section 207/223(f)	1.47	(4.76)	-	(3.29)
Multifamily - Section 223(a)(7)	1.47	(4.76)	-	(3.29)
Multifamily - Section 232	3.39	(5.48)	-	(2.09)
Section 242	2.63	(5.14)	-	(2.51)
H4H				
Single Family - Section 257	22.40	(8.41)	(0.61)	13.38

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2010		FY 2009	
	LLR	**LLG**	**LLR**	**LLG**
Beginning Balance of the Loan Guarantee Liability	$ 136	$ 33,886	$ 182	$ 19,304
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)		11,124		11,238
Fees and Other Collections		(17,578)		(15,446)
Other Subsidy Costs		3,378		3,497
Total of the above subsidy expense components		**(3,076)**		**(711)**
Adjustments:				
Fees Received		10,082		8,771
Foreclosed Property and Loans Acquired		6,814		3,907
Claim Payments to Lenders		(16,478)		(10,481)
Interest Accumulation on the Liability Balance		1,344		1,079
Other		16		(254)
Ending Balance before Reestimates	**136**	**32,588**	**182**	**21,615**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	(83)	(2,607)	(46)	5,364
Interest Expense Component		1,113		1,367
Adjustment of prior years' credit subsidy reestimates		3,811		5,540
Total Technical/Default Reestimate	**(83)**	**2,317**	**(46)**	**12,271**
Ending Balance of the Loan Guarantee Liability	**$ 53**	**$ 34,905**	**$ 136**	**$ 33,886**

Administrative Expense:

(Dollars in Millions)	FY 2010	FY 2009
MMI/CMHI	$ 543	$ 275
GI/SRI	30	294
H4H	9	16
Total	**$ 582**	**$ 585**

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.

The majority of FHA's Pre-Credit Reform liability relates to the Mark-to-Market program. A separate analysis was conducted to adjust the loan loss estimate for anticipated reductions for these project-based Section 8 rental assistance subsidies administered by the Office of Affordable Housing Preservation (OAHP). In fiscal year 2010, an assumption was implemented that only fifty percent of Mark-to-Market eligible projects would enter the program to better represent the historical pattern that not all eligible projects would opt to enter the program. All projects that are required to submit financial statements and have submitted annual financial statements within the past two years, received Section 8 assistance, expected to expire in the next five years, and had contract rents exceeding 100 percent of fair market value were included. In the analysis, the gross rent for these projects was reduced to bring the contract rent for assisted units to fair market levels. The effects of this rent reduction on projects' financial health was assessed and a revised loan principal balance was computed based on a sustainable debt service level. A potential claim was calculated based on this reduction of loan principal.

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 the loans into cohorts and risk categories. Multifamily 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. The single family GI/SRI loans are grouped into four risk categories. HECM loans are considered a separate risk category. There are thirteen different multifamily risk categories.

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

Significant A ssumptions – FHA developed 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.

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

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

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 systems.

Economic assumptions: Forecasts of economic conditions used in conjunction with loan-level data to generate Single Family and Multifamily claim and prepayment rates were obtained from Global Insights (formerly DRI) 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.

Reliance on historical performance: FHA relies on the average historical performance of its insured portfolio to forecast future performance of that portfolio. Changes in legislation, subsidy programs, tax treatment and economic factors all influence loan performance. FHA assumes that its portfolio will continue to perform consistently with its historical experience given a set of forecasted economic conditions throughout the remaining life of existing mortgage guarantees, which can be as long as 40 years for Multifamily programs and affect loan performance accordingly.

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. These 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 the 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 maturity comparable to the term of each cash flow for the loan guarantee is used in the present value calculation. This 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 applied credit subsidy rates to each FHA loan guarantee program since fiscal year 1992. Over this time FHA's credit subsidy rates have varied. The variance is caused by three factors: (1) additional loan performance data underlying the credit subsidy rate estimates, (2) revisions to the calculation methodology used to estimate the credit subsidy rates, and (3) revisions on expected claims and prepayments derived from the revised Actuarial Review of the MMI Fund. Loan performance data, which reflect mortgage market performance and FHA policy direction, are added as they become available. Revisions to the estimation methodology result from legislative direction and technical enhancements.

FHA estimated the credit subsidy rates for the 2010 cohort in December 2008. At the time of budget submission, the rates reflected prevailing policy and loan performance assumptions based on the most recent information available at that time. The annual credit subsidy reestimates allow FHA to adjust the LLG and subsidy expense to reflect the most current and accurate credit subsidy rate.

Described below are the programs that comprise the majority of FHA's fiscal year 2010 business. These descriptions highlight the factors that contributed to changing credit subsidy rates and the credit subsidy reestimates. Overall, FHA's liability increased slightly from the fiscal year 2009 estimates.

Mutual Mortgage Insurance (MMI) – During fiscal year 2010, FHA experienced better than anticipated credit quality of borrowers and an improved house price appreciation forecast in the short term. Higher quality borrowers and a more optimistic short term house price appreciation forecast caused the liability for MMI to decrease from $28,456 million at the end of fiscal year 2009 to $26,035 million at the end of fiscal year 2010.

GI/SRI Home Equity Conversion Mortgage (HECM) - The HECM activity from fiscal years 1992-2008 remains in the GI/SRI fund. The HECM liability for these years increased from $4,753 million at the end of fiscal year 2009 to $8,692 million at the end of fiscal year 2010. The increase in the liability is primarily due to a less optimistic house price appreciation forecast for HECM properties in the long term and new estimates of current and future tax and insurance default cases. The HECM liability is driven more by long term house price appreciations forecasts than short term forecasts. The drop in the long term forecast results in lower recoveries from future HECM assigned assets and the new estimates of current and future tax and insurance default cases increases the unpaid balance of these loans which increases the liability.

GI/SRI Section 221(d)(4) - The Section 221(d)(4) program was established to provide mortgage insurance for the construction or substantial rehabilitation of Multifamily rental properties with five or more units. Under this program, HUD may insure up to 90 percent of the total project cost and is prohibited from insuring loans with HUD-subsidized interest rates. The Section 221(d)(4) program is the largest Multifamily program in the GI/SRI fund. The Section 221(d)(4) liability decreased by $19 million in FY 2010.

Mark-to-Market - The Mark-to-Market (M2M) program was established by legislation to assess rents at the time of Section 8 Assistance contract renewal. If rents are above market levels, the project is referred to OAHP. OAHP then evaluates the project for potential financial restructuring to determine if the project could survive given the lower revenues from reduced rents. The pool of loans eligible for M2M restructuring is comprised of active insured loans with Section 8 Assistance contracts, which also meet all eligibility requirements such as financial statements submitted within the last 2 years and assistance contracts expiring within the next 5 years. While new Section 8 assistance contracts are not being offered to any properties, which reduces the number of active insured loans with section 8 contracts, the number of projects that meet M2M eligibility criteria may actually increase from year to year. A loan can fail one or more of the eligibility criteria one year but become eligible the following year. During fiscal year 2010, the M2M liability decreased primarily due to the new assumption that only fifty percent of Mark-to-Market eligible projects would enter the program which decreased the forecasted amount of loans in the program.

GI/SRI Section 234(c) - The Section 234(c) program insures loans for condominium purchases. Like HECM, the activity from fiscal year 1992-2008 remains in the GI/SRI fund. One of the many purposes of FHA's mortgage insurance programs is to encourage lenders to make affordable mortgage credit available for non-conventional forms of ownership. Condominium ownership, in which the separate owners of the individual units jointly own the development's common areas and facilities, is one particularly popular alternative. Like the MMI single family program, in fiscal year 2010 the Section 234(c) had lower claim rates due to the higher quality of borrowers, which resulted in decreased claims and an improved house price appreciation forecast for future years that resulted in higher proceeds from the sale of foreclosed properties. This resulted in a decrease in the liability from $694 million at the end of fiscal year 2009 to $467 million at the end of fiscal year 2010 in the GI/SRI fund.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2010 and 2009:

(Dollars in Millions)

	FY 2010		FY 2009	
Intragovernmental:				
Advances to HUD for Working Capital Fund Expenses	$	5	$	16
Total	**$**	**5**	**$**	**16**
With the Public:				
Escrow Monies Deposited at Minority-Owned Banks	$	70	$	92
Deposits in Transit		6		37
Total	**$**	**76**	**$**	**129**

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, 2010 and 2009 are as follows:

(Dollars in Millions)

	FY 2010	FY 2009
With the Public:		
Claims Payable	$ 351	$ 331
Premium Refunds	143	173
Single Family Property Disposition Payable	128	105
Miscellaneous Payables	25	30
Total	**$ 647**	**$ 639**

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, 2010 and 2009:

(Dollars in Millions)	FY 2009			FY 2010	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt:					
Debentures Issued to Claimants	$ 52	$ (38)	$ 14	$ (4)	$ 10
Other Debt:					
Borrowings from U.S. Treasury	4,832	(412)	4,420	329	4,749
Total	**$ 4,884**	**$ (450)**	**$ 4,434**	**$ 325**	**$ 4,759**

	FY 2010	FY 2009
Classification of Debt:		
Intragovernmental Debt	$ 4,749	$ 4,420
Debt held by the Public	10	14
Total	**$ 4,759**	**$ 4,434**

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 2010 and 4.00 percent to 10.375 percent in fiscal year 2009. 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 in fiscal year 2010 and $14 million in fiscal year 2009. The fair values for fiscal years 2010 and 2009 were $21 and $15 million, respectively.

