FHA

ANNUAL MANAGEMENT REPORT

FISCAL YEAR

2012

Federal • Housing • Administration

U.S. DEPARTMENT OF HOUSING
AND URBAN DEVELOPMENT

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.

A MESSAGE FROM THE ACTING COMMISSIONER

November 15, 2012

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

Since the beginning of the recession, FHA has played a key role in helping to facilitate the housing market's recovery. Throughout its history, FHA has supported access to affordable, sustainable homeownership opportunities for the underserved and for people with limited wealth. It has also acted as a stabilizing force in the housing market during times of economic distress. At no time has this countercyclical influence been more pronounced than during the recent housing crisis. In the face of ongoing challenges, FHA has provided access to mortgage finance opportunities during a period of severe constriction in conventional markets.

Credit Access

During fiscal year 2012, as the housing market began to show signs of recovery, FHA's overall market share continued to decline from its peak level in 2009. Still, FHA insured nearly 1.2 million single-family forward mortgage loans during the year, with a total dollar value of approximately $213 billion. Of the over 700 thousand home-purchase mortgages endorsed during the year, 78 percent were for first-time homebuyers, and 30 percent were for minority borrowers. Since its inception, FHA has now insured more than 40 million single-family mortgages.

In the multifamily mortgage market, FHA insured new loans for multifamily properties with a total mortgage amount of $13.1 billion. This activity not only bolstered the supply of much-needed rental housing, but also helped many multifamily owners refinance into more affordable loans, protecting recovery in communities across the country. The significant volume insured by FHA was made possible by a substantial improvement in processing procedures for multifamily loan applications.

FHA also experienced strong volume in its healthcare facilities financing programs in fiscal year 2012. Together, the Section 232 program for Residential Care Facilities and the principal Hospital insurance program under Section 242 endorsed 791 new loans with a total mortgage amount of $6.3 billion. Through these transactions, FHA not only increased access to quality health care in many communities, but created thousands of jobs tied to construction and medical care.

Financial Health

This fiscal year, the Mutual Mortgage Insurance Fund capital reserve ratio fell below zero to -1.44 percent. While this point-in-time valuation of the economic net worth of FHA's portfolio is obviously of concern, it does not mean that FHA will have to draw from the Treasury. Any required draw would be determined not by the economic assumptions of this review but those used in the President's budget released in February. In addition, by statute, analysis of the economic value of the fund does not take into consideration revenues generated after FY 2012, estimated by the actuaries to be $11 billion through the end of FY 2013. Final accounting is not done until the end of FY 2013. In the interim, FHA will launch a series of additional actions designed to strengthen the Fund while ensuring we don't harm borrowers or the emerging housing recovery. These measures emphasize maximizing recoveries on FHA's legacy loans which are responsible for significant stress on the Fund. Throughout this crisis, when FHA's health has faced challenges, we have taken action designed to protect the FHA and the American taxpayer alike. Indeed, the steps we have taken to date are estimated to have improved the health of the Fund by more than $20 billion.

Stepping into the breach during the worst recession since the Great Depression obviously increased FHA's risk, and we have not been immune to the lingering effects of the housing and economic crisis. But the reforms we have made thus far – the most sweeping in the nearly eighty-year history of FHA – as well as those we will continue to make moving forward, have altered the long term trajectory of the MMI Fund. So while stresses and difficulties remain in the near term, we are committed to ensuring that FHA is strong, stable, and viable – not just for the next few years, but for the next few generations.

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

This report is divided into four sections:

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

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

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

- ***Auditor's Report*** on the Federal Housing Administration's (FHA) fiscal year 2012 financial statements, internal controls and compliance with laws and regulations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

SUSTAINABLE
PROTECT
AFFORDABLE

FEDERAL HOUSING ADMINISTRATION AT A GLANCE

PURPOSE AND HISTORY:

The Federal Housing Administration (FHA), a part of the United States Department of Housing and Urban Development (HUD), provides insurance on single-family, multifamily, and healthcare loans made by FHA-approved lenders throughout the United States (U.S.) and its territories. FHA's headquarters is located in Washington, D.C. with field offices throughout the country, consisting primarily of 4 Single Family Homeownership Centers (HOCs), 17 Multifamily Hubs, and 47 Multifamily Production Offices.

FHA has a rich and diverse history, with its lineage dating back to the Great Depression, of providing opportunities for home ownership and supporting the housing market during periods of instability. During the Great Depression, the failure of the banking system created instability in the housing market and resulted in fewer loans issued. This instability heightened the need for federal programs to alleviate the home ownership crisis and restore the diminished values of loan collateral.

In response, The National Housing Act of 1934 was passed by Congress and signed into law creating the FHA to provide favorable insured financing for long term fixed rate mortgages. The legislation provided a framework for a comprehensive national homeownership platform, bridging the gap between lenders and homeowners to support affordable homeownership. It revolutionized home ownership by creating our current financial mortgage system, thereby increasing the size of the housing market.

After World War II, FHA helped finance homeownership for veterans and families of soldiers, both single-family and multifamily dwellings. In the 1950s, 1960s and 1970s, FHA helped to spark the production of millions of units of privately-owned apartments for elderly, handicapped and lower income Americans. When soaring inflation and energy costs threatened the survival of thousands of private apartment buildings in the 1970s, FHA's emergency financing helped the homeowners retain their homes. In the 1980s, the FHA introduced flexible programs, such as Streamline Refinance, that helped to steady falling housing prices, making it possible for homeowners to finance their mortgages into more competitive interest rates and lower monthly payments. Today, FHA contributes to the future of the Nation by continuing to play its role of stabilizing the housing markets, promoting sound and affordable housing programs for homeowners and assisting homeowners at risk of foreclosure to stay in their homes.

ROLE AND RESPONSIBILITY:

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

In response to changing needs and the extended housing crisis, FHA has balanced its role in supporting the mortgage markets with its statutory mandate to operate on a sound basis. FHA continues to work with the President and Congress to provide effective programs and sound pricing that reflects FHA's commitment to support the economic recovery. FHA is currently focused on the following three fundamental priorities:

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

STABILIZING THE HOUSING MARKET AND ASSISTING HOMEOWNERS

To address the challenges of the recent housing crisis, FHA has developed new programs, modified existing programs, and improved controls. These initiatives align with the Administration's strategy to help responsible homeowners and support the housing market recovery. More specifically, FHA has focused on the following:

FHA Streamline Refinance	Modification under HAMP	Extending Forbearance Period
• Allowing eligible homeowners to take advantage of low interest rates • Eliminating additional underwriting for qualified homeowners • Increasing lender participation by modifying Compare Ratio	• Increasing assistance to troubled homeowners through temporary and permanent loan modifications • Increasing lender incentives to encourage investors to utilize program • Expanding borrowers opportunity to rebuild equity	• Extending forbearance period for unemployed homeowners from 4 to 12 months • Allowing borrowers to stay in their homes while they search for job • Providing families a greater chance of avoiding default and reducing foreclosures

PROTECTING THE STRENGTH OF FHA

FHA has continued to introduce new policies that have improved loan quality, fortified lender enforcement, and helped protect the future loan performance while strengthening the Mutual Mortgage Insurance (MMI) fund. During fiscal year 2012, FHA revised its upfront and periodic premium structure to align with the market conditions and to augment its Capital Reserves. Additionally, FHA expanded its sale of troubled mortgages through the Distressed Asset Stabilization Program. The program allows private investors to purchase pools of mortgages headed for foreclosures to help severely delinquent borrowers find affordable mortgage solutions through re-modification or short sale.

It offers a two-pronged opportunity by providing help for struggling homeowners and reducing losses to FHA.

In addition, FHA was party to a $25 billion settlement with the nation's five largest mortgage servicers to address mortgage loan servicing and foreclosure abuses. In fiscal year 2012, FHA collected approximately $1.1 billion related to settlements. With a new premium structure, expanded note sales, and the infusion of the settlement funds, FHA is minimizing its losses.

Finally, FHA understands that managing risk plays an important role in sustaining its future. Throughout fiscal year 2012, FHA continued its commitment to a strong and effective risk management system and has expanded its capacity to assess financial and operational risk. In order to manage risk more effectively, FHA has created a separate risk management office. FHA has set underwriting minimums that combine credit score and down payment requirements to balance risk management with broad access to housing credit for borrowers. It has strengthened its underwriting procedures, eliminated approval for loan correspondents and increased the net worth requirements for lenders wanting to underwrite FHA loans. In addition, it has increased enforcement and eliminated lenders who are involved in fraudulent or abusive practices.

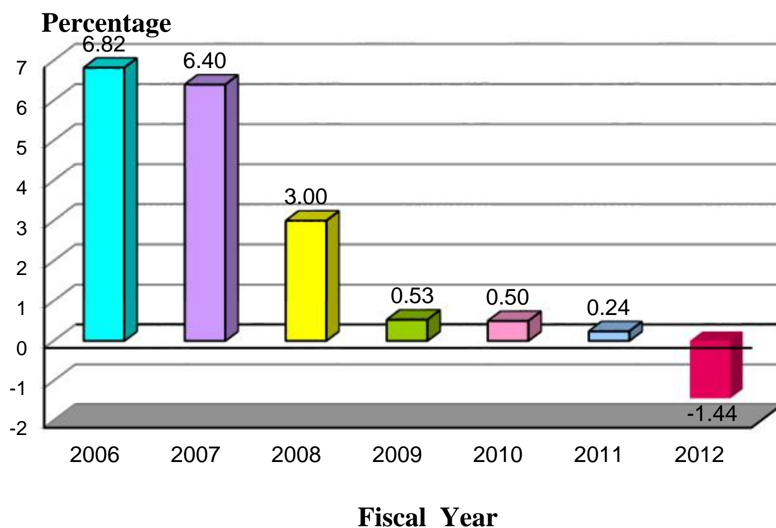
FHA has seen the benefits of these efforts as an agency and has ensured the highest credit quality books of business in its history over the past two years that will yield historically high levels of net receipts in the years ahead. While additional risks remain for FHA because of the current economic conditions, efforts undertaken by the Administration will put FHA in a much more favorable position moving forward.

MMI Capital Ratio

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

The Mutual Mortgage Insurance Fund (MMIF) Capital Resources are comprised of two accounts: a Financing Account and a Capital Reserve account. The funds in the Financing Account cover estimated losses over the life of the loan cohorts while the Capital Reserve covers losses in excess of what is estimated to be needed in the Financing Account. The housing crisis that began in fiscal year 2008 has resulted in the capital ratio falling below that 2 percent threshold for four years in a row. This fiscal year, the ratio fell below zero, to -1.44 percent.

MMI Capital Ratio



Note: The fiscal year 2006 – fiscal year 2008 ratios are based on unamortized IIF and do not include HECM loans. The fiscal year 2009 - 2012 ratio calculations use amortized IIF and include HECM loans endorsed starting in fiscal year 2009.

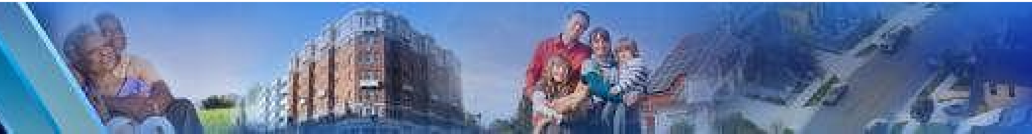
The low capital ratio today reflects an expectation that FHA's current pool of insured loans still has significant foreclosure and claim activity yet to occur. Projected losses are particularly large for the fiscal

year 2006 – 2009 loans. These loan cohorts were negatively impacted both by the severe recession and unemployment as well as the large presence of seller-assisted down payment loans. In contrast, fiscal year 2011 and 2012 loans are expected to produce significant net revenues that can be used to offset some losses from earlier years. At this point in time, fiscal year 2010 endorsements are expected to be close to break-even.

Although a capital ratio of less than zero suggests that FHA may need to call upon its permanent-and-indefinite budget authority with the Treasury for additional support, this result is not necessarily assured. The capital reserve ratio is calculated by an independent actuarial firm, using FHA data and applying an independent economic forecast while the president's budget, which incorporates a re-estimate of the economic value of the FHA book, applies the forecast developed by the President's Council of Economic Advisors. In years past, due in part to evolving economic forecast between the times each measure is prepared, there has been some difference in the results yielded in each review.

Due to a series of changes to the program made since 2009, FHA continues to benefit from much stronger borrower credit quality than was experienced in prior fiscal years. Further, FHA will continue insuring loans, and the independent actuary projects that fiscal year 2013 commitments will provide about $11 billion in additional capital resources. In addition, FHA is undertaking a number of initiatives to reduce losses from legacy loans originated during the height of the crisis.

The fiscal year 2012 independent actuarial study predicts that, absent any changes made by FHA, the capital ratio will be above zero in fiscal year 2014 and return to 2.0 percent in fiscal year 2017. In order to accelerate this timeline, FHA will continue implementing policy changes with a goal of managing risks to the MMIF and replenishing the capital reserve account while ensuring that it continues to serve its role of providing liquidity and access to the market.

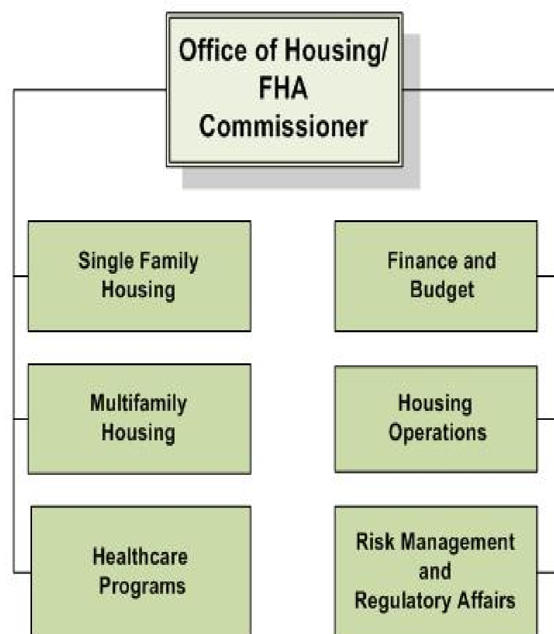


MISSION AND ORGANIZATIONAL STRUCTURE

In fiscal year 2012, FHA continued its mission to create strong, sustainable affordable homes for all. FHA was created to address a set of economic conditions during the 1930s similar to those the country is facing today. Property values were declining, unemployment was rising, incomes were dropping, homeowners were defaulting on their mortgages, and credit markets were contracting. FHA eased the mortgage crisis by bridging the gap between lenders and homeowners so that families could have access to new ways of financing their homes with long-term affordable mortgages. Today FHA continues to play a critical role in supporting mortgage markets to stimulate the economy, stabilize neighborhoods heavily impacted by foreclosures, and catalyze housing construction and renovation.

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

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



Note on Forward-Looking Information Presented

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

PERFORMANCE GOALS AND OBJECTIVES

HUD Strategic Plan

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

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

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

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

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

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

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

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

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

Strategic Goal 5: Transform the Way HUD Does Business

Fiscal Years 2012-2013 Agency Priority Goals

From the outcome measures that support the HUD strategic goals and sub goals, the Secretary has identified five Agency Priority Goals (APGs) to focus on during fiscal years 2012 and 2013. These APGs are identified by their respective outcome measure in the HUD Strategic Plan. FHA is the key supporting office for Strategic Goal 1, sub goal 1A, Foreclosure Prevention and plays a critical role in Strategic Goal 2, sub goal 2A, Rental Assistance. FHA also contributes to the Department's energy efficiency goal APG 13 by offering energy efficient loan products through Strategic Goal 4, sub goal 4B.