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 2010, FHA’s U.S. Treasury borrowings carried interest rates ranging from 1.68 percent to 7.59 percent. In fiscal year 2009, they carried interest rates ranged from 3.71 percent to 7.34 percent. The maturity dates for these borrowings occur from September 2017 – September 2029. 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, 2010 and 2009:

(Dollars in Millions)

FY 2010		Current
Intragovernmental:		
Receipt Account Liability	$	1,165
Total	**$**	**1,165**
With the Public:		
Trust and Deposit Liabilities	$	120
Disbursements in Transit		74
Miscellaneous Liabilities		233
Total	**$**	**427**

FY 2009		Current
Intragovernmental:		
Receipt Account Liability	$	1,913
Total	**$**	**1,913**
With the Public:		
Trust and Deposit Liabilities	$	116
Disbursements in Transit		64
Miscellaneous Liabilities		236
Total	**$**	**416**

Special Receipt Account Liability

The special receipt account liability is created from negative subsidy endorsements and downward credit subsidy in the GI/SRI special 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.

Miscellaneous Liabilities

Miscellaneous liabilities mainly include unearned revenue generated from Multifamily notes. It also 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, 2010. As a result, no contingent liability has been recorded.

Pending Litigation Against FHA

(Dollars in Millions)

	FY 2010	**FY 2009**
Expected Outcome	Estimated Loss	Estimated Loss
Probable	-	-
Reasonably Possible	-	$23
Remote	-	-

Note 12. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2010 and 2009 are as follows:

(Dollars in Millions)	FY 2010			FY 2009		
	MMI/CMHI	GI/SRI	H4H	MMI/CMHI	GI/SRI	H4H
Intragovernmental:						
Interest Expense	$ 140	$ 144	$ -	$ 160	$ 123	$ -
Imputed Costs	19	-	-	7	8	-
Other Expenses	1	-	2	-	-	5
Total	**$ 160**	**$ 144**	**$ 2**	**$ 167**	**$ 131**	**$ 5**
With the Public:						
Salary and Administrative Expenses	$ 542	$ 30	$ 7	$ 275	$ 294	$ 11
Subsidy Expense	(4,812)	2,762	3	6,347	2,987	1
Interest Expense	595	695	-	1,568	294	-
Interest Accumulation Expense	1,076	268	-	830	269	-
Bad Debt Expense	(7)	(342)	-	(7)	1,438	-
Loan Loss Reserve Expense	(4)	(79)	-	(5)	(44)	-
Other Expenses	67	25	-	64	64	-
Total	**$ (2,543)**	**$ 3,359**	**$ 10**	**$ 9,072**	**$ 5,302**	**$ 12**

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 by SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards,* 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, 2010 and 2009 are as follows:

(Dollars in Millions)	FY 2010		FY 2009	
	MMI/CMHI	**GI/SRI**	**MMI/CMHI**	**GI/SRI**
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 1,215	$ 412	$ 990	$ 392
Interest Revenue from MMI/CMHI Investments	366	-	633	-
Gain on Sale of MMI/CMHI Investments	554	-	133	-
	$ 2,135	**$ 412**	**$ 1,756**	**$ 392**
With the Public:				
Insurance Premium Revenue	$ 28	$ 16	$ 16	$ 20
Income from Notes and Properties	35	54	31	31
Other Revenue	-	-	-	20
Total	**$ 63**	**$ 70**	**$ 47**	**$ 71**

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 liquidating accounts 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 2010 were:

	Upfront Premium Rates
Single Family	1.75%, 2.25% (As of April 5th)
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%
HECM	2.00% (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 2010 were:

	Annual Periodic Premium Rates
Single Family	0.50% or 0.55%
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%
HECM	0.50%

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 2010, 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, 2010 and 2009 are as follows:

(Dollars in Millions)

FY 2010

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

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

FY 2009

Budgetary Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (347)	$ (86)	$ (433)
HUD	-	(59)	(59)
Total	**$ (347)**	**$ (145)**	**$ (492)**

Other Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (1,730)	$ -	$ (1,730)
HUD	470	-	470
Total	**$ (1,260)**	**$ -**	**$ (1,260)**

Transfers Out to U.S. Treasury

Transfers out to U.S. Treasury consists of negative subsidy from new endorsements, modifications and downward credit subsidy reestimates in the GI/SRI general fund receipt account, and the prior year unobligated balance of budgetary resources in the GI/SRI liquidating 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, 2010 and 2009 are as follows:

(Dollars in Millions)

FY 2010	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**
FY 2009						
Positive Subsidy	$ 15	$ 470	$ -	$ (7)	$ -	$ 478
Working Capital and Contract Expenses	310	195	(59)	(115)	(59)	272
Reestimates	-	6,793	-	(6,793)	-	-
GI/SRI Liquidating	86	96	-	(14)	(86)	82
Total	**$ 411**	**$ 7,554**	**$ (59)**	**$ (6,929)**	**$ (145)**	**$ 832**

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; the year-end unobligated balance in the GI/SRI liquidating account is returned to the U.S. Treasury; 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 2009 have been reconciled to the fiscal year 2009 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 2010 Statement of Budgetary Resources will be presented in the fiscal year 2012 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2012 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2010 and 2009 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders		**FY 2010**		**FY 2009**
MMI/CMHI	$	1,139	$	638
GI/SRI		454		475
H4H		1		1
Undelivered Orders Subtotal	**$**	**1,594**	**$**	**1,114**
Accounts Payable				
MMI/CMHI	$	719	$	857
GI/SRI		350		333
Accounts Payable Subtotal	**$**	**1,069**	**$**	**1,190**
Unpaid Obligations Total	**$**	**2,663**	**$**	**2,304**

Note 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2010 and 2009:

(Dollars in Millions)

FY 2010	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**

(Dollars in Millions)

FY 2009	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 8,084	$ 664	$ -	$ 8,748
Notes	9	378	-	387
Property	3,418	180	-	3,598
Interest Earned from U.S Treasury	2,008	392	-	2,400
Subsidy	926	13	1	940
Reestimates	10,491	6,793	-	17,284
Other	44	195	-	239
Total	**$ 24,980**	**$ 8,615**	**$ 1**	**$ 33,596**

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, 2010 and 2009:

(Dollars in Millions)

FY 2010	MMI/CMHI	EI	Total
Transfers:			
Working Capital and Contract Expenses	$ (71)	$ (1)	$ (72)
Total	**$ (71)**	**$ (1)**	**$ (72)**

(Dollars in Millions)

FY 2009	MMI/CMHI	EI	Total
Transfers:			
Working Capital and Contract Expenses	$ (58)	$ -	$ (58)
Total	**$ (58)**	**$ -**	**$ (58)**

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2010 and 2009:

(Dollars in Millions)

FY 2010	MMI/CMHI	GI/SRI	H4H	Total
Obligations:				
Claims	$ 14,017	$ 2,007	$ -	$ 16,024
Single Family Property Management Contracts	808	21	-	829
Contract Obligations	112	6	-	118
Subsidy	2,651	521	3	3,175
Downward Reestimates	26	164	-	190
Upward Reestimates	9,868	863	-	10,731
Interest on Borrowings	139	151	-	290
Other	257	150	2	409
Total	**$ 27,878**	**$ 3,883**	**$ 5**	**$ 31,766**

(Dollars in Millions)