FHA plans to assist homeowners avoid foreclosure through its programs as well as through third-party lender loss mitigation initiatives. This goal also projects that additional homeowners will be assisted through joint HUD-Treasury programs. FHA programs facilitate the development and preservation of affordable housing to support the Department's Rental Assistance APG. FHA also plans to expand the supply of affordable rental homes where they are most needed. FHA's PowerSaver and Energy Efficient mortgages are estimated to support up to 30,000 homeowners in conducting energy efficiency retrofits to their homes over the two year period.

Performance Reporting

FHA has developed a comprehensive Management Action Plan to address a substantial number of the strategic goals and sub goals. The significant targets and achievements for each FHA program goals are presented in the following sections. Targets and actual achievements for each goal are reported as of June 30, 2012. Targets and actual achievements as of September 30, 2012 will be reported in HUD's Annual Performance Report (APR), published February 2013.

FHA PROGRAMS

Office of Single Family Housing

Single Family Programs

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

Single Family is balancing its' Strategic Objectives by managing the long term viability of the Mutual Mortgage Insurance Fund; maintaining the FHA mission to serve the underserved and first-time homebuyer by providing affordable housing options; and providing liquidity in the counter-cyclical role that supports the housing market.

Charles Coulter
Deputy Assistant Secretary
for Single Family Housing Programs

FHA strives to strengthen the nation's housing market, bolster the economy and to protect and educate consumers when they buy, refinance or rent a home. For fiscal year 2012, FHA endorsed 1.2 million single-family forward (non-HECM) mortgages totaling $213.3 billion. FHA's share of mortgage originations has been at an all-time high during the housing market crisis, increasing from 3 percent in fiscal years 2005 and 2006 to a high of nearly 29 percent in the fourth quarter of fiscal year 2008. For fiscal year 2012, FHA's share of mortgage originations was approximately 15.5 percent. FHA's market share is higher among home purchase loans than among refinance loans. Its purchase-loan share peaked over 30 percent in the third quarter of fiscal year 2010 and remains over 20 percent today. That business primarily supports first-time homebuyers. In fiscal year 2012, 77.6 percent of FHA purchase-loan endorsements were for first- time homebuyers, which is a 2.3 percent increase from fiscal year 2011.

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

Single Family Housing Helping Homeowners Stay in Their Homes

A borrower in Wisconsin was in default for five months and needed assistance in updating financial information to be reviewed for loss mitigation. After contacting the National Servicing Center (NSC), a specialist held a conference call with the servicer and borrower to update financial information from the borrower. The Servicer was able to review the information and approve the borrower for a loan modification. The loan modification resulted in a monthly payment relief and reinstatement of the loan.

The following table reflects the FHA single family forward insurance profile in fiscal years 2012 and 2011:

Table 1: SF Forward Insurance

	FY 2012		FY 2011		Percentage
	Number	**Percent**	**Number**	**Percent**	**Change**
Total Insurance-In-Force (EOY)	7,710,745		7,304,368		5.6%
Total Forward Endorsements	1,184,741		1,197,821		-1.1%
Average Loan Amount	$180,041		$181,840		-1.0%
First Time Home Buyers	569,828	77.6%	585,007	75.3%	2.3%
Minority Borrowers	248,627	27.3%	265,238	26.1%	1.2%
Low/Moderate Income	554,963	60.7%	605,283	59.2%	1.5%
Average FICO Score	698		701		

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

FHA offers a number of loan programs that meet a wide range of borrower needs. FHA mortgages are attractive to lenders because they can be packaged into mortgage-backed securities, which are guaranteed by the Government National Mortgage Association and backed by the full faith and credit of the United States Government. The following table shows loan volume by program for fiscal years 2012 and 2011.

Table 2: SF Loan Volume

Section of Act	FHA Primary Programs	FY 2012	FY 2011	Volume Change	Percentage Change
203(b)	One-to-Four Family Home Mortgage Insurance	1,162,260	1,175,917	-13.657	-1.2%
	Purchases	713,030	757,807	-44,777	-5.9%
	Refinance	449,230	418,110	31,120	7.4%
203(k)	Rehabilitation Loan	22,476	21,266	1,210	5.7%
255	Home Equity Conversion Mortgages	54,676	73,093	-18,417	-25.2%
	HECM Standard	50,857	69,264	-18,407	-26.6%
	HECM Saver	3,819	3,829	-10	-0.3%

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

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

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

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

The section 203(b) program is FHA's primary program for insuring the financing of new or existing one-to-four family dwellings and individual condominium units. Section 203(b) is the largest of FHA's Single Family programs, covering 97 percent of total Single Family Insurance-in-Force and 98 percent of fiscal year 2012 insurance issued for homes with up to four housing units (excluding HECMs). Homebuyers may obtain FHA-insured mortgages from HUD-approved lenders to purchase homes (including condominium units) with low down payments. The borrower's down payment requirement may be as little as 3.5 percent (with a 96.5 percent loan-to-value (LTV) ratio) for purchases, and 2.25 percent (with a 97.75 percent LTV) for refinances. By insuring commercial lenders against loss, HUD encourages them to invest capital in the home mortgage market. HUD insures loans made by private financial institutions with terms for up to 30 years. FHA loans may finance homes in both urban and rural areas.

FHA has the authority to establish and collect a single up-front mortgage insurance premium, as well as annual premiums. The up-front premium may be financed into the mortgage. The maximum mortgage

amount that FHA will insure is based on the median home prices for the county in which the property is located, as well as certain minimum and maximum amounts. The current minimum limit (floor) for a

one-unit property is $271,050, while the current maximum limit (ceiling) for a one-unit property is $729,750. The loan limits change annually based on median home prices. Higher limits also exist for one-to-four unit properties in Alaska, Hawaii, Guam and the Virgin Islands. These same limits apply to other forward mortgage programs insured by FHA under section 203.

The program is open to any individual able to meet the down payment (equity), mortgage payment, other debt payment, and credit characteristic requirements. Although the program is generally limited to primary residences, under certain circumstances, a borrower may use 203(b) financing for a secondary residence. The program is also available for use on a limited basis by non-profit or governmental entities.

Section 203(k*):* *Rehabilitation Loan*

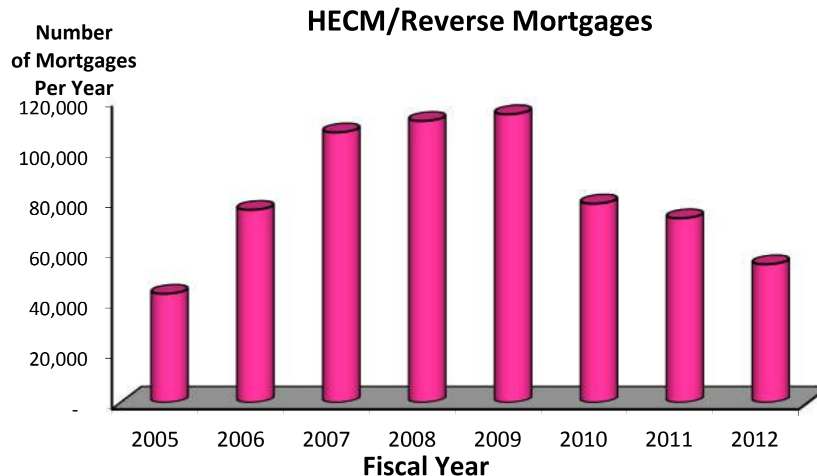
Section 203(k) is FHA's Single Family program designed to finance acquisition costs and the costs of property improvements into one mortgage loan. This program offers purchase and refinance products and may be utilized to make repairs necessary to meet minimum property standards, as well as property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

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

Since the program's inception, FHA has endorsed almost 779 thousand HECM loans. The number of reverse mortgages insured by FHA increased over the fiscal years 2005 – 2009; however, endorsements have been declining each year from a high in fiscal year 2009 of 115 thousand to 55 thousand in fiscal year 2012.

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

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



The HECM Program has continued to experience challenges over the last two years. For example, four of the larger originators of HECM loans withdrew from the market place. While several lenders continue to offer the HECM program and there is significant interest by other lenders in entering the market, FHA is working closely with industry partners and entities representing seniors to propose and formulate changes to the program that will ensure its effectiveness and sustainability.

On January 3, 2011, FHA published a Mortgagee Letter addressing a growing number of delinquent HECM mortgages on which borrowers have not paid required property charges such as taxes, insurance or homeowner association dues. In most cases, mortgagees have advanced corporate funds on the borrower's behalf. The Mortgagee Letter provided extensive guidance to the reverse mortgage industry on issuing property charge delinquency notices and initiating extensive loss mitigation and counseling efforts to ensure that HECM borrowers are provided an opportunity to establish repayment plans to repay amounts advanced on their behalf and bring the mortgages into compliance. FHA is continuing its efforts to focus on developing and implementing origination and servicing policies and guidelines that will address issues related to property taxes and insurance defaults and support enhancements to the program that will ensure that seniors have access to this very important program.

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

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

unsecured loans to finance the cost of home improvements. The Power Saver loan program (described below) has been established inside of the Title I program.

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

Volumes by fiscal year are as shown in the table below:

Table 3: Title I and Title II Endorsements Counts

Loan Type	FY 2012	FY 2011	FY 2010
Title I Manufactured Homes	655	986	1,776
Title I Property Improvement	7,050	5,563	4,407
Title I Total	7,705	6,549	6,183
Title II Manufactured Housing	20,479	21,378	30,751

FHA PowerSaver

PowerSaver is a pilot program that was implemented in fiscal year 2011. This program offers credit-worthy borrowers low-cost loans to make energy-saving improvements to their homes. Backed by the Federal Housing Administration, these new FHA PowerSaver loans offer homeowners up to $25,000 to make these improvements. Unlike FHA's core insurance program for mortgages in first-lien position, PowerSaver insures a lien positioned in first or second place, and insures loans without a lien, provided the loan amount is less than $7,500. The volume of PowerSaver loans has been less than anticipated. The program faces challenges with respect to liquidity options. Three PowerSaver lenders are working in earnest to secure source funding. A fourth lender has found a limited option through a grantee using funds from the Department of Energy, who restricts use of the funds in order to meet its own goals. All of the lenders seeking a funding source are presently developing legal agreements for execution, or are engaged in discussion with interested investors.

To increase financing opportunities to homeowners, staff from Home Mortgage Insurance Division (HMID) is evaluating a limited policy waiver to permit PowerSaver financing for qualified energy upgrades that were completed 90 days prior to loan closing. Such a policy would support emergency improvements where homeowners cannot wait for lender approval of credit documentation and an appraisal. This waiver is presently permitted by statute. HMID anticipates this flexibility would be responsive to market realities by opening financing opportunities for "quick improvements", such as HVAC and hot water heater replacements. Additionally, program stakeholders have indicated this flexibility would encourage widespread marketing by contractors, who hold the dominant contact with homeowners. With this policy, contractors can advise homeowners about potential PowerSaver opportunities at the point of sale.

FHA anticipates extending the pilot program until all of the appropriated funds ($25M) are exhausted, or until the access to funds expires in 2018.

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

FHA's Energy Efficient Mortgages program (EEM) helps homeowners save money on utility bills by enabling them to finance the cost of adding energy efficiency features to new or existing housing as part of their FHA insured home purchase or refinancing mortgage. During fiscal year 2012, FHA insured 658 Energy Efficient Mortgages, totaling $124.1 million. The volume of EEM loans has declined in recent years. This program is being reviewed to determine if improvements can be made to expand originations as part of the Department's commitment to energy efficient initiatives.

Performance Goals and Objectives

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

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

G1 Sub Goal

1A Stem the foreclosure crisis

Target Activities

- Assist 200,000 seriously delinquent homeowners through FHA loss mitigation tools in fiscal years 2012 - 2013.
  - Single Family is on track to exceed this targeted goal for assisting delinquent FHA borrowers through loss mitigation tools. Through June 30, 2012, Single family assisted 108,507 FHA borrowers through loss mitigation tools. Single Family is currently at 54.2% of the goal.

- Assist 500,000 early delinquent homeowners (< 90 days in default) with early intervention tools in fiscal year 2012-2013.
  - Single Family is currently exceeding its targeted goals for assisting delinquent FHA borrowers through early intervention tools. More than 228,957 FHA borrowers have been assisted through early intervention tools as of June 30, 2012. Single Family is currently at 45.8% of the goal.

- Achieve or reduce the re-default rate of loss mitigation program participants within the first 6 months following the loss mitigation action to 10 percent or less. Achieving 10 percent by the end of fiscal year 2012, and sustaining 10 percent throughout fiscal year 2013.
  - The Re-default Rate supporting goal was set with the expectation that the Trial Modification program would be implemented by the start of fiscal year 2012, but the actual implementation began in January 2012. This 3-month delay allowed some mortgage servicers to continue to process loan modifications, that otherwise may not have passed the trial program, leading to a higher percentage of claims re-defaulting in the first six months of fiscal year 2012, resulting in a 14.49% re-default rate through third quarter fiscal year 2012.

- Achieve a Consolidated Claim Workout (CCW) Ratio of 65 percent for all FHA borrowers that receive loss mitigation assistance.
  - The CCW ratio as of June 30, 2012 is 60.8%. While the workout ratio supporting goal is about 4 percent below target, it continues to demonstrate a positive increase each month. Since the Attorneys General (AG) Global Settlement was completed, banks started moving the foreclosure pipeline through the process. This gives rise to large increases in foreclosure claims that have occurred as of the third quarter in fiscal year 2012, and continue to occur above historical norms. The workout ratio is a calculation of all claims during the year. Consequently, the large increase in foreclosures, even if only for a few months, will continue to have an adverse impact on the overall rate for fiscal year 2012 and perhaps beyond.

- Reduce the average days to list REO properties nationally by 2 percent of the fiscal year 2011 average.
  - The average number of days to list REO properties for fiscal year 2011 was 45 days. The average number of days to list REO properties for fiscal year 2012 through third quarter was 24, thereby reducing the number of days by 46.7%.
- Reduce by 2 percent the average time in inventory for Real Estate Owned (REO) properties nationally from Fiscal year 2011 average.
  - Average time in inventory for REO properties for fiscal year 2011 was 192 days. The average time in inventory for REO properties for fiscal year 2012 through third quarter was 144 days, thereby reducing the number of days by 25%.

- Target 24 of the Single Family REO workshops/meetings being conducted in Neighborhood Stabilization Program (NSP) areas for fiscal year 2012-2013 or 12 workshops in fiscal year 2012 and 12 workshops in fiscal year 2013.
  - FHA exceeded this goal. As of June 30, 2012, 69 workshops have been conducted.

Strategic Goal 4 (G4): *Build Inclusive and Sustainable Communities Free from Discrimination*

G4 Sub Goal

4B Promote energy-efficient buildings and location-efficient communities that are healthy, affordable, and diverse

Target Activities

- Achieve 2,150 PowerSaver loan disbursements in fiscal year 2012-2013. Fiscal year 2012 target is 150 loan disbursements and the remaining 2,000 in fiscal year 2013.
  - As of June 30, 2012 there were 51 loans. Because of program delays, Single Family does not anticipate that the goals for fiscal year 2012 will be met, but believes that total goals can be achieved with the policy waiver described above, and execution of investor agreements.

Management Initiatives and Program Improvements

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

Mortgage Insurance for Condominiums

In fiscal year 2012, the condominium homeownership market represented 3.9 percent of all 203(b) endorsements and 2.8 percent of all HECM endorsements. Condominium purchases provide affordable homeownership opportunities for individuals who may not otherwise be able to secure financing. Since implementing baseline guidance for Condominium project approvals and loan level requirements, which are mandated by the Housing and Economic Recovery Act (HERA) of 2008, FHA staff has routinely met with industry stakeholders and other parties to discuss current market conditions and further expansion and definition of FHA condominium guidelines. FHA issued new condominium baseline guidance in June 2011. FHA will continue to monitor the performance of condominium loans and market conditions and will issue proposed rules to formalize condominium regulations. This process includes providing the public an opportunity to comment on proposed guidelines and regulatory content.

Housing Counseling Program

HUD's Housing Counseling Program is authorized by Section 106 of the Housing and Urban Development Act of 1968, as amended by the Dodd-Frank Act, to provide or contract with organizations to offer counseling to tenants and homeowners seeking to improve their housing conditions. More than 2,520 HUD-approved agencies currently provide these services. Although Housing Counseling activities are not funded through FHA resources, they have a significant impact on FHA programs.

HUD awards grants annually to HUD-approved housing counseling agencies through a competitive process. In fiscal year 2012, HUD awarded over $42 million in housing counseling grants to more than 1,146 agencies. The $42 million in grants were allocated to support the full spectrum of housing counseling services, including foreclosure intervention; pre-purchase; rental; reverse mortgage post-purchase and homeless. The awards will also support counselor training, and outreach and counseling efforts designed to identify and assist victims of mortgage modification scams and report those cases to the applicable authorities. Subtitle D of Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376) (July 21, 2010) (Dodd-Frank Act), which consists of sections 1440 through 1453, made several amendments to strengthen HUD's Housing Counseling Program. Section 1442 amended section 4 of the Department of Housing and Urban Development Act (Department of HUD Act) to establish an Office of Housing Counseling within HUD specifically devoted to administration and oversight of housing counseling agencies, individual counselors and the counseling services offered under the program. The Department submitted a plan to establish the Office of Housing Counseling to Congress in January 2012. Congress approved the establishment of this office in May 2012. The Office of Housing Counseling was launched by the Department on October 1, 2012.

FHA Support of Refinancing Options to enable borrowers to take advantage of historically low interest rates

FHA continues to implement and enhance policies to enable borrowers to refinance during this period of low interest rates. These new or revised policies include the following programs:

FHA Short Refinance Program

On March 26, 2010, HUD and the Department of the Treasury announced enhancements to the existing Making Home Affordable Program and FHA refinance program. This program is designed for borrowers who owe more on their conventional mortgages than the value of their homes. The borrowers were given the opportunity to refinance into affordable FHA loans. This program requires the lender or investor to write-off the unpaid principal balance of the original first lien mortgage by at least 10 percent. Lenders are not required to offer this program and it has not been widely adopted by mortgagees because of issues related to forgiving principal and restrictions placed by investors on this, and other, loss mitigation programs. FHA implemented the enhancements with the publication of Mortgagee Letter 2012-05. The enhancements are intended to expand participation in the program. The enhancements include extending the program period through December 31, 2014, and providing an

opportunity for borrowers who are delinquent on their current mortgages to qualify for this program upon successful completion of a trial payment period. Through fiscal year 2012, FHA has endorsed 1,773 Short Refinance mortgages with an outstanding principal balance of $306 million.

FHA Streamlined Refinance Program

FHA's Streamline Refinance program, which has been available since 1986, provides existing FHA borrowers with the opportunity to refinance their current loan while requiring limited documentation. In 2012, this program was further enhanced when FHA significantly reduced the mortgage insurance premiums charged in connection with the refinance of a previous FHA insured loan that was endorsed on or before May 31, 2009. This reduction of MIP, from the rates currently in effect, will potentially allow over 3 million households with current FHA loans the ability to take advantage of today's historically low interest rates via the refinance of their current loan. The reduced MIP for the affected streamline refinances will enable these borrowers to keep the same MIP rate, which was in effect for their previous loan, on their new refinance loan. This reduction of MIP became effective on June 11, 2012. Since the reduction took effect, and as of September 30, 2012, FHA received over 193,000 requests for case number assignments for mortgages eligible for reduced MIP under this program.

Strengthening the MMI Fund

As part of FHA's initiatives designed to strengthen the capital of the Mutual Mortgage Insurance (MMI) Fund, FHA recently instituted an increase to the Mortgage Insurance Premiums (MIP) charged in connection with loans, other than the Streamline Refinance loans described above. The increases were implemented in two phases. The first phase consisted of an increase of 75 basis points (0.75 percent) to the up-front MIP combined with an increase of 10 basis points (0.10 percent) to the Annual MIP. The second phase implemented an additional 25 basis points (0.25 percent) increase to the Annual MIP for loans with a principal balance greater than $625,500. These increases were designed to balance the necessary capital influx to the MMI fund while having a minimal impact to the mortgage market.

Expansion of Loss Mitigation Tools

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

Risk Management

- *Lender Enforcement Activities on Risk and Fraud.* In order to protect the health of the FHA insurance fund during this period of prolonged fragility in the economic recovery, FHA continues to enhance

its risk management framework and strengthen its lender network by implementing new policies, refining existing processes, and developing additional technological capacity:

- Lender Approval and Recertification. During 2012, FHA reviewed the fiscal year 2011 audited financial statements of approved lenders to ensure compliance with new net worth requirements that went into effect May 20, 2011. Also in 2012, FHA extended its waiver of the requirement that supervised lenders with less than $500 million in consolidated assets submit audited financial statements. Under the waiver, these small supervised lenders are required to submit either a current or fourth quarter Call Report.

  FHA's oversight of approved lenders was strengthened in fiscal year 2012 with the issuance of Mortgagee Letter 2012-02, "Closing a Loan in the Name of an FHA-Approved Mortgagee Acting as a Sponsored Third-Party Originator (TPO)." Mortgagee Letter 2012-02 clarifies FHA requirements and provides guidance on originating and closing loans via the sponsored TPO process. It also reminds sponsoring mortgagees that they must assume full responsibility for the FHA compliance of their TPOs and that program violations may result in administrative action.

  As part of the FHA Transformation Initiative, the Office of Lender Activities has developed the Lender Electronic Assessment Portal (LEAP), an online portal that uses Oracle/Siebel technology to house data record collection and risk and fraud detection activities for FHA's Office of Lender Activities. LEAP was created to migrate multiple systems onto one comprehensive platform and to streamline business processes. The first phase of LEAP, the automation of FHA's lender approval application, was implemented in spring of 2012. This process moved new lender applications from a paper-based format to an automated, online format. The online application includes business rules to ensure that each new lender submits a complete application package before it is routed to a Lender Approval analyst for review. It also allows for automated querying of third-party databases and automates workflow and communications with lender applicants.

- Lender Monitoring and Enforcement. Monitoring reviews of FHA-approved lenders are conducted to ensure that FHA-insured mortgages are originated, underwritten and serviced in compliance with the Department's requirements. During fiscal year 2012, the Quality Assurance Division (QAD) conducted 307 monitoring reviews of FHA-approved lenders, evaluating 16,454 loans for compliance with HUD requirements. This exceeded the goal of conducting 300 reviews by 2 percent. In addition, 100 percent of all files reviewed by FHA were evaluated for accuracy of the good faith estimates. This year, FHA's Processing and Underwriting Division used its adverse selection criteria (e.g. risk based rules algorithm, early payment defaults, complaints) to select 22,401 loans for post endorsement technical review, and completed an initial review of 95 percent or 21,291 of those files.

  When material deficiencies are discovered on loans in the course of a monitoring review, FHA may seek indemnification from the lender against future insurance claim losses. This fiscal year, FHA received 1,919 indemnifications from lenders through its loan reviews, thereby avoiding an

estimated $171 million in insurance claim losses. FHA withdrew the approval of 153 noncompliant lenders during fiscal year 2012.

FHA made significant improvements to its lender and loan review processes during 2012. FHA conducted a comprehensive evaluation of its lending violation criteria in order to standardize the basis for rating loans "unacceptable." Additionally, FHA developed improved criteria for selecting loans with material deficiencies for review. This included developing methodology for reviewing all loans that go to claim within 24 months from the date of endorsement. The loan review process was also enhanced by implementing workload and summary reports in the Neighborhood Watch Early Warning System to assist in effectively processing selected files.

FHA has also made recent improvements to the loan review business processes by reengineering its monitoring technology and procedures. During 2012, FHA conducted a detailed statistical analysis of its post endorsement loan selection model to better identify loans likely to have serious or material violations. This model was then tested through actual loan reviews to validate initial assumptions and make necessary enhancements to the final algorithm for selecting forward and reverse mortgages that will undergo a loan review.

As a further improvement in loan file reviews, FHA implemented the contractor-driven Targeted Secondary Review of loans selected for post endorsement technical reviews. The new Targeted Secondary Reviews use an industry-style risk and fraud report to identify potential fraud, misrepresentation, and heightened risk. During fiscal year 2012 approximately 26 percent of loans selected for post endorsement technical loan review were also subject to a Targeted Secondary Review. In January 2012, FHA further enhanced the Targeted Secondary Review process by implementing increased third-party searches and re-verifications to 100 percent of files selected. Third-party searches and re-verifications include employment, income, assets, occupancy, property history, judgment or lien, appraiser, and loan officer. The third-party searches and re-verifications utilize automated system searches, traditional "cold calling," and written re-verifications to validate loan transaction information. In fiscal year 2012, the FHA selected 5,854 files for Targeted Secondary Review and the contractor completed the review of all of these files.

- Credit Watch Termination. Through the Credit Watch Termination Initiative, FHA continues to exercise its authority to terminate lenders' approval to originate or underwrite loans for insurance when those lenders' default and claim rates in HUD field office jurisdictions exceed the Department's threshold. As announced in February 2012, FHA will reformulate the compare ratio calculation under the Credit Watch Termination Initiative to better measure lender risk. The first stage will be the removal of FHA streamline refinances from the compare ratio. During the interim period before the formula changes are complete, FHA has modified its execution of the Credit Watch Termination Initiative in a way that best aligns with its announced policy changes.

Appraiser Roster

FHA maintains and manages a roster of real estate appraisers authorized to conduct appraisals for FHA insured mortgages. As of the close of fiscal year 2012, there are 52,002 appraisers nationwide listed on the roster. As part of its Risk Management, and to ensure compliance with written guidance and appraisal reporting standards, FHA employed a risk based algorithm for their review of appraisers. FHA imposed 1,780 sanctions and terminated 97 appraisers from its appraiser roster in fiscal year 2012 as part of its appraisal oversight functions.

Single Family Asset Management

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

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

- Centralization of mortgagee compliance functions under a Mortgagee Compliance Manager (MCM) responsible for activity before and after the property is conveyed, including approval of claims for payment, title reviews, and inspection reviews.

- Separation of marketing functions (Asset Managers) from property management functions (Field Service Managers). Field Service Managers provide property maintenance and preservation services consisting of, but not limited to, inspecting the property, securing the property, performing cosmetic enhancements/repairs, and providing on-going maintenance. The Asset Managers are responsible for the marketing and sale of REO properties.

- A centralized REO case management system and centralized property bidding/listing site. This system ensures that HUD receives the highest net return for its sealed bid process and the Department has an audit trail for oversight of the conveyance and REO processes.

Single Family Notes Inventory

As of September 30, 2012 Secretary-held notes, including HECM, totaled $4,889 billion. Single Family Notes are assigned to the Secretary when FHA pays claims to lenders prior to foreclosure and takes possession of mortgage notes for servicing. Under the partial claim option, a lender will advance funds on behalf of FHA-insured homeowners in an amount necessary to reinstate a delinquent loan. Upon acceptance of the advance, the borrower executes a promissory note, creating a secondary mortgage payable to HUD. This promissory note or "partial claim" is not due and payable until the borrower pays off the first mortgage or no longer owns the property. Outstanding Single Family Notes Partial Claims

increased by 9.8 percent (109,037 notes at the end of fiscal year 2011 to 119,742 at the end of fiscal year 2012) in fiscal year 2012. The increase is primarily due to the FHA-HAMP program, which combines a partial claim with a loan modification. Single Family Notes assigned through HECM comprised $2,784 million of the total Secretary-held mortgage notes inventory through the end of fiscal year 2012.

Single Family Loan Sale

In fiscal year 2012, FHA continued the Single Family Loan Sale Pilot that began late in fiscal year 2009. The goal of the program is to maximize returns to the FHA insurance funds while providing another disposition alternative for defaulted single family mortgages, rather than having these assets be conveyed to HUD as foreclosed properties.

During this fiscal year, FHA conducted three sales of defaulted Secretary-held assets. In these offerings the Department accepted bids on pools of defaulted mortgages. In the first two sales, 314 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 third sale offered 9,441 loans with an unpaid principal balance of $1.7 billion to the market in two parts. Part one was held on September 12th, and offered 6 national pools of loans. Part two of the sale targets loans in high default areas and winning bidders agree to service the assets to promote homeownership and rental occupancy and to avoid selling foreclosure homes on the majority of the assets.

Office of Multifamily Housing

Multifamily Housing Programs

Multifamily Housing Programs (MHP) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, and cooperatives. 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 2012, Multifamily Housing initially endorsed 1,286 FHA-insured apartment loans totaling $12.3 billion through 89 active lenders. In addition, Multifamily endorsed 93 Risk Sharing loans totaling $798 million (Table 1). In fiscal year 2012, Multifamily introduced Green Refinance Plus – a partnership with Fannie Mae and Government Sponsored Entities (GSEs) to increase energy efficient upgrades in older affordable properties.

"By providing necessary liquidity to the market place, Multifamily has played an integral role (especially over the last four years) in the stabilization of housing for people seeking market-rate rentals; as well as increasing quality of life for the elderly, low-income and disabled."

Marie Head
Deputy Assistant Secretary
for Multifamily Housing Programs

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 213, 220, 221(d)(4) and 231: New Construction and Substantial Rehabilitation programs

MHP provide mortgage insurance on loans to facilitate new construction or substantial rehabilitation of rental housing apartments and also cooperatives. Section 221(d)(4) supports standard rental apartments for moderate-income families while Section 231 is for the creation of housing for seniors age 62 or older. The principal difference between these programs is the type of housing being developed. Section 213 is for cooperatives while Section 220 is for rental housing in urban renewal or concentrated development areas. While all these programs offer market-rate loans, they can also 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. For fiscal year 2013, the Department is suspending the Section 221(d)(3) program which has been available to non-profits for developing standard rental apartments. That program requires positive credit subsidy (which is Congressionally appropriated) and higher Mortgage Insurance Premiums (MIP) than Section 221(d)(4).