FY 2009	MMI/CMHI	GI/SRI	H4H	Total
Obligations:				
Claims	$ 8,780	$ 1,685	$ -	$ 10,465
Single Family Property Management Contracts	166	7	-	173
Contract Obligations	73	52	5	130
Subsidy	926	205	1	1,132
Downward Reestimates	108	19	-	127
Upward Reestimates	10,384	6,793	-	17,177
Interest on Borrowings	160	125	-	285
Other	50	156	-	206
Total	**$ 20,647**	**$ 9,042**	**$ 6**	**$ 29,695**

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, 2010 and 2009:

(Dollars in Millions)	FY 2010	FY 2009
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred	$ 31,766	$ 29,695
Spending Authority from Offsetting Collections and Recoveries	(32,217)	(33,481)
Offsetting Receipts	(619)	(183)
Transfers In / Out	1,504	(1,260)
Imputed Financing from Costs Absorbed by Others	19	15
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ 453**	**$ (5,214)**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS		
Undelivered Orders and Adjustments	$ (468)	$ 209
Revenue and Other Resources	30,073	31,343
Purchase of Assets	(21,497)	(10,903)
Appropriation for prior year Re-estimate	(10,731)	(17,176)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$ (2,623)**	**$ 3,473**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ (2,170)**	**$ (1,741)**
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	$ 8,183	$ 14,054
Downward Re-estimate of Credit Subsidy Expense	(5,865)	(1,784)
Changes in Loan Loss Reserve Expense	(83)	(49)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	(349)	1,431
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(3,100)	(1,084)
Gains or Losses on Sales of Credit Program Assets	46	73
Other	1,790	1,523
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ 622**	**$ 14,164**
NET COST (SURPLUS) OF OPERATIONS	**$ (1,548)**	**$ 12,423**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows on September 30, 2010 and 2009:

(Dollars in Millions) Agency		Fund Balance with U.S. Treasury		Investments in U.S. Treasury Securities		Other Assets
FY 2010						
U.S. Treasury	$	39,078	$	4,150	$	-
HUD		-		-		5
Total	**$**	**39,078**	**$**	**4,150**	**$**	**5**
FY 2009						
U.S. Treasury	$	30,130	$	10,635	$	-
HUD		-		-		16
Total	**$**	**30,130**	**$**	**10,635**	**$**	**16**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2010 and 2009:

(Dollars in Millions) Agency		Borrowings from U.S. Treasury		Other Liabilities
FY 2010				
U.S. Treasury	$	4,749	$	1,165
Total	**$**	**4,749**	**$**	**1,165**
FY 2009				
U.S. Treasury	$	4,420	$	1,913
Total	**$**	**4,420**	**$**	**1,913**

Required Supplementary Information

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

(Dollars in Millions)

	MMI/CMHI	GI/SRI	Other	Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$ 30,622	$ 7,113	$ 465	$ 38,200
Recoveries of Prior Year Obligations	98	30	-	128
Budget Authority:				
Appropriations received	189	979	70	1,238
Borrowing Authority	1	799	-	800
Spending Authority from Offsetting Collections:				
Earned				
Collected	29,160	2,982	13	32,155
Receivable from Federal Sources	(64)	(1)	-	(65)
Unfilled Customer Orders	-	(1)	-	(1)
Net Transfers	(71)	-	(1)	(72)
Permanently Not Available	(285)	(426)	-	(711)
TOTAL BUDGETARY RESOURCES	**$ 59,650**	**$ 11,475**	**$ 547**	**71,672**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 27,878	$ 3,883	$ 5	$ 31,766
Unobligated Balance-Apportioned	4,021	173	383	4,577
Unobligated Balance Not Available	27,751	7,419	159	35,329
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 59,650**	**$ 11,475**	**$ 547**	**71,672**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$ 1,498	$ 805	$ 1	$ 2,304
Receivable from Federal Sources Carried Forward	(86)	(3)	-	(89)
Obligations Incurred	27,878	3,883	5	31,766
Gross Outlays	(27,419)	(3,855)	(5)	(31,279)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations	(98)	(30)	-	(128)
Change in Receivable from Federal Sources	63	2	-	65
Obligated Balance, Net, End of Period:				
Unpaid Obligations	1,859	803	1	2,663
Receivable from Federal Sources	(23)	(1)	-	(24)
Outlays:				
Disbursements	$ 27,419	$ 3,855	$ 5	$ 31,279
Collections	(29,160)	(2,982)	(13)	(32,155)
Subtotal	(1,741)	873	(8)	(876)
Less: Offsetting Receipts	-	619	-	619
NET OUTLAYS	**$ (1,741)**	**$ 254**	**$ (8)**	**$ (1,495)**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program
September 30, 2009:

(Dollars in Millions)

	MMI/CMHI	GI/SRI	Other	Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$ 26,833	$ 853	$ 9	$ 27,695
Recoveries of Prior Year Obligations	17	19	-	36
Budget Authority:				
Appropriations received	146	6,947	461	7,554
Borrowing Authority	85	385	-	470
Spending Authority from Offsetting Collections:				
Earned				
Collected	24,980	8,615	1	33,596
Receivable from Federal Sources	(147)	(4)	-	(151)
Unfilled Customer Orders	-	-	-	-
Net Transfers	(58)	-	-	(58)
Permanently Not Available	(586)	(661)	-	(1,247)
TOTAL BUDGETARY RESOURCES	**$ 51,270**	**$ 16,154**	**$ 471**	**$ 67,895**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 20,647	$ 9,042	$ 6	$ 29,695
Unobligated Balance-Apportioned	5,644	341	465	6,450
Unobligated Balance Not Available	24,979	6,771	-	31,750
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 51,270**	**$ 16,154**	**$ 471**	**$ 67,895**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$ 1,589	$ 870	$ -	$ 2,459
Receivable from Federal Sources Carried Forward	(234)	(6)	-	(240)
Obligations Incurred	20,647	9,042	6	29,695
Gross Outlays	(20,721)	(9,088)	(5)	(29,814)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations	(17)	(19)	-	(36)
Change in Receivable from Federal Sources	147	4	-	151
Obligated Balance, Net, End of Period:				
Unpaid Obligations	1,498	805	1	2,304
Receivable from Federal Sources	(87)	(2)	-	(89)
Outlays:				
Disbursements	$ 20,721	$ 9,088	$ 5	$ 29,814
Collections	(24,980)	(8,615)	(1)	(33,596)
Subtotal	(4,259)	473	4	(3,782)
Less: Offsetting Receipts	-	183	-	183
NET OUTLAYS	**$ (4,259)**	**$ 290**	**$ 4**	**$ (3,965)**

Required Supplementary Information

Schedule D : C omparative C ombining Budgetary R esources b y A ppropriation for the MMI/CMHI Program
September 30, 2010:

(Dollars in Millions)

	Program	Liquidating	Financing	Capital Reserve	MMI/CMHI Total
BUDGETARY RESOURCES					
Unobligated Balance Carried Forward					
Beginning of period	$ 48	$ 30	$ 19,940	$ 10,604	$ 30,622
Recoveries of Prior Year Obligations	6	30	62	-	98
Budget Authority:					
Appropriations received	189	-	-	-	189
Borrowing Authority	-	-	1	-	1
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	20	25,440	3,700	29,160
Receivable from Federal Sources	-	-	(2)	(62)	(64)
Unfilled Customer Orders	-	-	-	-	-
Net Transfers	9,796	-	-	(9,867)	(71)
Permanently Not Available	(25)	-	(260)	-	(285)
TOTAL BUDGETARY RESOURCES	**$ 10,014**	**$ 80**	**$ 45,181**	**$ 4,375**	**$ 59,650**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 9,979	$ 44	$ 17,855	$ -	$ 27,878
Unobligated Balance-Apportioned	5	13	4,003	-	4,021
Unobligated Balance Not Available	30	23	23,323	4,375	27,751
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 10,014**	**$ 80**	**$ 45,181**	**$ 4,375**	**$ 59,650**
CHANGE IN OBLIGATED BALANCES					
Obligated Balance, Net, Beginning of Period:					
Unpaid Obligations Carried Forward	$ 88	$ 200	$ 1,210	$ -	$ 1,498
Receivable from Federal Sources Carried Forward	-	-	(2)	(84)	(86)
Obligations Incurred	9,979	44	17,855	-	27,878
Gross Outlays	(9,929)	(45)	(17,445)	-	(27,419)
Obligated Balance Transfers, Net:					
Recoveries of Prior Year Obligations	(6)	(30)	(62)	-	(98)
Change in Receivable from Federal Sources	-	-	2	61	63
Obligated Balance, Net, End of Period:					
Unpaid Obligations	132	169	1,558	-	1,859
Receivable from Federal Sources	-	-	-	(23)	(23)
Outlays:					
Disbursements	$ 9,929	$ 45	$ 17,445	$ -	$ 27,419
Collections	-	(20)	(25,440)	(3,700)	(29,160)
Subtotal	9,929	25	(7,995)	(3,700)	(1,741)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 9,929**	**$ 25**	**$ (7,995)**	**$ (3,700)**	**$ (1,741)**