Section 221(d)(4) can be utilized by non-profit owners at much less cost, but with virtually the same benefits as with Section 221(d)(3), including recognition of a developer's fee.

Ascension Manor – Section 221(d)(4)

The Ukrainian Catholic Archdiocese of Philadelphia, along with its development partner, The Michaels Organization hosted a grand reopening and dedication ceremony of the newly revitalized Ascension Manor, a landmark affordable housing community in North Philadelphia that the Archdiocese has owned for the past four decades. The Manor has undergone a complete modernization. The two high-rises now serve almost 300 seniors and individuals with disabilities from all ethnic and cultural backgrounds.

Working with The Michaels Organization, the Archdiocese was able to refinance two previous loans from FHA with a new loan insured under FHA's 221(d)(4) Substantial Rehabilitation program. The refinance generated enough funding for the Archdiocese to make significant capital improvements to the building systems, and to transform the community rooms, common areas, and residential units.

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

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

The FHA Section 223(a)(7) mortgage insurance program offers a streamline refinancing option for multifamily properties already insured by FHA. In addition to expedited processing, the Section 223(a)(7) program can reduce debt service and free up operating income to property owners for other project needs.

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

Under these programs, FHA shares risk on loans originated, underwritten and serviced by Fannie Mae and Freddie Mac in the case of 542(b) or state Housing Finance Agencies under 542 (c). 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, all of which must be "affordable" per the definition given for Low Income Housing Tax Credits, so that 20 percent of units are affordable at 50 percent of Area Median Income (AMI) or 40 percent of units are available at 60 percent of AMI.

Table 1: Multifamily Endorsements by Program

Section of the Act	Endorsements for Fiscal Year 2012		
	Dollars (millions)	**Percentage**	**# of Mortgages**
Section 221(d)(4):New Construction and Substantial Rehabilitation Program	$ 2,332	18%	158
Sections 223(f) and 223(a)(7): Purchase/Refinancing Program of Existing MHP Projects	$9,585	73%	1,110
Section 542(b) and 542(c): Risk-Sharing with QPEs & HFAs	$798	6%	93
Other Programs	$390	3%	18

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

Performance Goals and Objectives

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

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

G2 Sub Goals

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

Target Activity

- Achieve 75 percent of endorsed multifamily properties that have affordability, preservation or sustainability components.
    - As of June 30, 2012, Multifamily reported 66 percent of our Initial Endorsements as having affordability, preservation, and/or sustainability features, against a target of 75 percent. Multifamily expects to meet this goal by the end of the fiscal year.

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

G2 Sub Goals

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

Target Activity

- Provide 13,138 Low Income Housing Tax Credit / Tax Exempt (LIHTC/TE) developed units for fiscal years 2012-2013 or 9,200 units in fiscal year 2012 and 3,938 in Fiscal year 2013.
    - As of June 30, 2012, Multifamily reported 14,391 new completed tax-credits/tax-exempt units, thus meeting the goal for both 2012-2013.
- Restructure 80 percent (53 properties) of eligible properties with approvable action plans within the Mark-to-Market (M2M) pipeline. The target is 53 properties per year for fiscal year 2012-2013.
    - As of the June 30, 2012, we have exceeded our target of 53 properties with approval action plans within the M2M pipeline. This was due in part because more assets entered and completed the program than originally projected. Our actual through June 30, 2012 is 92 projects.

Office of MHP Development

The Office of MHP Development provides direction and oversight for FHA mortgage insurance and risk sharing loan origination. During fiscal year 2012, the Office of MHP Development endorsed 1,379 loans. MHP Development initial endorsements of FHA-insured and Risk Sharing Apartment loans totaled $13.1 billion and covered 200,652 units, continuing to support 54,525 private sector jobs in the construction, property management, service provision and administrative fields created in fiscal year 2011.

Because of the continued significant difficulties in the housing market during fiscal year 2012, the dollar volume for FHA endorsements maintained historic volume and has increased consistently over the most recent three-year period, providing significant credit liquidity to the market during the country's major economic downturn. Additionally, Multifamily supports special initiatives directed to the elderly and underserved areas having high concentrations of low income or minority families.

Veranda at University Homes

Currently under construction, Veranda at University Homes is a 221(d)(4) 100-unit low-income housing tax credit (LIHTC) midrise complex, five (5) stories high and located in Atlanta, Georgia immediately adjacent to the Atlanta University Center, which consists of the Clark Atlanta University, Spellman College, Morehouse College, and Morris Brown campuses. The subject has a 100% project-based rental assistance (PBRA) contract through the Atlanta Housing Authority. The project is located west of downtown Atlanta and slightly north of Interstate 20. Numerous bus stops along various MARTA lines are within a reasonable walking distance. In addition, two MARTA rail stations are in close proximity to the project, west end to the south (1.5 miles) and to the North West (.5 miles). Adequate police and fire protection services are provided by the City of Atlanta and Fulton County. Retail and other commercial developments are easily accessible and can be found on major thorough fares such as Martin Luther King Dr. The project has convenient access to downtown landmarks including the Georgia Dome, Georgia World Congress Center, Centennial Olympic Park and the 5 million square foot Atlanta Market Center.

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) with restructuring authority through fiscal year 2015. Under this program, OAHP administers restructuring of existing debt, for certain privately owned assisted multifamily properties, to levels that are supported by comparable market rents affordable to tenants. OAHP also provides assistance for oversight and preservation of a wide spectrum of affordable housing programs.

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

During fiscal year 2012, OAHP completed restructuring on 105 properties, covering 8,908 units under the M2M program, of which 89 properties or 85 percent resulted in reduced rents and Section 8 savings. Of the 105 properties, 41 resulted in full debt restructuring, contributing to the long-term preservation of 3,182 units, which represented an annual Section 8 savings of $19 million. Additionally, 48 properties consisting of 4,115 units reduced rents only, representing an annual Section 8 savings of $66.4 million. The restructured units yielded an annual net savings (non-incurrence of cost) to FHA of over $85.4 million.

Multifamily Asset Management

As of September 30, 2012, FHA's Multifamily insured portfolio totaled 10,221 mortgages with a total outstanding principal balance of approximately $57.2 billion.

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, FHA 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. During fiscal year 2012, FHA sold 32 Multifamily first lien mortgage notes to successful bidders. The gross proceeds from these sales were $158.9 million.

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

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

    - *Addressing obsolete housing*. Notice 11-03 allows for the conversion of efficiency units into 1-bedroom units, to reduce vacancies.
    - *Flexible subsidy debt*. Notice 11-05 allows for the deferral of flexible subsidy debt, creating more options for owners.

- *FHA reforms*. HUD is developing a Tax Credit Pilot program to facilitate the refinance and rehab of Section 8 properties using FHA mortgage insurance. We are also making enhancements to the 223(f) refinance program to allow for additional repairs.
- *Early Warning System and other "Breaking Ground" Initiatives*. Processing times have been substantially reduced, particularly in offices with large backlogs of cases, as a result of staff adopting new workload management techniques including display of cases on a whiteboard reviewed weekly by the processing team and use of an "Early Warning System" screening tool to quickly identify problematic applications.

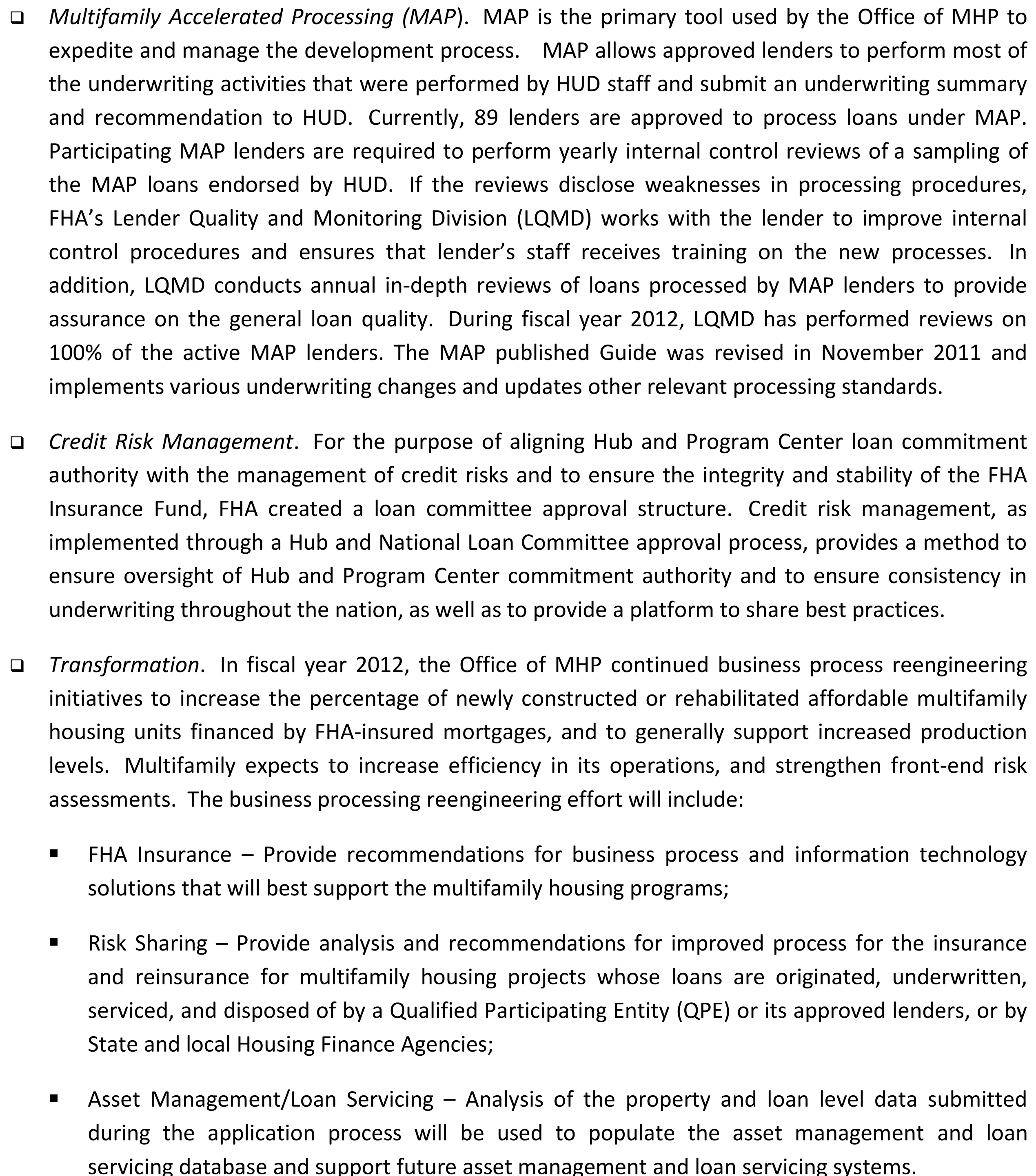
Pineshores Apartments – LIHTC

Preserving older properties: Pineshores Apartments is the refinance of a 120-unit project that combines a FHA-insured loan with new low-income housing tax credits for restricted rents at 45%, 50% and 60% of Area Median Income located in the Mt. Morris Township, Michigan. In addition, for easy access, the MTA Linden Road bus line is located directly in front of the project. As part of the rehabilitation, Energy Star appliances are being installed in all the units, HVAC systems and other "green" designs including low flow showerheads and toilets and daylight sensors on all outdoor lighting.

Management Initiatives and Program Improvements

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

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



- *Multifamily Accelerated Processing (MAP)*. MAP is the primary tool used by the Office of MHP to expedite and manage the development process. MAP allows approved lenders to perform most of the underwriting activities that were performed by HUD staff and submit an underwriting summary and recommendation to HUD. Currently, 89 lenders are approved to process loans under MAP. Participating MAP lenders are required to perform yearly internal control reviews of a sampling of the MAP loans endorsed by HUD. If the reviews disclose weaknesses in processing procedures, FHA's Lender Quality and Monitoring Division (LQMD) 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. During fiscal year 2012, LQMD has performed reviews on 100% of the active MAP lenders. The MAP published Guide was revised in November 2011 and implements various underwriting changes and updates other relevant processing standards.

- *Credit Risk Management*. For the purpose of aligning Hub and Program Center loan commitment authority with the management of credit risks and to ensure the integrity and stability of the FHA Insurance Fund, FHA created a 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 2012, the Office of MHP continued business process reengineering initiatives to increase the percentage of newly constructed or rehabilitated affordable multifamily housing units financed by FHA-insured mortgages, and to generally support increased production levels. Multifamily expects to increase efficiency in its operations, and strengthen front-end risk assessments. The business processing reengineering effort will include:

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

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

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

Interim steps have been taken to improve loan processing times immediately. FHA studied the workflow of two Hubs, analyzed the findings and implemented the Breaking Ground initiative that helped reduce processing times. A modernized, re-vamped IT platform is necessary to sustain and continue that initiative and support continued improvements.

Risk Management

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

In an effort to improve its overall risk management, the Office of MHP is revising lender/underwriter qualifications to further minimize the Department's risk. The final rule for lender/underwriter qualification revisions will be published in fiscal year 2013.

During fiscal year 2012, Multifamily continued to introduce initiatives with a goal of managing risk within its programs, given the current state of the housing market. These initiatives originated in June 2010 with Mortgagee Letter 2010-20, Implementation of Final Rule FR 5356-F-02, "Federal Housing Administration: Continuation of FHA Reform—Strengthening Risk Management through Responsible FHA-Approved Lenders." The improvements from this issuance increased the net worth requirements for FHA-approved lenders, thereby ensuring that 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, Multifamily uses a Multifamily Risk of Claim (MROC) scoring algorithm to measure credit risk and the probability of a loan claiming. A risk management assessment is conducted monthly to review portfolio performance by lender and by loan, for each geographic area, in an effort to determine trends in defaults and delinquency, application sharing and areas of concerns.

Office of Healthcare Programs

Healthcare Programs

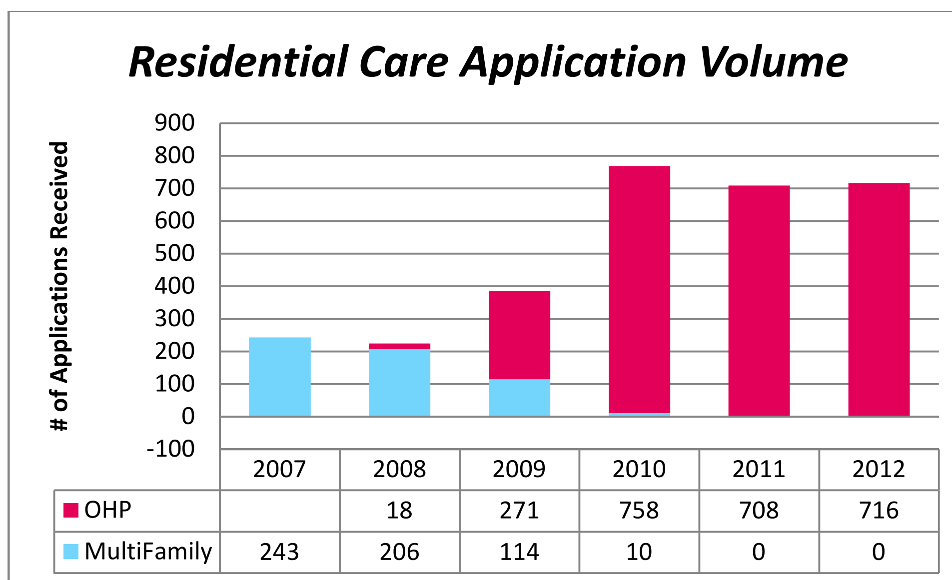
The Office of Healthcare Programs (OHP) administers the following programs that enable low cost financing of health care facility projects and improve access to quality health care by reducing the cost of capital.