Required Supplementary Information

Schedule D : Comparative Combining Budgetary Resources by Appropriation for the MMI /CMHI Program
September 30, 2009:

(Dollars in Millions)

	Program	Liquidating	Financing	Capital Reserve	MMI/CMHI Total
BUDGETARY RESOURCES					
Unobligated Balance Carried Forward					
Beginning of period	$ 48	$ 50	$ 7,651	$ 19,084	$ 26,833
Recoveries of Prior Year Obligations	9	-	8	-	17
Budget Authority:					
Appropriations received	146	-	-	-	146
Borrowing Authority	-	-	85	-	85
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	15	22,914	2,051	24,980
Receivable from Federal Sources	-	-	-	(147)	(147)
Unfilled Customer Orders	-	-	-	-	-
Net Transfers	10,326	-	-	(10,384)	(58)
Permanently Not Available	(23)	-	(563)	-	(586)
TOTAL BUDGETARY RESOURCES	**$ 10,506**	**$ 65**	**$ 30,095**	**$ 10,604**	**$ 51,270**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 10,456	$ 35	$ 10,156	$ -	$ 20,647
Unobligated Balance-Apportioned	16	19	5,609	-	5,644
Unobligated Balance Not Available	34	11	14,330	10,604	24,979
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 10,506**	**$ 65**	**$ 30,095**	**$ 10,604**	**$ 51,270**
CHANGE IN OBLIGATED BALANCES					
Obligated Balance, Net, Beginning of Period:					
Unpaid Obligations Carried Forward	$ 66	$ 205	$ 1,318	$ -	$ 1,589
Receivable from Federal Sources Carried Forward	-	-	(2)	(232)	(234)
Obligations Incurred	10,456	35	10,156	-	20,647
Gross Outlays	(10,425)	(40)	(10,256)	-	(20,721)
Obligated Balance Transfers, Net:	-	-	-	-	-
Recoveries of Prior Year Obligations	(9)	-	(8)	-	(17)
Change in Receivable from Federal Sources	-	-	-	147	147
Obligated Balance, Net, End of Period:	-	-	-	-	-
Unpaid Obligations	88	200	1,210	-	1,498
Receivable from Federal Sources	-	-	(2)	(85)	(87)
Outlays:	-	-	-	-	-
Disbursements	$ 10,425	$ 40	$ 10,256	$ -	$ 20,721
Collections	-	(15)	(22,914)	(2,051)	(24,980)
Subtotal	10,425	25	(12,658)	(2,051)	(4,259)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 10,425**	**$ 25**	**$ (12,658)**	**$ (2,051)**	**$ (4,259)**

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program
September 30, 2010:

(Dollars in Millions)

	Program		Liquidating		Financing		GI/SRI Total
BUDGETARY RESOURCES							
Unobligated Balance Carried Forward							
Beginning of period	$	67	$	187	$	6,859	$ 7,113
Recoveries of Prior Year Obligations		19		3		8	30
Budget Authority:							
Appropriations received		871		101		7	979
Borrowing Authority		-		10		789	799
Spending Authority from Offsetting Collections:							
Earned							
Collected		-		241		2,741	2,982
Receivable from Federal Sources		-		-		(1)	(1)
Unfilled Customer Orders		-		-		(1)	(1)
Net Transfers		-		-		-	-
Permanently Not Available		(23)		(214)		(189)	(426)
TOTAL BUDGETARY RESOURCES	**$**	**934**	**$**	**328**	**$**	**10,213**	**$ 11,475**
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred	$	877	$	112	$	2,894	$ 3,883
Unobligated Balance-Apportioned		9		107		57	173
Unobligated Balance Not Available		48		109		7,262	7,419
TOTAL STATUS OF BUDGETARY RESOURCES	**$**	**934**	**$**	**328**	**$**	**10,213**	**$ 11,475**
CHANGE IN OBLIGATED BALANCES							
Obligated Balance, Net, Beginning of Period:							
Unpaid Obligations Carried Forward	$	82	$	470	$	253	$ 805
Receivable from Federal Sources Carried Forward		-		(1)		(2)	(3)
Obligations Incurred		877		112		2,894	3,883
Gross Outlays		(913)		(136)		(2,806)	(3,855)
Obligated Balance Transfers, Net:							
Recoveries of Prior Year Obligations		(19)		(3)		(8)	(30)
Change in Receivable from Federal Sources		-		-		2	2
Obligated Balance, Net, End of Period:							
Unpaid Obligations		27		443		333	803
Receivable from Federal Sources		-		(1)		-	(1)
Outlays:							
Disbursements	$	913	$	136	$	2,806	$ 3,855
Collections		-		(241)		(2,741)	(2,982)
Subtotal		913		(105)		65	873
Less: Offsetting Receipts		-		-		-	619
NET OUTLAYS	**$**	**913**	**$**	**(105)**	**$**	**65**	**$ 254**

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program
September 30, 2009:

(Dollars in Millions)

		Program		Liquidating		Financing		GI/SRI Total
BUDGETARY RESOURCES								
Unobligated Balance Carried Forward								
Beginning of period	$	88	$	269	$	496	$	853
Recoveries of Prior Year Obligations		8		8		3		19
Budget Authority:		-		-		-		-
Appropriations received		6,850		97		-		6,947
Borrowing Authority		-		-		385		385
Spending Authority from Offsetting Collections:		-		-		-		-
Earned		-		-		-		-
Collected		-		298		8,317		8,615
Receivable from Federal Sources		-		(5)		1		(4)
Unfilled Customer Orders		-		-		-		-
Net Transfers		-		-		-		-
Permanently Not Available		(36)		(305)		(320)		(661)
TOTAL BUDGETARY RESOURCES	**$**	**6,910**	**$**	**362**	**$**	**8,882**	**$**	**16,154**
STATUS OF BUDGETARY RESOURCES								
Obligations Incurred	$	6,843	$	175	$	2,024	$	9,042
Unobligated Balance-Apportioned		20		56		265		341
Unobligated Balance Not Available		47		131		6,593		6,771
TOTAL STATUS OF BUDGETARY RESOURCES	**$**	**6,910**	**$**	**362**	**$**	**8,882**	**$**	**16,154**
CHANGE IN OBLIGATED BALANCES								
Obligated Balance, Net, Beginning of Period:								
Unpaid Obligations Carried Forward	$	98	$	494	$	278	$	870
Receivable from Federal Sources Carried Forward		-		(5)		(1)		(6)
Obligations Incurred		6,843		175		2,024		9,042
Gross Outlays		(6,851)		(191)		(2,046)		(9,088)
Obligated Balance Transfers, Net:		-		-		-		-
Recoveries of Prior Year Obligations		(8)		(8)		(3)		(19)
Change in Receivable from Federal Sources		-		5		(1)		4
Obligated Balance, Net, End of Period:		-		-		-		-
Unpaid Obligations		82		470		253		805
Receivable from Federal Sources		-		-		(2)		(2)
Outlays:		-		-		-		-
Disbursements	$	6,851	$	191	$	2,046	$	9,088
Collections		-		(298)		(8,317)		(8,615)
Subtotal		6,851		(107)		(6,271)		473
Less: Offsetting Receipts		-		-		-		183
NET OUTLAYS	**$**	**6,851**	**$**	**(107)**	**$**	**(6,271)**	**$**	**290**

Required Supplementary Information

Schedule F: Comparative Combining Budgetary Resources by Appropriation for the H4H Program
September 30, 2010:

(Dollars in Millions)

	Program	Financing	H4H Total
BUDGETARY RESOURCES			
Unobligated Balance Carried Forward			
Beginning of period	$ 464	$ 1	$ 465
Recoveries of Prior Year Obligations	-	-	-
Budget Authority:			
Appropriations received	-	-	-
Borrowing Authority	-	-	-
Spending Authority from Offsetting Collections:			
Earned			
Collected	9	4	13
Receivable from Federal Sources	-	-	-
Unfilled Customer Orders	-	-	-
Anticipated for rest of year	-	-	-
Net Transfers	-	-	-
Permanently Not Available	-	-	-
TOTAL BUDGETARY RESOURCES	**$ 473**	**$ 5**	**$ 478**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 5	$ -	$ 5
Unobligated Balance-Apportioned	309	5	314
Unobligated Balance Not Available	159	-	159
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 473**	**$ 5**	**$ 478**
CHANGE IN OBLIGATED BALANCES			
Obligated Balance, Net, Beginning of Period:			
Unpaid Obligations Carried Forward	$ 1	$ -	$ 1
Receivable from Federal Sources Carried Forward	-	-	-
Obligations Incurred	5	-	5
Gross Outlays	(5)	-	(5)
Obligated Balance Transfers, Net:			
Recoveries of Prior Year Obligations	-	-	-
Change in Receivable from Federal Sources	-	-	-
Obligated Balance, Net, End of Period:			
Unpaid Obligations	1	-	1
Receivable from Federal Sources	-	-	-
Outlays:			
Disbursements	$ 5	$ -	$ 5
Collections	(9)	(4)	(13)
Subtotal	(4)	(4)	(8)
Less: Offsetting Receipts	-	-	-
NET OUTLAYS	**$ (4)**	**$ (4)**	**$ (8)**

Required Supplementary Information

Schedule F: Comparative Combining Budgetary Resources by Appropriation for the H4H Program
September 30, 2009:

(Dollars in Millions)

	Program	Financing	H4H Total
BUDGETARY RESOURCES			
Unobligated Balance Carried Forward			
Beginning of period	$ 9	$ -	$ 9
Recoveries of Prior Year Obligations	-	-	-
Budget Authority:			
Appropriations received	461	-	461
Borrowing Authority	-	-	-
Spending Authority from Offsetting Collections:			
Earned			
Collected	-	1	1
Receivable from Federal Sources	-	-	-
Unfilled Customer Orders	-	-	-
Anticipated for rest of year	-	-	-
Net Transfers	-	-	-
Permanently Not Available	-	-	-
TOTAL BUDGETARY RESOURCES	**$ 470**	**$ 1**	**$ 471**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 6	$ -	$ 6
Unobligated Balance-Apportioned	464	1	465
Unobligated Balance Not Available	-	-	-
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 470**	**$ 1**	**$ 471**
CHANGE IN OBLIGATED BALANCES			
Obligated Balance, Net, Beginning of Period:			
Unpaid Obligations Carried Forward	$ -	$ -	$ -
Receivable from Federal Sources Carried Forward	-	-	-
Obligations Incurred	6	-	6
Gross Outlays	(5)	-	(5)
Obligated Balance Transfers, Net:			
Recoveries of Prior Year Obligations	-	-	-
Change in Receivable from Federal Sources	-	-	-
Obligated Balance, Net, End of Period:			
Unpaid Obligations	1	-	1
Receivable from Federal Sources	-	-	-
Outlays:			
Disbursements	$ 5	$ -	$ 5
Collections	-	(1)	(1)
Subtotal	5	(1)	4
Less: Offsetting Receipts	-	-	-
NET OUTLAYS	**$ 5**	**$ (1)**	**$ 4**

Required Supplementary Information

Schedule G: Comparative Combining Budgetary Resources by Appropriation for the Energy Innovation Program and the Transformation Initiative Program

September 30, 2010:

(Dollars in Millions)

	EI Total	TI Total
BUDGETARY RESOURCES		
Unobligated Balance Carried Forward		
Beginning of period	$ -	$ -
Recoveries of Prior Year Obligations	-	-
Budget Authority:		
Appropriations received	50	20
Borrowing Authority	-	-
Spending Authority from Offsetting Collections:		
Earned		
Collected	-	-
Receivable from Federal Sources	-	-
Unfilled Customer Orders	-	-
Anticipated for rest of year	-	-
Net Transfers	(1)	-
Permanently Not Available	-	-
TOTAL BUDGETARY RESOURCES	**$ 49**	**$ 20**
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred	-	-
Unobligated Balance-Apportioned	49	-
Unobligated Balance Not Available	-	20
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 49**	**$ 20**
CHANGE IN OBLIGATED BALANCES		
Obligated Balance, Net, Beginning of Period:		
Unpaid Obligations Carried Forward	$ -	$ -
Receivable from Federal Sources Carried Forward	-	-
Obligations Incurred	-	-
Gross Outlays	-	-
Obligated Balance Transfers, Net:		
Recoveries of Prior Year Obligations	-	-
Change in Receivable from Federal Sources	-	-
Obligated Balance, Net, End of Period:		
Unpaid Obligations	-	-
Receivable from Federal Sources	-	-
Outlays:		
Disbursements	$ -	$ -
Collections	-	-
Subtotal	-	-
Less: Offsetting Receipts	-	-
NET OUTLAYS	**$ -**	**$ -**

AUDITOR'S REPORT

This report is a condensed version of a more detailed report issued separately in November 2010 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2010 and 2009" (2011-FO-0002). The report is available at HUD, OIG's internet site at http://www.hud.gov/offices/oig/reports/files/ig11f0002.pdf

audit report

Issue Date
November 5, 2010

Audit Case Number
2011-FO-0002

TO: David H. Stevens, Assistant Secretary for Housing-Federal Housing Commissioner, H

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

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2010 and 2009

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 (CG) to audit fiscal year 2010 financial statements of the Federal Housing Administration (FHA). FHA's financial statements as of and for the fiscal year ended September 30, 2009 were audited by Urbach Kahn & Werlin LLP, which was acquired by CG on March 22, 2010. The contract required that the audit be performed according to generally accepted government auditing standards (GAGAS).

CG is responsible for the attached Independent Auditor's Report dated November 3, 2010 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, regulations and government-wide policies. Within 30 days of this report, UKW expects to issue a separate letter to management dated November 3, 2010 regarding other less significant matters that came to its attention during the audit.

This report includes both the Independent Auditor's 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). The MD&A is not included in this report. FHA plans to separately publish an annual report for fiscal year 2010 that conforms to FASAB standards.

The report contains two significant deficiencies in FHA's internal controls and one reportable instance of noncompliance with laws and regulations. The report contains eight new recommendations. Within 120 days of the report issue date, FHA is required to provide its final management decision which included a corrective action plan for each recommendation. As part of the audit resolution process, we will record eight 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 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

Commissioner
Federal Housing Administration

We have audited the accompanying consolidated balance sheet of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2010 and the related consolidated statements of net cost, changes in net position, and the combined statement of budgetary resources (Principal Financial Statements) for the year then ended.

Summary

We concluded that FHA's Principal Financial Statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting resulted in the following matters being identified as significant deficiencies:

- Effective monitoring of modernization efforts and existing systems are necessary to mitigate near-term financial reporting risks
- Economic conditions and inherent model design increase risks to management's Liability for Loan Guarantee credit reform estimates

We identified one reportable instance of noncompliance with laws and regulations related to the capital requirements for the Mutual Mortgage Insurance Fund.

This report (including Appendices A through D) discusses: (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

In our opinion, the Principal Financial Statements referred to above present fairly, in all material respects, the financial position of FHA as of September 30, 2010, and its net cost, changes in net position, and combined budgetary resources for the year then ended, in conformity with accounting principles generally accepted in the United States of America. The financial statements of FHA as of and for the year ended September 30, 2009 were audited by Urbach Kahn & Werlin LLP, of which practice was acquired by Clifton Gunderson LLP (CG) by merger on March 22, 2010. Urbach Kahn & Werlin LLP's report dated November 9, 2009 expressed an unqualified opinion on those financial statements.