"An increasing demand is being placed on the public health system. FHA's Healthcare Programs play a vital role by providing low cost financing for facilities that are helping to meet this demand."

Roger Miller
Deputy Assistant Secretary
for Healthcare Programs

Section 232 Mortgage Insurance for Residential Care Facilities

The Residential Care Facilities program insures loans to finance the construction, substantial rehabilitation, acquisition or refinancing of healthcare facilities. Eligible facilities include nursing homes, intermediate care facilities, board and care homes, and assisted living facilities. During fiscal year 2012, OHP issued 785 commitments totaling $6 billion for 90,372 units. At the end of fiscal year 2012, the portfolio contained 2,847 loans with an unpaid principal balance of $20 billion. Since fiscal year 2008, industry demand for the program has grown from 224 initial applications received to 716 applications received in fiscal year 2012.



	2007	2008	2009	2010	2011	2012
OHP		18	271	758	708	716
MultiFamily	243	206	114	10	0	0

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

Highlighted 232 Project – Mayberry Gardens

Construction on Phase V of assisted living project Mayberry Gardens, located in Garland, Texas, was completed in April 2012. The three new 11-bed buildings and club house were added to the existing campus with a 241(a) loan. Each residential building has been designed as a standalone home, with its own living/dining area, residential kitchen, office, and common areas. Phases I through III of the project were financed with Section 232 new construction loans and Phase IV was added with a 241(a) loan. This Phase V construction project now includes a total of 121 assisted living apartment units.

Phase V of Mayberry Gardens, located in Garland, Texas was completed in April 2012.

Economic Impact of 232 New Construction/Substantial Rehabilitation Projects

In addition to providing important healthcare facilities, construction and rehabilitation projects have a significant economic impact on local communities, including a substantial impact on employment. As of September 30, 2012, the Section 232 Program has insured 25 projects in 14 states creating/utilizing over 5,270 full-time equivalent construction jobs with a total construction economic impact of $643 million dollars. Once the projects are fully constructed, the residential healthcare facilities will create over 2,600 full-time equivalent jobs and provide a total annual economic impact of $316 million dollars to their local communities.

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. The 242 Program provides access to capital for numerous facilities that provide some of the top care in the Nation. Eight of the hospitals in OHP's portfolio have been ranked by U.S. News and World Report for having some of the premier departments across the country. This includes the #1 ranking for Orthopedics in the country (Hospital for Special Surgery) and the #6 overall Top Hospital in the United States (New York Presbyterian Hospital). Due to the low cost of capital provided by FHA, these hospitals have a reputation of being groundbreaking facilities providing many firsts in their regions and across the nation. This includes the nation's first-ever FDA approved 3D digital mammography technology for breast cancer screening and diagnosis (Albany Medical Center) and the first successful pacemaker implantation for an infant in the United States (Baton Rouge General Hospital). As a result, OHP has made "FHA" synonymous in the medical community with "low-cost quality healthcare."

FHA currently has 110 active hospital loans with unpaid principal balances totaling $9 billion. In fiscal year 2012, FHA issued 6 insurance commitments totaling $246 million. The unpaid principal balance of insured loans has more than doubled from $4 billion in fiscal year 2004 to $9 billion in fiscal year 2012.

<u>Highlighted 242 Projects</u>

Knox Community Hospital - Mount Vernon, OH

FHA committed to insure a $37.1 million mortgage loan for Knox Community Hospital on November 30, 2011. Knox Community Hospital, a sole community provider designated by The Center for Medicare and Medicaid Services, is a not-for-profit operating a 115-bed acute care facility.

The $37.1 million loan allows Knox Community Hospital to renovate operating rooms, expand the catheterization laboratory for diagnostic and interventional cardiac services, and implement a hospital-wide electronic health records system. In addition, the loan will refinance $15.9 million of 2004 revenue bonds held by the hospital. By insuring the mortgage loan, FHA is enabling the hospital to obtain lower cost financing that will save an estimated $8.5 million in interest costs over the life of the loan.

HUD estimates that the Knox Community Hospital construction project will support approximately 328 full-time jobs and provide an economic boost of $61 million to the community. Following construction completion, the completed project will support an estimated 372 total full-time equivalents in the community and provide an annual economic benefit of $48 million each year.

Gates Vascular Institute, located in Buffalo, New York, was financed by a $100.3 million FHA-insured loan.

Gates Vascular Institute - Buffalo, NY

An FHA-insured mortgage loan for $100.3 million financed the construction of the new 478,000-square-foot 10-story Gates Vascular Institute facility adjacent to Kaleida Health's Buffalo General Medical Center. The building includes a new emergency room, 62 extended recovery bays, seven operating rooms, 16 cardiac care unit beds, 15 cardiac catheterization/angioplasty labs, and support space. The new facility also houses research and development facilities, including four floors owned by the State University of New York-Buffalo (UB) for its Clinical and Translational Research Center and a Biosciences Incubator.

Kaleida officials say the new building will help transform Buffalo into a regional destination for excellence in health care, on par with medical research centers available in Cleveland and Pittsburgh. The collaborative work being done in this building will play a major role in the continued growth of a life-sciences industry in Buffalo and the creation of a knowledge-based economy leading to the creation of thousands of new jobs in the area.

Performance Goals and Objectives

The Office of Healthcare Programs is responsible for critical activities within the HUD Strategic Plan. Listed below are the Management Action Plan goals.

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

G2 Sub Goal

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

Target Activities

- Achieve enough initially endorsed Section 232 Residential Care Facility mortgages to preserve 558 occupied affordable assisted living facility dwelling units/ for Medicaid-eligible tenants in fiscal year 2012-2013.
    - As of June 30, 2012, OHP has preserved 1,343 occupied affordable assisted living facility dwelling units, more than doubling the target number of units.

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

G3 Sub Goal

3B Utilize HUD assistance to improve health outcomes.

Target Activities

- Increase the average Centers for Medicare/Medicaid Services (CMS) quality rating of the FHA residential care facility portfolio by issuing skilled nursing home commitments with an average CMS rating of 2.2 or higher.
    - As of June 30, 2012, the average quality CMS rating for new commitments issued for skilled nursing homes was 3.0, substantially exceeding the performance goal.

- Enable 8 hospitals to obtain affordable financing for construction or modernization projects that result in the provision of needed healthcare to communities through the issuance of Section 242 FHA mortgage insurance.
    - As of June 30, 2012, FHA enabled 2 hospitals to obtain affordable financing. The target for this goal was established based upon the assumption that the Section 242/223(f) refinancing regulations would be finalized within fiscal year 2012, authorizing OHP to start processing 223(f) refinancing applications for hospitals under the Section 242 program. However, this did not occur and it is now anticipated that the rule will be finalized in fiscal year 2013. As a result, OHP was not authorized to accept 223(f) applications from hospitals, which resulted in a lower number of applications received and a slightly lower yield of projects completed by the end of the fiscal year.

Risk Management

With an outstanding portfolio balance of $29 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 payments.

OHP is working to improve underwriting standards and ensure consistent applications 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.

Proactive 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 to work out problems. Approaches to loss prevention include working with State Agencies on early notification of potential adverse action; expediting refinancing; working with lenders who have identified potential owners, operators or equity providers and using available options to supplement funds until a property is stabilized. Options for minimizing losses on HUD-held loans include partial payments of claim, positioning notes for re-assignment, modifying mortgages and identifying equity providers/purchasers.

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

Office of Risk Management and Regulatory Affairs

In 2010, FHA received Congressional approval to establish the Office of Risk Management and Regulatory Affairs (ORMRA) and create the position of Deputy Assistant Secretary for Risk Management and Regulatory Affairs, which reports directly to the Assistant Secretary for Housing – FHA Commissioner. The office functions within the Office of Housing to assess and manage risks in the program areas for Single Family Housing, Multifamily Housing and the Office of Healthcare Programs. Within ORMRA, risk assessment and management functions reside in the Office of Evaluation (OE) and the newly established Office of Risk Management (ORM). The Office of Manufactured Housing which creates and enforces the national construction and safety standards for manufactured homes resides in the Regulatory Affairs side of the Office.

"Risk management is about understanding and explaining our risk well enough to enable the FHA's leadership to make informed choices as we set out to achieve our mission".

Frank Vetrano
Deputy Assistant Secretary
for the Office of Risk
Management and Regulatory
Affairs

The Office of Evaluation oversees the annual independent actuarial studies that determine the net worth of the insurance fund and conducts ongoing portfolio analysis designed to assess risks to the insurance fund. The actuarial studies forecast the effect that various economic risks will have on the fund, including alternative scenarios for volatile interest rates and recoveries and recessions of various degrees. The Office of Evaluation also performs ongoing and in-depth analysis to determine the effects of various risks on the portfolio.

One significant initiative of ORMRA is implementing the concept of risk management within FHA program offices by such things as monthly credit risk committee meetings. In addition, ORMRA is exploring the creation of quarterly operational risk committees to assess and remediate operational risks relating to people, process, and technology, in partnership with the program offices. ORMRA's several top priorities for Fiscal Year 2012 included: (1) defining and clearly communicating FHA's risk credit appetite to the lender community; (2) aligning policy enforcement to FHA's material deficiency standard and improving the feedback loop; and (3) improving the REO disposition activities and loss severity rates.

ANALYSIS OF FINANCIAL STATEMENTS

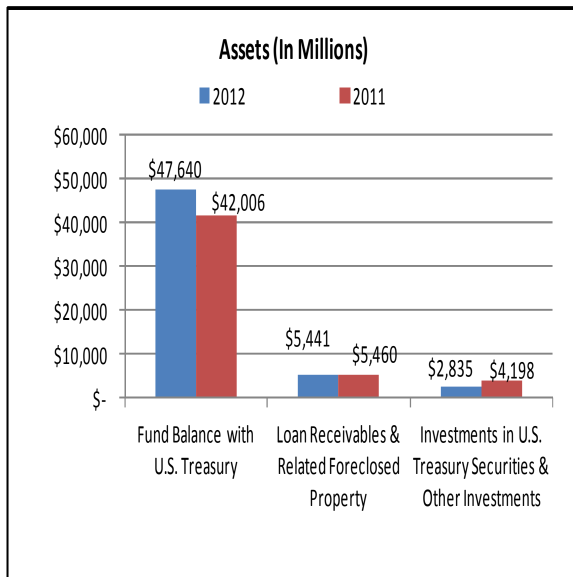
This section presents a summary analysis of FHA's financial statements. The financial statements in this report were prepared using (GAAP) General Accepted Accounting Principles in the United States for Federal entities, the Federal Credit Reform Act of 1990 and in accordance with the Office of Management 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 financial statements. This is the 20th consecutive year FHA has received an unqualified audit opinion on its financial statements.

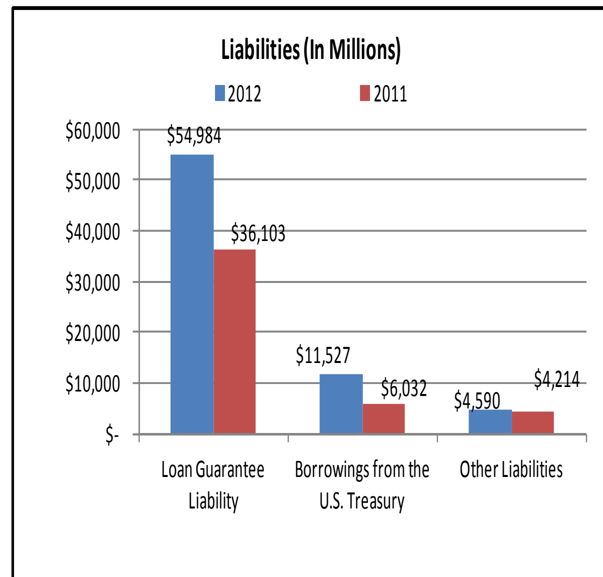
Overview of Financial Position

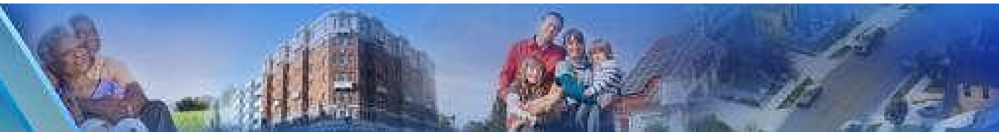
A summary of FHA's change in financial position from fiscal year 2011 to fiscal year 2012 is presented in the following sections on Assets and Liabilities, Net Cost and Budgetary Resources.

Assets and Liabilities

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







The increase in assets is primarily attributable to cash accrued from the maturity of investments and sale of several large bonds, not reinvested, and the interest earned on the cash balances in the financing accounts. The earned interest amount totaled $1,880 million in fiscal year 2012. FHA also earned interest and realized gains on investments in the MMI capital reserve account. Interest earned on these investments totaled $117 million and the gain on the sale of investments totaled $1,116 million. Also, during fiscal year 2012, FHA increases its revenues through funds received from the National Servicing Settlement with the Country's five largest loan servicers, as well as settlements from lenders as a result of increased monitoring and enforcement actions.

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

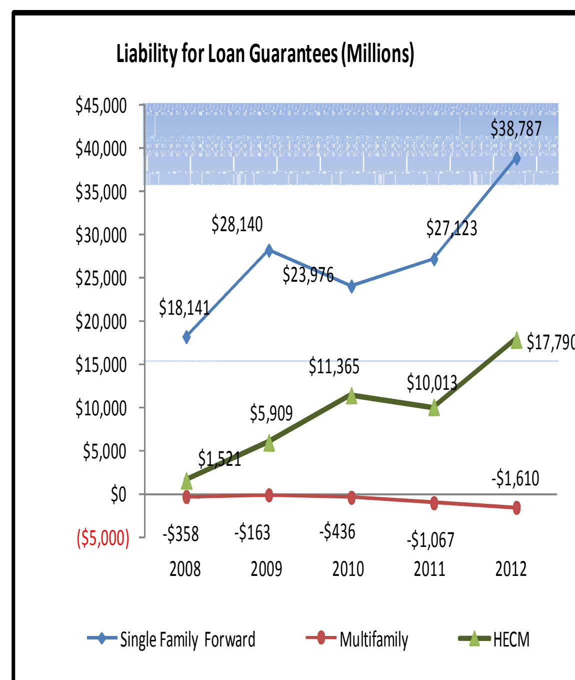
The LLG related to Credit Reform loans (made after September 30, 1991) is comprised of the present value of anticipated cash outflows, such as claim payments, premiums refunds, property expense for on-hand properties and sales expense for sold properties, less anticipated cash inflows, such as premium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

Schedule of Liability for Loan Guarantees
(Dollars in Millions)

	FY 2012	FY 2011	Difference	% Change
Single Family Forward	$ 38,787	$ 27,123	$ 11,664	43%
HECM	17,790	10,013	7,777	78%
Multifamily/Healthcare	(1,610)	(1,067)	(543)	51%
Total	**$ 54,967**	**$ 36,069**	**$ 18,898**	**52%**

The $11,664 million single family forward LLG increase is primarily caused by historically low interest rates and decreased anticipated revenues; fewer short sales, which increased anticipated losses on conveyance claims in the near term; and slower price growth caused by an additional year delay before recovery takes place.

The $7,777 million HECM LLG increase is primarily due to revised estimates of borrower and loan longevity; recessionary effect of more properties being conveyed to HUD after loan termination; and updated adjustment for so-called tax-and-insurance defaults.



The $543 million multifamily/healthcare LLG decrease can be attributed to decreases in several programs. The 223(f) liability decreased by $246 million principally due to lower claim expectations. Section 232 Refinance liability decreased by $115 million due to lower claim expectations and significantly increased insurance-in-force in fiscal year 2012 endorsements. The Section 242 liability decreased by $23 million due to higher premium revenue caused by decreased pre-payment expectations.

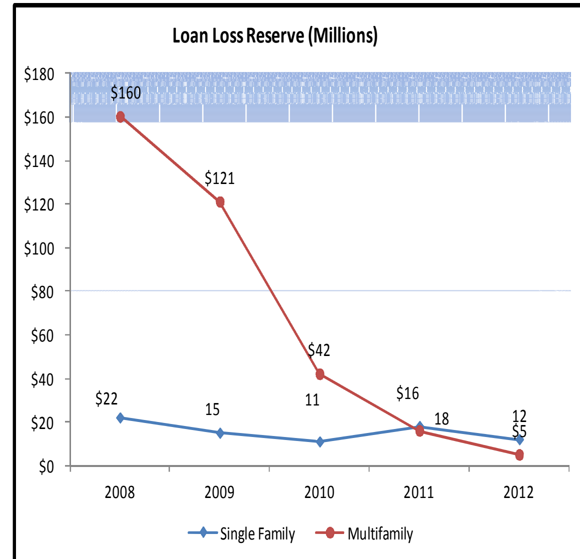
Pre-1992 Loan Loss Reserve (LLR)

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

Schedule of Loan Loss Reserve
(Dollars in Millions)

	FY 2012	FY 2011	Difference	% Change
Single Family	$ 12	$ 18	$ (6)	-33%
Multifamily/Healthcare	5	16	(11)	-69%
Total	**$ 17**	**$ 34**	**$ (17)**	**-50%**

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



Overall, loss reserves decreased by $17 million, from $34 million in fiscal year 2011 to $17 million in fiscal year 2012. The majority of the decrease can be attributed to decreasing liability for pre-credit reform multifamily loans outstanding.

Net Cost/ (Surplus)

FHA's program costs exceeded revenues in fiscal year 2012, resulting in a net loss. The most important facet of FHA's cost and revenue activity is the treatment of loan guarantee subsidy cost. Loan guarantee subsidy cost is the estimated long-term cost to FHA of a loan guarantee calculated on a net present value basis, excluding administrative costs. The cost of a loan guarantee is the net present value of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements as well as payments made to FHA, including premiums, penalties, and recoveries are also included in the calculation.

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

	FY 2012	FY 2011	Difference	% Change
Program Cost	$ 23,523	$ 5,697	$ 17,826	313%
Less: Program Revenues	3,226	2,178	1,048	48%
Net Cost (Surplus)	**$ 20,297**	**$ 3,519**	**$ 16,778**	**477%**

FHA had a net program loss in 2012. The program cost difference is primarily due to the increase in subsidy cost in fiscal year 2012 for the re-estimates of the Loan Guarantee Liability in Single Family Housing and HECM programs.

Budgetary Resources

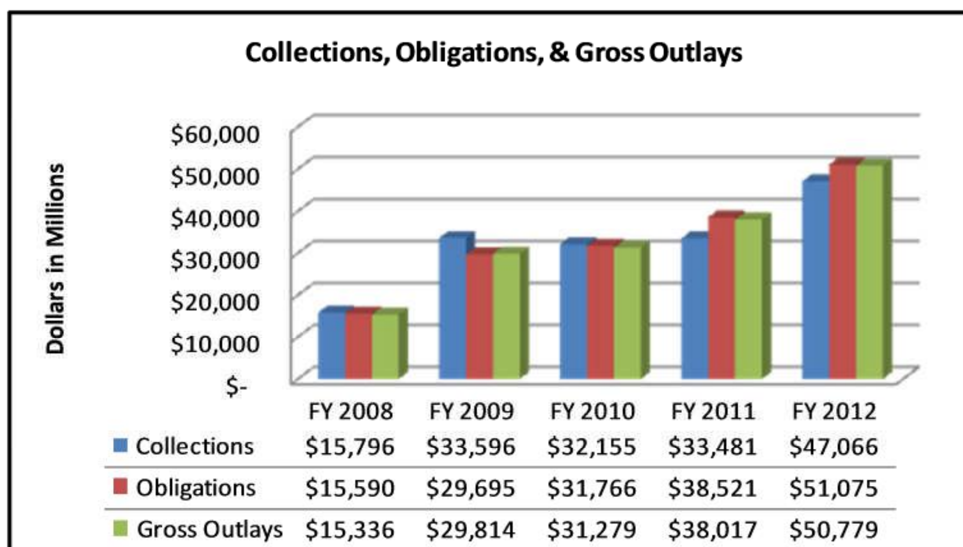
FHA finances its operations primarily through appropriations, borrowings from the U.S. Treasury, spending authority from offsetting collections, and prior year unobligated balances carried forward.

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

Budgetary Resources
(Dollars in millions)

	FY 2012	FY 2011	Difference	% Change
Offsetting Collections	$ 47,066	$ 33,481	$ 13,585	41%
Unobligated Balance Carried Forward	41,814	39,906	1,908	5%
Appropriations	912	3,243	(2,331)	-72%
Borrowing Authority	5,760	3,838	1,922	50%
Recoveries, Transfers, and Other	(128)	(133)	5	-4%
Total Budgetary Resources	**$ 95,424**	**$ 80,335**	**$ 15,089**	**19%**

These resources were used to cover the fiscal year 2012 obligations totaling $51,075 million. These obligations included: claim payments on defaulted guaranteed loans and the cost of acquiring, maintaining and disposing of foreclosed properties.



SYSTEMS, CONTROLS, AND COMPLIANCE

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

FHA's internal controls support effective operation of the FHA insurance programs, reliable financial reporting, and compliance with laws and regulations.

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

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

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

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, 2012 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2012

Annual Assurance Statement on Internal Control over Financial Reporting

The Federal Housing Administration's (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, 2012 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

Carol J. Galante

Acting Assistant Secretary for Housing,
Federal Housing Commissioner

FHA Compliance with OMB Circular A-127, Financial Management Systems

FHA's management has reviewed FHA's core financial system and fifteen mixed financial systems for compliance with the OMB Circular A-127, FFMIA Implementation Guidelines, the National Institute of Standards and Technology (NIST) Special Publication 800-53 controls required under the Federal Information Security Management Act, and OMB Circular A-123, "Management's responsibility for Internal Controls". Management has concluded that FHA's core financial system complies with the Federal Financial Management System Requirements and applicable accounting standards, and implements the U.S. Standard General Ledger at the transaction level. FHA's fifteen mixed financial and program systems are integrated with the core financial system through extensive electronic interfaces. Operating interdependently, these financial systems taken together are substantially in compliance with FFMIA, OMB Circular A-127, and OMB Circular A-123 requirements.

In the fiscal year 2011 financial statement audit, FHA's independent auditors identified a significant deficiency relating to security management, system access, and configuration management. FHA has implemented additional controls during fiscal year 2012 to address these deficiencies.

FHA's independent auditors also noted our responsibility to comply with the OMB Circular A-127 requirement that financial systems "support the most current federal business practices and system requirements." FHA's financial systems vary widely in age and rely upon many different kinds of hardware and software for their operation. The auditors have recommended that FHA assess the sustainability and scalability of these systems to meet future changes in program operations and policy.

The Office of the Housing FHA Comptroller continuously monitors all FHA accounting and financial operations through weekly management meetings and through exception reporting for operational problems identified by managers and staff. FHA has sustained program operations with its current systems through significant changes in its mortgage insurance operations since 2008, adapting staff and contractor workloads where necessary. Through continuous monitoring, FHA management has validated the continued sustainability and scalability of existing systems to meet operating requirements in the foreseeable future.

Management considers FHA's existing systems can continue to sustain the operation of the FHA insurance programs for the immediately foreseeable future. FHA management recognizes that these systems must eventually be modernized to meet advancing standards and new expectations for efficiency and flexibility. FHA is currently investing in a major systems modernization program that will apply current technologies to:

- Detect and prevent fraud, waste, and abuse
- Prudently manage credit risk at both the portfolio and loan level
- Implementing streamlined business processes and modern information technology infrastructure

The first priorities of the program have been the deployment of a Portfolio Evaluation Tool to monitor and control risk, deployment of a Risk and Fraud tool to detect risk early in the load process, and

automation of lender applications and approval. The FHA Transformation program is building a Financial Services Platform using the latest Oracle technology to support evolving FHA requirements for risk management and improving FHA's controls over the insurance portfolio. The Financial Service Platform provides FHA with a modern application infrastructure for future modernization priorities.

Fiscal Year 2012 Material Weaknesses

There were no material weaknesses identified for fiscal year 2012.

Improper Payments Elimination and Recovery Act of 2010

In accordance with the Improper Payments Elimination and Recovery Act (IPERA) of 2010, enacted on July 22, 2010, and the OMB Memorandum dated April 14, 2011, FHA complied with the requirements and determined which of its program activities required review this year. Pursuant to the Act, FHA has analyzed the dollar volumes of each disbursement program for the period between May 1, 2011 and April 30, 2012. Based on a HUD threshold of $40 million, the following disbursements programs exceeded the threshold:

- Single Family Insurance Claims System (SFIC)
- Home Equity Conversion Mortgage (HECM) Notes
- Multifamily Insurance Claims (MFIC)
- Multifamily Notes
- Single Family Acquired Asset Management System (SAMS) Disbursement Program
- Contracts and Grants

During fiscal year 2012, limited risk assessments were conducted on all programs to determine that the programs are of low risk and there were no changes that might be vulnerable to improper payments. Our risk assessment revealed that there were no significant changes to processes by which the disbursements were processed, leading us to conclude that systems are not susceptible to improper payments. We have performed random statistical sampling and analyses of HECM Notes, MFIC and SAMS case files and statistical testing of SFIC disbursements in fiscal year 2012. The findings from case files review have confirmed that programs are not susceptible to significant risk of improper payments for the fiscal year 2012. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A, concluded that each of these programs has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

Legislation passed in 2010 requires agencies that enter into contracts worth more than $1 million in a fiscal year to complete a cost-effective program for identifying errors made in paying contracts and grants and recovering any improper payments. In fiscal year 2012, we estimated total contract disbursements of $112 million.

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

FHA has established a payment recapture process for its claim disbursement systems. It has an extensive debt collection program to recover overpayments.

Limitations of Financial Statements

The following limitations apply to the preparation of the fiscal year 2012 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

MESSAGE FROM THE DEPUTY ASSISTANT SECRETARY FOR FINANCE AND BUDGET

November 15, 2012

Another challenging year has come to a close and FHA is able to recognize some significant accomplishments that enhanced financial reporting and strengthened internal controls over financial data and system processing. The effects of these efforts are confirmed by FHA's receipt of a 20th consecutive unqualified audit opinion on its annual financial statements and has had no material weaknesses for the last five years.

Some areas of primary focus during fiscal year 2012 were to continue corrective actions towards addressing audit recommendations relating to prior year's significant deficiencies of the agency not being able to effectively analyze and resolve Information Technology control deficiencies, improve the capital reserves, and reduce the risk associated with our legacy financial systems.

During the year, FHA finalized the development and testing of the new Single Family Home Equity Conversion Mortgage Business Service Provider (HECMBSP) system that will encompass the management of the entire program. At the start of fiscal year 2013, HECMBSP will go online to manage the collection of premiums, notes servicing, and payment of claims. This new HECM system will initially assist with eliminating the backlog of HECM claims and allow claims to be processed more timely going forward. In addition, FHA was able to successfully convert 3 bank lockboxes to the Treasury Pay.Gov system. This change allows FHA approved mortgage lenders to process payment electronically and significantly reduces reporting and bank service fees for the agency.

During fiscal year 2012, FHA saw a significant increase in the amount of Single Family periodic insurance premium collections. The total premiums collected increased from $4.8 billion in fiscal year 2011 to $6.2 billion this year, an increase of 28 percent. The increased collections also resulted in a single month collection record of $500 million. Another challenge met successfully, was the processing of an increased volume of single family claims. During this fiscal year, the Single Family Claims Branch paid 394,380 insurance claims valued at over $20 billion; up from $16.7 billion paid in fiscal year 2011.

Due to the current housing market conditions, FHA has been unable to restore the MMI fund capital ratio to the minimum 2% required by the Cranston-Gonzales National Affordable Housing Act of 1990. FHA has made four premium rate changes since April 2010, which have brought in additional reserves to meet the high volume of claims. The impact of these premium rate changes for the full fiscal year 2013 financial year, along with new endorsements, will provide about $11 billion towards bolstering the reserve. As FHA continues to address changes in the housing market and achieve FHA's mission, we will continue to focus on improved financial management.