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, which integrate historical data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. Nearly 75% of the losses included in this reserve for the Mutual Mortgage Insurance (MMI) Fund are projected to be incurred in the next twenty four months and are based on the current volume of delinquent insured loans. Changes from the historical loss rates for these delinquent loans 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, 2010, this Capital Reserve account had $11.3 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

In planning and performing our audits, we considered FHA's internal control over financial reporting and compliance (internal control) as a basis for designing audit procedures that are appropriate in the circumstances and complying with Office of Management and Budget (OMB) audit guidance, but not for the purpose of expressing an opinion on the effectiveness of FHA's internal control. Accordingly, we do not express an opinion on FHA's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as described below, we identified deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency 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. 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 charge with governance. We noted two matters, summarized below and more fully described in Appendix A, involving the internal control and its operation that we consider to be significant deficiencies:

> Effective monitoring of modernization efforts and existing systems are necessary to mitigate near-term financial reporting risks
>
> FHA's current financial system is comprised of numerous aging information systems developed independently over the last thirty years and integrated with the general ledger through electronic interfaces. These systems will continue to require expensive maintenance and monitoring and are likely to pose increasing risks to the reliability of FHA's financial reporting and business operations until modernization efforts are completed. In FY2010, FHA initiated a multi-year systems modernization effort that will replace, as well as enhance, a number of critical FHA business systems and operational processes. Overall project plans have been developed but those plans will require additional detail as the project moves to its next phase. Furthermore, modernization project plans need to consider and incorporate the sustainability and scalability of the current systems until they are replaced.
>
> Economic conditions and inherent model design increase risks to management's Liability for Loan Guarantee credit reform estimates
>
> FHA's process for estimating the Liability for Loan Guarantee for single family programs uses assumptions developed through an annual independent actuarial study of the Mutual Mortgage Insurance fund. The econometric models developed for this study are significantly driven by historical claim payment patterns and numerous economic and portfolio variables. During FY2010, FHA and its independent actuary made significant improvements to the models. However, the current economic environment and the depressed housing market are causing changes in mortgage loan behavior that continue to strain the forecasting ability of the models. In the current extreme environment, the models do not have sufficient experience to confidently predict the effects of delays in foreclosures and claims, the increased use of FHA loss mitigation programs, and the risk of redefaults on mitigated loans.
>
> The design of the current models does not provide an effective way to communicate risks and the precision of the model estimates. The FHA financial statements may not effectively present the relative risks in management's estimates in this challenging economic environment.

Additional detail and the related recommendations for these findings are provided in Appendix A of this report.

Our consideration of internal control was for the limited purpose described in the first paragraph above and would not necessarily identify all significant deficiencies in internal control that are also considered to be material weaknesses. However, we believe neither of the significant deficiencies described above is a material weakness.

Compliance with Laws and Regulations

The results of our tests of compliance with laws, regulations and government-wide policies disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, as described below. Providing an opinion on compliance with laws and regulations and government-wide policies was not an objective of our audit and, accordingly, we do not express such an opinion.

> The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance Fund maintain a minimum level of capital sufficient to sustain a moderate recession. This capital requirement, called 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 insurance-in-force. The Act required FHA to maintain a minimum Capital Ratio of two percent and conduct an annual independent actuarial study to 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 such study, assess the financial status of the Fund, recommend adjustments and evaluate of the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the Fund. As of the date of our audit, this report had not yet been submitted, but FHA data indicated that this ratio remained below the required two percent through FY2010.

Supplementary Information

The information in the Management's Discussion and Analysis and Required Supplementary Information sections is not a required part of the Principal Financial Statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Management Responsibilities

Management is responsible for the information in the Annual Management Report, including the preparation of: 1) the Principal Financial Statements in conformity with accounting principles generally accepted in the United States of America, 2) Management's Discussion and Analysis (including the performance measures), and 3) Required Supplementary Information. Management is also responsible for 1) 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, 2) ensuring that FHA's financial management systems substantially comply with the Federal Financial Management Improvement Act of 1996 (FFMIA), and 3) complying with applicable laws, regulations and government-wide policies.

Objectives, Scope and Methodology

Our responsibility is to express an opinion on FHA's Principal Financial Statements based on our audit. We conducted our audit 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 Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In planning and performing our audit, we also obtained an understanding of FHA and its operations, including its internal control over financial reporting (including safeguarding of assets) and compliance with laws, regulations and government-wide policies (including execution of transactions in accordance with budget authority), determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to evaluate and report on internal control and determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04 and *Government Auditing Standards*, which include ensuring:

- Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Transactions are executed in accordance with (1) laws governing the use of budget authority, (2) other laws and regulations that could have a direct and material effect on the financial statements, and (3) any other laws, regulations, and government-wide policies identified by OMB audit guidance.

We did not test 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. Because of inherent limitations in internal control, misstatements due to error or fraud 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.

We are also responsible for testing compliance with selected provisions of laws, regulations and government-wide policies that have a direct and material effect on the financial statements. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2010. Compliance with FFMIA will be reported on by the HUD Office of Inspector General (OIG) in connection with their audit of the consolidated financial statements of HUD.

We limited our tests of compliance to the provisions described above and we did not test compliance with all laws and regulations applicable to FHA. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

FHA Comments and Our Evaluation

FHA management concurred with our findings and their related recommendations. The full text of FHA management's response is included in Appendix B. We did not perform audit procedures on FHA management's written response and accordingly, we express no opinion on it. Our assessment of FHA management's response is included in Appendix C. The current status of prior year findings and recommendations is included in Appendix D.

We also noted other less significant matters involving FHA's internal control and its operation, which we have reported to the management of FHA in a separate letter, dated November 3, 2010.

Distribution

This report is intended solely for the information and use of the HUD OIG, the management of HUD and FHA, OMB, GAO and the Congress of the United States, 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, 2010

Appendix A
Significant Deficiencies

In our report dated November 3, 2010, we described the results of our audit of the consolidated balance sheet of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2010, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources (Principal Financial Statements) for the year then ended. The objective of our audit was to express an opinion on these financial statements. In connection with our audit, we also considered FHA's internal control over financial reporting and tested FHA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements. The following sections present additional detail on the internal control matters discussed in that report.

Background

FHA's current financial system is comprised of numerous aging information systems developed independently over the last thirty years and integrated with the general ledger through electronic interfaces. Many of these systems are COBOL-based applications on either an IBM or Unisys mainframe. Substantially all of FHA's source transaction data is entered by and transmitted from lenders via electronic data interchange or web interfaces. Many of FHA's business systems are owned by the Office of Single Family Housing or the Office of Multifamily Housing and support both HUD and FHA program activities. Infrastructure and general support of FHA and HUD systems are provided by HUD's Office of the Chief Information Officer. When FHA's general ledger system, the FHA Subsidiary ledger (FHASL), was implemented in 2002, FHA planned to integrate new business applications as modules that would be on the same platform and language as FHASL. Due in part to FHA's declining single family mortgage loan market share and reduced IT systems development budgets during that period, few systems were replaced through 2008 and only two multifamily systems were replaced in FY2009. The subsequent housing crisis, several new housing program initiatives and the rebound in business volume illustrated the need for a comprehensive reassessment of FHA's business processes in addition to the need for a systems upgrade. The 2009 Office of Housing's IT Strategy and Improvement Plan served as the first entity-level systems risk assessment and provided the initial framework for the modernization effort currently underway. The Plan recommended 33 technology and architecture approaches and 25 specific initiatives, including replacement of several of FHA's largest and most key business systems. Critical objectives of the initiatives were to "improve fraud detection, improve risk management and loss mitigation, improve program operations and limit mission constraints related to dated technology".

Each initiative was reviewed, evaluated and prioritized based on established risk criteria. The efforts to address these system recommendations are expected to take several years and cost hundreds of millions of dollars.

1. Effective monitoring of modernization efforts and existing systems are necessary to mitigate near-term financial reporting risks

FHA's financial systems will continue to require expensive maintenance and monitoring and are likely to pose increasing risks to the reliability of FHA's financial reporting and business operations until current modernization efforts are completed. FHA needs to be diligent in its oversight of the modernization effort and ensure the project considers the evolving risks to the existing infrastructure during the transition.

By the end of FY2009, FHA had established a modernization project management office with a core leadership team. This team developed a modernization project plan and a concept of operations document, identified certain overarching needs and requirements, and awarded several contracts for system development risk assessment, requirements and design support services. They also issued a modernization risk management plan document that will be used to monitor systems development risks.

The modernization project plan is a high-level summary plan of numerous tasks to be completed across each of the major phases of the project. This can be a useful oversight tool for general project management and enables the project to be broken down into specific steps with critical dependencies and timelines identified.

The modernization project team also worked with the HUD Office of the Chief Information Officer to define the future computing environment within which the new systems will operate. They subsequently established that a modular, standard financial industry structure would be most practical given the current architecture and programmatic needs. They also completed a concept of operations plan and an OMB-required business case for the modernization project. Upon establishing this framework, the team developed an overarching risk management plan document which serves as a risk inventory that highlights potential delays or failures in the systems migration process.

In order to begin work on the most critical initiatives, FHA awarded several multi-million dollar blanket purchase contracts for system development risk assessment, requirements determination, and design support services. This will allow FHA to begin the needs definition and design phases on the fraud mitigation, business intelligence, and counterparty risk management initiatives. FHA is scheduled to complete their risk assessment documents related to these initiatives in FY2011.

The modernization project team also verbally highlighted several potential steps to upgrade key existing applications in the short term to ensure they continue to meet FHA's needs until the modernization efforts are fully implemented.