George Tomchick
Deputy Assistant Secretary for Finance and Budget

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2012 and 2011
(Dollars in Millions)

	FY 2012	FY 2011
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 47,640	$ 42,006
Investments (Note 4)	2,775	4,135
Other Assets (Note 7)	3	3
Total Intragovernmental	$ 50,418	$ 46,144
Investments (Note 4)	$ 60	$ 63
Accounts Receivable, Net (Note 5)	24	32
Loans Receivable and Related Foreclosed Property, Net (Note 6)	5,441	5,460
Other Assets (Note 7)	60	69
TOTAL ASSETS	**$ 56,003**	**$ 51,768**
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 8)	$ 6	$ -
Borrowings from U.S. Treasury (Note 9)	11,527	6,032
Other Liabilities (Note 10)	3,473	3,051
Total Intragovernmental	$ 15,006	$ 9,083
Accounts Payable (Note 8)	$ 721	$ 723
Loan Guarantee Liability (Note 6)	54,984	36,103
Debentures Issued to Claimants (Note 9)	-	10
Other Liabilities (Note 10)	396	430
TOTAL LIABILITIES	**$ 71,107**	**$ 46,349**
NET POSITION		
Unexpended Appropriations (Note 16)	$ 862	$ 850
Cumulative Results of Operations	(15,966)	4,569
TOTAL NET POSITION	**(15,104)**	**$ 5,419**
TOTAL LIABILITIES AND NET POSITION	**$ 56,003**	**$ 51,768**

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, 2012 and 2011
(Dollars in Millions)

	FY 2012	FY 2011
Single Family Forward		
Intragovernmental Gross Costs	$ 327	$ 274
Less: Intragovernmental Earned Revenue	2,608	1,426
Intragovernmental Net Costs	(2,281)	(1,152)
Gross Costs With the Public	15,455	7,246
Less: Earned Revenues	50	25
Net Costs With the Public	15,405	7,221
Single Family Forward Net Cost (Surplus)	**$ 13,124**	**$ 6,069**
HECM		
Intragovernmental Gross Costs	$ 52	$ 48
Less: Intragovernmental Earned Revenue	477	631
Intragovernmental Net Costs	(425)	(583)
Gross Costs With the Public	8,159	(1,626)
Less: Earned Revenues	5	1
Net Costs With the Public	8,154	(1,627)
HECM Net Cost (Surplus)	**$ 7,729**	**$ (2,210)**
Multifamily/Healthcare		
Intragovernmental Gross Costs	$ 85	$ 89
Less: Intragovernmental Earned Revenue	28	49
Intragovernmental Net Costs	57	40
Gross Costs With the Public	$ (1,244)	$ (1,029)
Less: Earned Revenues	58	47
Net Costs With the Public	(1,302)	(1,076)
Multifamily/Healthcare Net Cost (Surplus)	**$ (1,245)**	**$ (1,036)**
Administrative and Contracts		
Intragovernmental Gross Costs	$ 29	$ 22
Less: Intragovernmental Earned Revenue	-	-
Intragovernmental Net Costs	29	22
Gross Costs With the Public	660	674
Less: Earned Revenues	-	-
Net Costs With the Public	660	674
Adminstrative and Contracts Net Cost (Surplus)	**$ 689**	**$ 696**
Net Cost of Operations	**$ 20,297**	**$ 3,519**

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 Changes in NET POSITION
For the Periods Ended September 30, 2012 and 2011
(Dollars in Millions)

	FY 2012 Cumulative Results of Operations	FY 2012 Unexpended Appropriations	FY 2011 Cumulative Results of Operations	FY 2011 Unexpended Appropriations
BEGINNING BALANCES	**$ 4,569**	**$ 850**	**$ 6,761**	**880**
Budgetary Financing Sources				
Appropriations Received (Note 16)	-	983	-	3,311
Other Adjustments (Note 16)	-	(24)	3	(25)
Appropriations Used (Note 16)	875	(875)	3,244	(3,244)
Transfers-Out (Note 15 and Note 16)	(395)	(72)	(492)	(72)
Other Financing Sources				
Transfers In/Out (Note 15)	(481)	-	(1,229)	-
Imputed Financing (Note 12)	15	-	18	-
Other	(252)	-	(217)	
Total Financing Sources	**$ (238)**	**$ 12**	**$ 1,327**	**(30)**
Net (Cost) Surplus of Operations	**(20,297)**	**-**	**(3,519)**	**-**
ENDING BALANCES	**$ (15,966)**	**$ 862**	**$ 4,569**	**$ 850**

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, 2012
(Dollars in Millions)

	FY 2012 Budgetary	FY 2012 Non-Budgetary	FY 2012 Total
Budgetary Resources:			
Unobligated balance brought forward, October 1	5,565	36,249	41,814
Unobligated balance brought forward, October 1, as adjusted	5,565	36,249	41,814
Recoveries of prior year unpaid obligations	26	122	148
Other changes in unobligated balance (+ or -)	(276)	-	(276)
Unobligated balance from prior year budget authority, net	5,315	36,371	41,686
Appropriations (discretionary and mandatory)	912	-	912
Borrowing authority (discretionary and mandatory)	-	5,760	5,760
Spending authority from offsetting collections (discretionary and mandatory)	12,737	34,329	47,066
Total budgetary resources	**18,964**	**76,460**	**95,424**
Status of Budgetary Resources:			
Obligations incurred	14,890	36,185	51,075
Unobligated balance, end of year:			
Apportioned	59	18,346	18,405
Unapportioned	4,015	21,929	25,944
Total unobligated balance, end of year	4,074	40,275	44,349
Total budgetary resources	**18,964**	**76,460**	**95,424**
Change in Obligated Balance:			
Unpaid obligations, brought forward, October 1 (gross)	737	2,320	3,057
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(20)	(1)	(21)
Obligated balance, start of year (net), before adjustments (+ or -)	717	2,319	3,036
Obligated balance, start of year (net), as adjusted	717	2,319	3,036
Obligations incurred	14,890	36,185	51,075
Outlays (gross) (-)	(14,868)	(35,911)	(50,779)
Change in uncollected customer payments from Federal sources (+ or -)	18	1	19
Recoveries of prior year unpaid obligations (-)	(26)	(122)	(148)
Unpaid obligations, end of year (gross)	733	2,472	3,205
Uncollected customer payments from Federal sources, end of year	(2)	-	(2)
Obligated balance, end of year (net)	731	2,472	3,203
Budget Authority and Outlays, Net:			
Budget authority, gross (discretionary and mandatory)	13,649	40,089	53,738
Actual offsetting collections (discretionary and mandatory) (-)	(12,766)	(34,595)	(47,361)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	18	1	19
Budget authority, net (discretionary and mandatory)	901	5,495	6,396
Outlays, gross (discretionary and mandatory)	14,868	35,911	50,779
Actual offsetting collections (discretionary and mandatory) (-)	(12,766)	(34,595)	(47,361)
Outlays, net (discretionary and mandatory)	2,102	1,316	3,418
Less Distributed offsetting receipts (-)	2,611	-	2,611
Agency outlays, net (discretionary and mandatory)	**(509)**	**1,316**	**807**

The accompanying notes are an integral part of these statements

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

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

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2012

Note 1. Significant Accounting Policies

Entity and Mission

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

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

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

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

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 Condominiums (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

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

Basis of Accounting

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

Basis of Consolidation

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

Fund Balance with U.S. Treasury

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

Investments

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

Under current legislation, FHA invests available MMI/CMHI capital reserve fund resources in excess of its current needs in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of the amortized premium or discount. Amortization of the premium or discount is recognized monthly on investments in U.S. Treasury securities using the interest

method in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 *Accounting for Selected Assets and Liabilities*, paragraph 71.

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

Credit Reform Accounting

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

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

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

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

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

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, purchase money mortgages (PMM), and notes related to partial claims. Under the requirements of the FCRA, PMM notes are considered to be direct loans while MNA notes are considered to be defaulted guaranteed loans. The PMM

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

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

Loan Guarantee Liability

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

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

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

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

Use of Estimates

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

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

To estimate the Allowance for Subsidy associated with loans receivable and related to foreclosed property and the liability for loan guarantees (LLG), FHA uses cash flow model assumptions associated with loan guarantee cases subject to the Federal Credit Reform Act of 1990 (FCRA), as described in Note 6, to estimate the cash flows

associated with future loan performance. To make reasonable projections of future loan performance, FHA develops assumptions, as described in Note 6, based on historical data, current and forecasted program and economic assumptions.

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

General Property, Plant and Equipment

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

Current HUD policy concerning SFFAS No. 10, *Accounting for Internal Use Software,* indicates that HUD will either own the software or the functionality provided by the software in the case of licensed or leased software. This includes "commercial off-the-shelf" 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. Permanent indefinite authority is also available to the MMI Program Fund if the Capital Reserve Fund does not have sufficient resources to be transferred to the MMI Financing Fund to cover upward reestimates.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards* and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf*, require that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. HUD allocates each responsibility segment's share of the program costs or resources provided by other Federal agencies. As a responsibility segment of HUD, FHA's portion of these costs was $15 million for fiscal year 2012 and $18 million for fiscal year 2011, and was included in FHA's financial statements as an imputed cost in the Consolidated Statements of Net Cost, and an imputed financing in the Consolidated Statements of Changes in Net Position.

Distributive Shares

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

Liabilities Covered by Budgetary Resources

Liabilities of federal agencies are required to be classified as those covered and not covered by budgetary resources, as defined by OMB Circular A-136, and in accordance with SFFAS No. 1. In the event that available

resources are insufficient to cover liabilities due at a point in time, FHA has authority to borrow monies from the U.S. Treasury (for post-1991 loan guarantees) or to draw on permanent indefinite appropriations 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.

Statement of Net Cost

In FY 2012, FHA revised the presentation of the Statement of Net Cost (SNC) to more closely align with FHA's major programs. For comparison purposes, the presentation of the FY 2011 SNC was also revised. Although overall net program cost for the FY 2011 SNC was not changed, certain reclassifications were made to the previously issued FY 2011 SNC to conform to the new format.

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, 2012 and 2011 are as follows:

(Dollars in millions)

	FY 2012	FY 2011
Intragovernmental:		
Fund Balance with Treasury	$ 2,894	$ 1,292
Investments in U.S. Treasury Securities	3	3
Total Intragovernmental	2,897	1,295
Other Assets	54	66
Total Non-Entity Assets	2,951	1,361
Total Entity Assets	53,052	50,407
Total Assets	**$ 56,003**	**$ 51,768**

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

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

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

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2012 and 2011:

(Dollars in millions)	FY 2012	FY 2011
Fund Balances:		
Revolving Funds	$ 43,449	$ 39,386
Appropriated Funds	790	795
Other Funds	3,401	1,825
Total	**$ 47,640**	**$ 42,006**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance		
Available	$ 18,405	$ 13,392
Unavailable	26,030	25,557
Obligated Balance Not Yet Disbursed	3,205	3,057
Total	**$ 47,640**	**$ 42,006**

Revolving Funds

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

Appropriated Funds

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

Other Funds

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

Status of Fund Balance with U.S. Treasury

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

Note 4. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2012 were as follows:

(Dollars in millions)

FY 2012	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 2,771	$ 1	$ 2,772	$ 2,772
GI/SRI Investments	3	-	3	3
Total	**$ 2,774**	**$ 1**	**$ 2,775**	**$ 2,775**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2011 were as follows:

FY 2011	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 4,091	$ 23	$ 4,114	$ 5,106
GI/SRI Investments	3	-	3	3
Subtotal	$ 4,095	$ 23	$ 4,117	$ 5,109
MMI/CMHI Accrued Interest	-	-	18	18
Total	**$ 4,095**	**$ 23**	**$ 4,135**	**$ 5,127**

Investments in Private-Sector Entities

Investments in Section 601 and Risk Sharing Debentures as of September 30, 2012 and 2011 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Returns of Investment	Redeemed	Ending Balance
FY 2012						
601 Program and Note Sales	$ 6	$ 21	$ 7	$ (31)	$ -	$ 3
Risk Sharing Debentures	57	-	-	-	-	57
Total	**$ 63**	**$ 21**	**$ 7**	**$ (31)**	**$ -**	**$ 60**
FY 2011						
601 Program and Note Sales	$ 9	$ -	$ (1)	$ (2)	$ -	$ 6
Risk Sharing Debentures	127	1	-	-	(71)	57
Total	**$ 136**	**$ 1**	**$ (1)**	**$ (2)**	**$ (71)**	**$ 63**

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2012 and 2011 are as follows:

(Dollars in millions)	Gross FY 2012	Gross FY2011	Allowance FY 2012	Allowance FY2011	Net FY 2012	Net FY2011
With the Public:						
Receivables related to credit program assets	$ 16	$ 16	$ -	$ -	$ 16	$ 16
Premiums receivable	6	4	-	-	6	4
Generic Debt Receivables	79	80	(79)	(80)	-	-
Miscellaneous receivables	2	12	-	-	2	12
Total	**$ 103**	**$ 112**	**$ (79)**	**$ (80)**	**$ 24**	**$ 32**

Receivables Related to Credit Program Assets

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

Premiums Receivable

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

Generic Debt Receivables

These amounts are mainly composed of receivables from various sources, the largest of which are partial claims, indemnifications, and restitutions relating to Single Family programs.

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:

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

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2012 and 2011 are as follows:

Direct Loan Program

(Dollars in Millions)

FY 2012	**Total**
Direct Loans	
Loan Receivables	15
Interest Receivables	11
Allowance	(11)
Total Direct Loans	**15**

(Dollars in Millions)

FY2011	**Total**
Direct Loans	
Loan Receivables	16
Interest Receivables	10
Allowance	(11)
Total Direct Loans	**15**

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

(Dollars in Millions)

FY 2012	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	17	1	18
Allowance for Loan Losses	(35)	(16)	(51)
Foreclosed Property	24	10	34
Subtotal	**6**	**(5)**	**1**
Multifamily/Healthcare			
Loan Receivables	-	2,338	2,338
Interest Receivables	-	219	219
Allowance for Loan Losses	-	(1,362)	(1,362)
Foreclosed Property	-	1	1
Subtotal	**-**	**1,196**	**1,196**
HECM			
Loan Receivables	-	5	5
Interest Receivables	-	1	1
Allowance for Loan Losses	-	(2)	(2)
Foreclosed Property	-	5	5
Subtotal	-	9	9
Total Guaranteed Loans	**6**	**1,200**	**1,206**

(Dollars in Millions)

FY2011	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	17	3	20
Interest Receivables	-	1	1
Allowance for Loan Losses	(43)	(13)	(56)
Foreclosed Property	32	11	43
Subtotal	**6**	**2**	**8**
Multifamily/Healthcare			
Loan Receivables	-	2,459	2,459
Interest Receivables	-	215	215
Allowance for Loan Losses	-	(1,660)	(1,660)
Foreclosed Property	-	1	1
Subtotal	**-**	**1,015**	**1,015**
HECM			
Loan Receivables	-	5	5
Interest Receivables	-	1	1
Allowance for Loan Losses	-	(1)	(1)
Foreclosed Property	-	4	4
Subtotal	-	9	9
Total Guaranteed Loans	**6**	**1,026**	**1,032**

*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 2012	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	1,582	53	1,635
Interest Receivables	3	2	5
Foreclosed Property	4,888	200	5,088
Allowance	(4,410)	(177)	(4,587)
Subtotal	**2,063**	**78**	**2,141**
Multifamily/Healthcare			
Loan Receivables	-	631	631
Interest Receivables	-	-	-
Foreclosed Property	-	1	1
Allowance	-	(382)	(382)
Subtotal	**-**	**250**	**250**
HECM			
Loan Receivables	163	1,775	1,938
Interest Receivables	38	805	843
Foreclosed Property	-	53	53
Allowance	(71)	(934)	(1,005)
Subtotal	**130**	**1,699**	**1,829**
Total Guaranteed Loans	**2,193**	**2,027**	**4,220**

(Dollars in Millions)

FY2011	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	1,116	43	1,159
Interest Receivables	-	2	2
Foreclosed Property	5,199	277	5,476
Allowance	(3,859)	(199)	(4,058)
Subtotal	**2,456**	**123**	**2,579**
Multifamily/Healthcare			
Loan Receivables	-	681	681
Interest Receivables	-	-	-
Foreclosed Property	-	-	-
Allowance	-	(448)	(448)
Subtotal	**-**	**233**	**233**
HECM			
Loan Receivables	26	1,395	1,421
Interest Receivables	5	643	648
Foreclosed Property	-	61	61
Allowance	(8)	(521)	(529)
Subtotal	**23**	**1,578**	**1,601**
Total Guaranteed Loans	**2,479**	**1,934**	**4,413**