While FHA has made notable progress over the current year to get the modernization project started, the current overarching project plan will require more detail to define a fully-functioning governance structure for the overall project going forward.

The project's next phase will be more comprehensive and challenging. Given the magnitude of the recent contract awards, the personnel and financial resources dedicated to the modernization will increase dramatically in FY2011 and 2012. We believe that the existing documents (i.e. the overarching project plan, the risk management plan, and the initiative-level risk assessment) will require more detail to properly coordinate the many consultant teams throughout the next phase of the project.

In addition, management has not provided documentation covering the sustainability of the existing systems during the modernization project. Such sustainability plans are not integrated into the overall project plan or the modernization risk management plan to ensure that they receive the necessary resources and do not lose visibility during the modernization life cycle.

OMB Circular No. A-130, *Management of Federal Information Resources*, states in Section 8, Policy, that "Agencies must plan in an integrated manner for managing information throughout its life cycle. Agencies will:...(e)Integrate planning for information systems with plans for resource allocation and use, including budgeting, acquisition and use of information technology;…" It further states that "Agencies must establish and maintain a capital planning and investment control process that links mission needs, information, and information technology in an effective and efficient manner….The agency's capital planning and investment control process must build from the agency's Enterprise Architecture (EA) and its transition from current architecture to target architecture."

Recommendations

We recommend that the Chair, FHA Transformation:

1a. 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)

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)

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)

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)

***2*. Economic conditions and inherent model design increase risks to management's Liability for Loan Guarantee credit reform estimates**

The Cranston-Gonzales National Affordable Housing Act of 1990 requires HUD to conduct an independent annual evaluation of the economic value and capital ratio of the Mutual Mortgage Insurance (MMI) fund. FHA uses the actuarially calculated assumptions regarding future claims, prepayments and recoveries in its cash flow models to estimate the net present value of future cash flows that make up the Single Family Liability for Loan Guarantee.

FHA's current contracted actuary has been conducting this evaluation of the MMI fund since 2004 and over that time has integrated numerous enhancements to their actuarial model to more effectively account for key risk factors, changes in the macroeconomic environment, program policies and the composition of the portfolio. Some of these changes include:

- Inclusion of a credit score variable
- Consideration of the effect of seller-funded down payment assistance
- Increased loan limits
- Recognition of home price dispersion from regional averages
- Expansion of loss mitigation programs
- Incorporation of new policies and programs (e.g. Hope for Homeowners)
- Recognition of the changing geographic distribution of the portfolio
- Incorporation of an econometric recovery model
- Use of enhanced stress testing

In FY2009, we reported that the inherent structure of the actuarial model used by the actuary might understate near-term claim levels in the current challenging economic environment. We recommended that management:

- Incorporate Metropolitan Statistical Area (MSA)-level forecast data in the models.
- Analyze delinquency data, default causes, recoveries and other potential leading indicators to determine whether they would better predict near-term claim costs.
- Document their analyses and conclusions.

Through FY2010, FHA expanded their analysis of performance data and included this information in their HERA Quarterly Reports to Congress. The independent actuary's current year models incorporate MSA-level house price forecast data to better account for the wider dispersion of projected house price appreciation across the US. FHA also enhanced their analysis of streamlined refinanced loans to more accurately identify the original source loan, so the actuary could carry forward the original loan characteristics and more accurately estimate the borrower's current equity position. Also for FY2010, the actuary developed a delinquency "transition" model to better account for the recent delays in foreclosure processing and claim filings, and to better estimate the impact of the significant increases in volume and duration of delinquent loans that have not yet "developed" into claims. They also incorporated new premium rate structures for FY2011 and forward as enacted by Congress in late September 2010.

The dramatic shift in the mortgage market in response to the economic crisis and the resulting fundamental changes in loan behavior continue to strain the econometric functionality of the actuarial model. These fundamental behavioral and programmatic changes include:

- Projecting claim levels beyond all but the most extreme FHA program experience
- Making changes in the predominant cause of defaults
- Recognizing loans with negative equity positions in excess of 40%
- Increasing delays in the time to process foreclosures and related claim filings
- Increasing use of loss mitigation programs
- Excessively restrictive credit market
- Continuing protracted weakness in the housing market

Appendix A
Significant Deficiencies, Continued

In normal market environments, the actuarial models are now designed to reasonably forecast the insured mortgage claim liability. In the current extreme environment, the models do not have sufficient experience to predict the cash flow effects of delays in completing foreclosures and claims, the increased use of loss mitigation, and the potential for redefaults on mitigated loans.

We noted that the default transition model was calibrated with historical claim experience from the latest 20-year period, which did not include a period of prolonged economic downturn. Furthermore, we think that delays in processing foreclosures and claims may cause the default transition model to understate near-term forecasted claims. These delays may also affect the longer-term claim payment model results.

In FY2011 and beyond, management expects that a large number of the currently delinquent loans will take part in various FHA loss mitigation programs. FHA has not performed a comprehensive analysis of the risk of redefault on mitigated loans and the delinquency transition model does not identify a specific redefault risk. FHA also has not analyzed the impact of recent loss mitigation efforts on its overall future claim projections.

The independent actuary's report stated that consistent and reliable model results are based on the constancy of the relationships among the loan variables in the model. However, when a quantum change in the mortgage market occurs, these predictive relationships break down and the models may be slow to adapt to the changes. The independent actuary concluded that they did not see evidence that such a shift had occurred. However, we believe such a quantum change has occurred and that it potentially affects the predictiveness of the default transition model, future claim payment, and prepayment models for FY2011 and FY2012. We noted a number of counterintuitive model results that suggest that such a shift has occurred. Management's documentation of their review of the actuarial report did not include an analysis or explanation of these counterintuitive results.

FASAB Technical Release 6, Preparing Estimates for Direct Loans and Loan Guarantee Subsidies states, "The cash flow estimation process, including all underlying assumptions, should be reviewed and approved at the appropriate level including revisions and updates to the original model. Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance."

The design of the current model does not provide an effective way to communicate risks as well as the precision of the model estimates. The FHA financial statements may not effectively present the relative risks in management's estimates in this challenging economic environment.

Recommendations

We recommend that FHA's Deputy Assistant Secretary for Finance and Budget and Deputy Assistant Secretary for Risk Management and Regulatory Affairs:

Appendix A
Significant Deficiencies, Continued

2a. Document their specific review and acceptance of the key assumptions, including key variables, in conjunction with their acceptance of the actuarial study. (New)

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)

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 anticipated variable relationships will continue. (New)

2d. Analyze the risk of redefaults and claims on loans that have undergone loss mitigation. (New)

2e. Investigate potential enhancements to the actuarial model to better communicate the precision of its estimates. (New)

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)

Appendix B
Management's Response

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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

OCT 29 2010

MEMORANDUM FOR: Clifton Gunderson LLP

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

SUBJECT: Response to Fiscal Year 2010 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 the last year. FHA will continue to address the concerns identified.

Report on Internal Controls – Significant Deficiencies

1. Effective monitoring of modernization efforts and existing systems are necessary to mitigate near-term financial reporting risks

FHA concurs with the recommendations identified.

2. Economic conditions and inherent model design increase risks to management estimates.

FHA concurs with the recommendations identified.

With regards to recommendation 2a, FHA will document the specific review and acceptance of the key assumptions, including key variables, starting with the FY 2011 actuarial study.

With regards to recommendation 2b, FHA agrees to document the due-diligence procedures it undertakes with the model outputs provided by the actuarial contractor, and to provide a written summary to the auditors. Such summary will also include any changes made by the contractor as a result of this due-diligence work. The written summary will be provided to the auditors around the time of delivery of the draft actuarial review. Any findings after that date will be incorporated into a final summary document to be delivered around the time of delivery of the final actuarial review.

www.hud.gov espanol.hud.gov

With regards to recommendation 2c, FHA will research and report on whether the FY 2010 actuarial study model on default-to-claim transitions by large negative coefficients for defaults during the "Subprime market expansion" and "Housing Crisis" years appear to represent delays in foreclosures or are the result of more intensive loss mitigation activities.

Regarding recommendation 2d, FHA will provide documented research on re-default and claim rates on loss-mitigation assisted cures.

Relating to recommendation 2e, FHA began this in FY2010 by having the actuarial contractors run all of the alternative economic scenarios produced by Moody's Analytics. The forward-loan contractor used this to provide an assessment of the probability that the economic value of the MMI Fund could be zero or less (40%). FHA is planning on requiring that the next generation actuarial contract model (FY2011) be capable of Monte Carlo simulations of fund value. That capacity will be used to explore VaR metrics and to provide for the probability of outlying events to impact the mean expected results. Other measures of risk-to-forecast will also be explored.

Regarding recommendation 2f, FHA will provide supplementary detail in the notes to the Financial Statements that discusses risks to the baseline forecasts used to calculate the LLG estimate. In this new narrative, FHA will discuss the key risk factors that could cause actual results to vary from what is assumed in the booked LLG.

Appendix C
CG's Assessment of Management's Response

CG has obtained and reviewed FHA management's response to the findings and recommendations made in connection with our audit of FHA's 2010 Principal Financial Statements, which is included as Appendix B. We did not perform audit procedures on FHA's written response to the findings and recommendations and accordingly, we express no opinion on them. Our assessment of management's responses is discussed below.

Assessment of management's response to significant deficiency No. 1:

As indicated in Appendix B, FHA management concurred with our findings 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 significant deficiency No. 2:

As indicated in Appendix B, FHA management concurred with our findings and recommendations. The specific actions proposed appear to adequately respond to each recommendation.

Appendix D
Status of Prior Year Findings and Recommendations

Our assessment of the current status of reportable conditions and material weaknesses identified in prior year audits is presented below:

FY 2009 Finding/Recommendation	***Type***	***Fiscal Year 2010 Status***
1a. The HUD Office of the Chief Information Officer in coordination with the Assistant Secretary for Housing, FHA Commissioner continue implementing the short term capacity management plan and further refine the plan to address 1) utilization benchmarks and required responses and 2) clear organizational and staff roles and responsibilities. (New)	Significant Deficiency 2009	Resolved
2a. The HUD Office of Chief Information Officer, in coordination with the FHA Commissioner, Assistant Secretary for Housing should conduct a risk assessment of the various system initiatives and required corrective actions in connection with the OCIO Strategic Plan and the IT Strategy and Improvement Plan. (Updated)	Significant Deficiency 2009	Partially resolved (See Significant Deficiency 1)
2b. Develop a prioritized plan of activities, including the development of the required enterprise architecture, into a detailed implementation plan to support the IT Strategy and Improvement Plan presented to Congress. (New)	Significant Deficiency 2009	Partially resolved (See Significant Deficiency 1)
3a. Continue to analyze trend data on seriously delinquent aged loans and determine whether a statistical correlation exists to support this metric as a leading indicator for short-term claim payment trends. (New)	Significant Deficiency 2009	Partially resolved (See Significant Deficiency 2)
3b. Continue to track and report the reasons for default and as long as “loss of income” remains a major factor for default, determine whether another economic indicator, such as initial unemployment claims, may be useful to support near term estimates for claim payments. (New)	Significant Deficiency 2009	Resolved
3c. Continue to analyze property disposition data in order to better support near-term projected recovery rates. (New)	Significant Deficiency 2009	Resolved
3d. Expand management’s financial cash flow model validation documentation to include expanded analyses of seriously delinquent aged loans data, case level historical recovery data, and other leading indicators as appropriate. (New)	Significant Deficiency 2009	Resolved
3e. Conduct research into available information on inventories and sales of “distressed” properties and consider whether such an indicator can be used to assist in supporting near-term trends in historical	Significant Deficiency 2009	Resolved

Appendix D
Status of Prior Year Findings and Recommendations, Continued

FY 2009 Finding/Recommendation	*Type*	*Fiscal Year 2010 Status*
and projected recovery rates. (New)		
3f. Document the final overall management conclusion whether the analyses performed suggest whether adjustments to the projected cash flows are warranted, and if so, how those adjustments are determined and their resulting value. (New)	Significant Deficiency 2009	Partially resolved (See Significant Deficiency 2)
4a. The Director, Office of Financial Analysis and Reporting, Office of the Comptroller should coordinate with the Multifamily Insurance Operations Branch to enforce least privilege by restricting access only to modules that are needed for the performance of specified tasks. (New)	Significant Deficiency 2009	Resolved
4b. Identify system roles that are incompatible and develop automated edit checks in FHASL to prevent the same person from performing conflicting functions on the same transaction. (New)	Significant Deficiency 2009	Resolved
4c. Terminate the parallel deployment of the Revenue Management and MFIS/F47 modules and restrict access to the development environment of FHASL to only those individuals with development responsibilities. (New)	Significant Deficiency 2009	Resolved
4d. Limit developers' access to the production environment to read-only, and ensure any support or training is completed in a test environment. (New)	Significant Deficiency 2009	Resolved
4e. Ensure proper implementation of the PeopleSoft application audit logging by identifying the data elements and the actions to capture, selecting the capture mechanism and defining the filters and reports to be generated to ensure accurate and relevant information is produced. (New)	Significant Deficiency 2009	Resolved
4f. Establish and implement a formal review process of the audit logs by updating policies and procedures to incorporate the generation of the audit logs, the periodic review of the logs, and the actions to be taken based on the results in accordance with HUD's Security Policy and NIST standards. (New)	Significant Deficiency 2009	Resolved
4g. Implement automated mechanisms or mitigating manual account reviews to ensure disabling of accounts that have been inactive for 90 days consistent with HUD's Security Policy. (New)	Significant Deficiency 2009	Resolved


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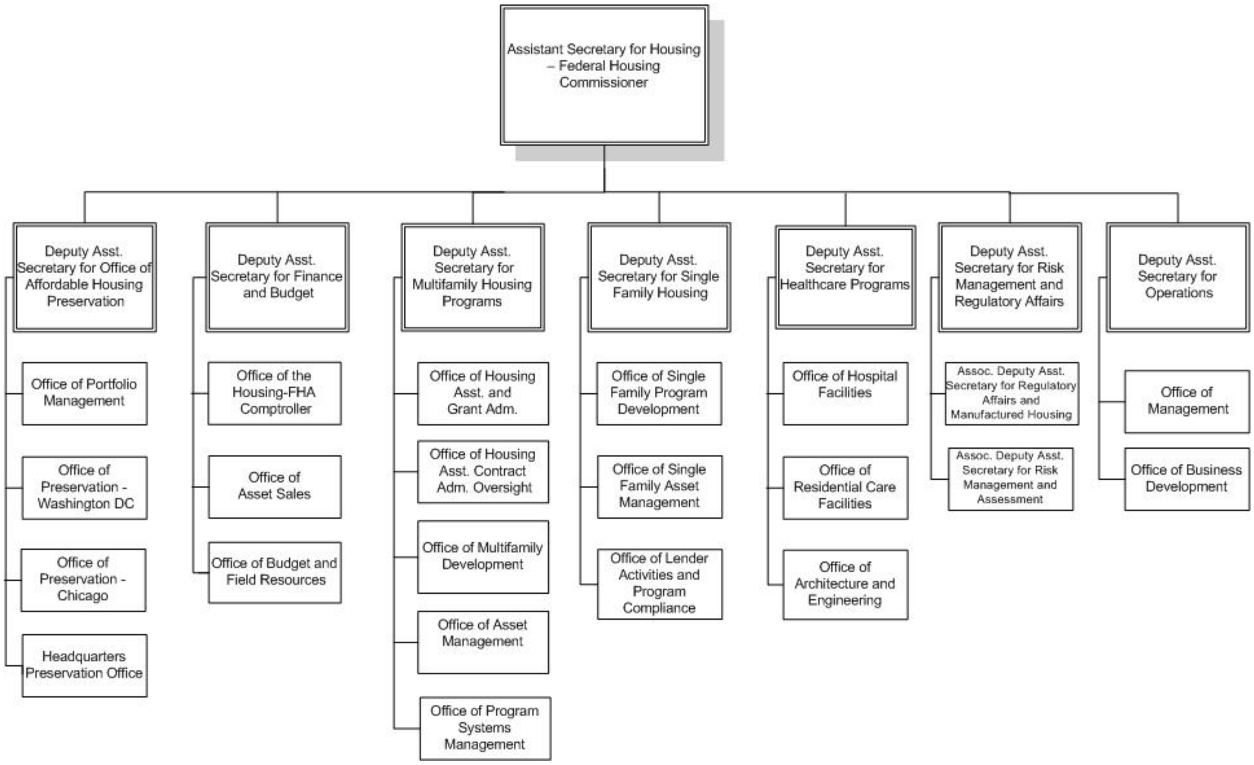
FHA Organizational Chart



The web address for this report can be found at:

http://www.hud.gov/offices/hsg/fhafy10annualmanagementreport.pdf

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