*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 2012):		
MMI/CMHI		
Single Family Forward	1,141,279	1,069,003
Multifamily/Healthcare	439	417
MMI/CMHI Subtotal	**1,141,718**	**1,069,420**
GI/SRI		
Single Family Forward	18,094	14,868
Multifamily/Healthcare	93,492	85,852
GI/SRI Subtotal	**111,586**	**100,720**
H4H		
Single Family - 257	124	122
H4H Subtotal	**124**	**122**
Total	**1,253,428**	**1,170,262**
Guaranteed Loans Outstanding (FY 2011):		
MMI/CMHI		
Single Family Forward	1,062,363	1,002,724
Multifamily/Healthcare	407	384
MMI/CMHI Subtotal	**1,062,770**	**1,003,108**
GI/SRI		
Single Family Forward	20,678	17,538
Multifamily/Healthcare	83,556	76,058
GI/SRI Subtotal	**104,234**	**93,596**
H4H		
Single Family - 257	125	124
H4H Subtotal	**125**	**124**
Total	**1,167,129**	**1,096,828**

New Guaranteed Loans Disbursed:

New Guaranteed Loans Disbursed (FY 2012):		
MMI/CMHI		
Single Family Forward	213,159	210,936
Multifamily/Healthcare	108	107
MMI/CMHI Subtotal	**213,267**	**211,043**
GI/SRI		
Single Family Forward	163	161
Multifamily/Healthcare	18,643	18,548
GI/SRI Subtotal	**18,806**	**18,709**
H4H		
Single Family - 257	-	-
H4H Subtotal	**-**	**-**
Total	**232,073**	**229,752**
New Guaranteed Loans Disbursed (FY 2011):		
MMI/CMHI		
Single Family Forward	217,629	215,282
Multifamily/Healthcare	85	85
MMI/CMHI Subtotal	**217,714**	**215,367**
GI/SRI		
Single Family Forward	177	176
Multifamily/Healthcare	16,512	16,442
GI/SRI Subtotal	**16,689**	**16,618**
H4H		
Single Family - 257	101	100
H4H Subtotal	**101**	**100**
Total	**234,504**	**232,085**

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 778,327 HECM loans with a maximum claim amount of $176 billion. Of these 778,327 HECM loans insured by FHA, 595,351 loans with a maximum claim amount of $140 billion are still active. As of September 30, 2012 the insurance-in-force (the outstanding balance of active loans) was $94 billion. The insurance in force includes balances drawn by the mortgagee; interest accrued on the balances drawn, service charges, and mortgage insurance premiums. The maximum claim amount is the dollar ceiling to which the outstanding loan balance can grow before being assigned to FHA.

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

(Dollars in Millions)

Loan Guarantee Programs		Current Year Endorsements	Cumulative Current Outstanding Balance	Cumulative Maximum Potential Liability
FY 2012	MMI/CMHI	$ 13,111	$ 48,412	$ 76,220
	GI/SRI	-	45,153	63,639
	Total	**$ 13,111**	**$ 93,565**	**$ 139,859**
FY 2011	MMI/CMHI	$ 18,141	$ 39,686	$ 65,624
	GI/SRI	-	44,949	66,151
	Total	**$ 18,141**	**$ 84,635**	**$ 131,775**

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2012	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 11	$ 1	$ -	$ 12
Multifamily/Healthcare	-	5	-	5
Subtotal	**$ 11**	**$ 6**	**$ -**	**$ 17**
LLG				
Single Family Forward	$ 37,105	$ 1,662	$ 20	$ 38,787
Multifamily/Healthcare	(17)	(1,593)	-	(1,610)
HECM	5,548	12,242	-	17,790
Subtotal	**$ 42,636**	**$ 12,311**	**$ 20**	**$ 54,967**
Loan Guarantee Liability Total	**$ 42,647**	**$ 12,317**	**$ 20**	**$ 54,984**

FY2011	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 18	$ -	$ -	$ 18
Multifamily/Healthcare	-	16	-	16
Subtotal	**$ 18**	**$ 16**	**$ -**	**$ 34**
LLG				
Single Family Forward	$ 26,305	$ 799	$ 19	$ 27,123
Multifamily/Healthcare	(12)	(1,055)	-	(1,067)
HECM	2,149	7,864	-	10,013
Subtotal	$ 28,442	$ 7,608	$ 19	$ 36,069
Loan Guarantee Liability Total	**$ 28,460**	**$ 7,624**	**$ 19**	**$ 36,103**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

FY 2012	MMI/CMHI	GI/SRI	H4H	Total
Single Family Forward				
Defaults	6,825	5	-	6,830
Fees and Other Collections	(13,194)	(7)	-	(13,201)
Other	992	-	-	992
Subtotal	**(5,377)**	**(2)**	**-**	**(5,379)**
Multifamily/Healthcare				
Defaults	4	642	-	646
Fees and Other Collections	(9)	(1,035)	-	(1,044)
Other	1	-	-	1
Subtotal	**(4)**	**(393)**	**-**	**(397)**
HECM				
Defaults	754	-	-	754
Fees and Other Collections	(953)	-	-	(953)
Subtotal	**(199)**	**-**	**-**	**(199)**
Total	**(5,580)**	**(395)**	**-**	**(5,975)**

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

Subsidy Expense for Modifications and Reestimates:

(Dollars in millions)

FY 2012	Total Modifications	Technical Reestimate
MMI/CMHI	-	16,636
GI/SRI	-	3,993
Total	-	20,629
FY 2011		
MMI/CMHI	-	8,395
GI/SRI	(37)	(574)
Total	(37)	7,821

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)

	FY 2012	FY 2011
MMI/CMHI	11,054	1,657
GI/SRI	3,599	(1,063)
H4H	-	11
Total	14,653	605

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2012 Loan Guarantees:				
MMI/CMHI				
Single Family				
Forward - 06/11/2012 - present	3.65	(6.40)	-	(2.75)
Forward - 04/09/2012 - 06/10/2012	3.65	(6.65)	-	(3.00)
Forward - 10/01/11 - 04/08/2012	2.67	(5.84)	1.01	(2.16)
HECM	5.73	(7.25)	-	(1.52)
Short Refinance	6.38	(5.99)	(0.39)	-
Multifamily				
Cooperatives - 06/11/2012 - present	3.65	(6.40)	-	(2.75)
Cooperatives - 04/09/2012 - 06/10/2012	3.65	(6.65)	-	(3.00)
Cooperatives - 10/01/11 - 04/08/2012	2.67	(5.84)	1.01	(2.16)
GI/SRI				
Multifamily				
Apartments	5.32	(6.41)	-	(1.09)
Apartments Refinance	3.45	(5.62)	-	(2.17)
Apartments Refinance	3.45	(5.62)	-	(2.17)
Healthcare				
Residential Care	3.60	(5.56)	-	(1.96)
Hospitals	1.79	(5.61)	-	(3.82)

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

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2012 LLR	FY 2012 LLG	FY2011 LLR	FY2011 LLG
Beginning Balance of the Loan Guarantee Liability	$ 34	$ 36,070	$ 53	$ 34,905
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	8,230	-	6,578
Fees and Other Collections	-	(15,198)	-	(15,929)
Other Subsidy Costs	-	993	-	2,172
Total of the above subsidy expense components	**-**	**(5,975)**	**-**	**(7,179)**
Adjustments:				
Fees Received		10,733		8,582
Foreclosed Property and Loans Acquired		5,857		5,082
Claim Payments to Lenders		(20,260)		(17,200)
Interest Accumulation on the Liability Balance		1,417		1,388
Other		(36)		11
Ending Balance before Reestimates	**34**	**27,806**	**53**	**25,589**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	(17)	14,553	(19)	(1,647)
Interest Expense Component	-	5,616	-	1,397
Adjustment of prior years' credit subsidy reestimates	-	6,992	-	10,730
Total Technical/Default Reestimate	**(17)**	**27,161**	**(19)**	**10,480**
Ending Balance of the Loan Guarantee Liability	**$ 17**	**$ 54,967**	**$ 34**	**$ 36,069**

Administrative Expense:

(Dollars in Millions)	FY 2012	FY2011
MMI/CMHI	646	663
GI/SRI	-	6
H4H	-	4
Total	**646**	**673**

Credit Reform Valuation Methodology

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

To apply the present value computations, FHA divides loans into cohorts and risk categories. Multifamily and Healthcare 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, which are programmatic groupings used for the President's Budget. Each risk category has characteristics that distinguish it from others, including types of loans and properties, premium rate structure, and underwriting and servicing requirements. For activity related to fiscal years 1992-2008, the MMI Fund has one risk category, and for activity related to fiscal years 2009 and onward, the MMI Fund has two risk categories, with HECM loans considered a separate category from standard forward loans. The Single Family GI/SRI Fund loans are grouped into four risk categories. There are thirteen different Multifamily risk categories and six Healthcare categories.

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

Significant Assumptions – FHA developed economic and financial models in order to estimate the present value of future program cash flows. The models incorporate information on the cash flows' expected magnitude and timing. The results of those 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. Surviving loans generally provide an ongoing (premium) revenue stream.

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

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

Additional information about loan performance assumptions is provided below:

Sources of data: FHA uses historical data obtained from its internal business systems as the basis for behavioral models of insured-loan performance. Those data include loan, borrower, and property characteristics, as well as servicing records (delinquencies) and information on Secretary-held notes and properties.

Economic assumptions: Independent forecasts of economic conditions are used in conjunction with loan-level data to generate program specific claim and prepayment rates. Sources of forecast data include IHS Global Insight and Moody's Analytics. OMB provides other economic assumptions used such as discount rates from the latest President's Budget.

Actuarial Review: An independent actuarial study of the MMI Fund each year produces the conditional claim and prepayment rates and loss severity rates used as inputs to the Single Family LLG calculation, both for forward and HECM loans.

Reliance on historical performance: FHA analyzes the historical performance of its insured portfolio in relation to economic conditions at the time. This performance is integrated econometrically with economic forecasts to generate future performance patterns for the outstanding portfolios. Changes in legislation, program requirements, tax treatment, and economic factors all influence loan performance. FHA assumes that each portfolio will

continue to perform consistently with its historical experience, taking into account differences due to changing portfolio composition—-via loan, borrower, and property characteristics—and forecasted economic conditions.

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

Discount rates: The disbursement-weighted interest rate on U.S. Treasury securities of maturity comparable to guaranteed loan term is the discount factor used in the present value calculation for cohorts 1992 to 2000. For the 2001 and future cohorts, the rate on U.S. Treasury securities of maturities comparable to cash flow timing for the loan guarantee is used in the present value calculation. This latter methodology is referred to as the basket-of-zeros discounting methodology. OMB provides these rates to all Federal agencies for use in preparing credit subsidy estimates and requires their use under OMB Circular A-11, Part 4, and "Instructions on Budget Execution." The basket-of-zeros discount factors are also disbursement weighted. For 2012 LLG estimation we use discount rates consistent with the FY2013 President's Budget.

Analysis of Change in the Liability for Loan Guarantees LLG values are estimates of future cash flows based upon business run-off or run-down scenarios. They provide an accounting of requirements for loss reserves against anticipated future credit expenses, net of anticipated future premium revenues, on active insurance portfolios at the end of the fiscal year of record. There is no consideration of any potential offsets from future insurance commitments. Increases in LLG from the previous year suggest the need for larger loss reserves, and declines suggest that some current reserves can be released. This treatment is in accordance with Federal GAAP standards. The LLG provides to FHA management an anticipation of what can be expected in the formal budget re-estimate exercise that takes place in December of each year. That is where final determinations are made concerning required cash reserves against future, anticipated credit losses. In that exercise, the value of each portfolio run-off is compared to current balances in the various Financing Accounts that support each program and budget cohort. Under Federal Credit Reform, comparison of the updated net-present-value calculations of the run-off to current balances in the Financing Accounts determines whether there are to be net flows from those business accounts to the Federal budget (net receipts), or net flows from budget accounts to the business accounts (indirect appropriations). This annual budget re-estimate exercise is performed for all Federal direct loan and guarantee programs.

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

Described below are the programs that comprise the majority of FHA's loan guarantee business. These descriptions highlight factors that contributed to changing LLG estimates for FY 2012. Overall, FHA's liability increased from the fiscal year 2011 estimates.

Mutual Mortgage Insurance (MMI) Fund – On net, the MMI Fund LLG increased from $28,454 million at the end of fiscal year 2011 to $42,652 at the end of fiscal year 2012. This increase is the result of many factors. There are, however, three primary factors at work this year in the forward-loan portfolio and three in the HECM (reverse mortgage) portfolio. First for forward loans is that historically low interest rates accelerate portfolio run-off and decrease anticipated revenues. Any recapture of those loans (and revenue streams) in future books-of-business is not considered in the LLG calculation. Second are modeling refinements that have the effect of changing the balance of anticipated claims to favor more conveyance actions (via foreclosure) and fewer short sales, and that also increase anticipated losses on conveyance claims in the near term. The third major factor affecting portfolio

valuation this year is that home-price forecasts now call for an additional year delay before recovery takes place, and slower price growth in that recovery.

The first factor affecting the HECM LLG calculation this year is revised estimates of borrower and loan longevity. Loans that are active for 15 years or more have heightened risk of net losses for FHA once termination occurs and final recoveries (via property sales) are known. This year's model predicts more loans in the current portfolio will likely survive beyond the 15-year mark. Not only are borrowers expected to live longer, but current housing market conditions create situations where those that might otherwise have sold their homes and moved in the first five-to-ten years decide, instead, to age in-place. Second is a recessionary effect of more properties being conveyed to HUD after loan termination than has been program experience in the past. In the past, it was common for as many as 70 percent of properties to be sold directly by owners and estate executors. In the current environment, that rate has fallen to just 30 percent. The impact for LLG calculations comes via the property management expenses HUD incurs after conveyance. Those contractor expenses are not present when there is a direct owner/executor property-sale. The third principal factor increasing HECM LLG this year is an updated adjustment for so-called tax-and-insurance defaults. Borrowers are required to pay all property tax assessments and maintain hazard insurance during the life of the HECM loan. When they do not make these payments, the loan servicer advances funds, charges that to the loan balance, and then works with the borrower on a repayment plan. This year we estimate that fewer borrowers will be successful under such repayment plans. That creates predictions of more early loan terminations, which both lower revenue predictions and increase estimates of short-fall claims (property value less than loan amount).

To address continued weakness in housing markets, and its impact on LLG, FHA raised forward-loan insurance premiums in April 2012. This was the fourth premium increase under the current Administration and the fifth since the financial crisis of 2008. An additional pricing adjustment was made in June of this year, with a 25 basis point annual premium add-on for loans above $625,500. In a separate move, and in order to accelerate refinancing of loans insured during the peak years of the housing market into today's historically-low interest rates, FHA created a premium-rate carve-out for loans insured prior to June 2009. Starting in June 2012, loans with FHA insurance dates before June 2009 have the option of a streamline refinance action with a minimum upfront premium (1 basis point) and annual premiums consistent with their present payments (55 basis points). Though that will serve to create surplus-income cushions in household budgets that will reduce anticipated credit costs of the new refinance loans, it has the immediate effect of increasing LLG by expanding anticipated payoff rates during the next two years.

FHA continues to face delayed claim actions because of significant foreclosure process bottlenecks in so-called judicial States, where court approval is required to schedule foreclosure auctions. Those delays are addressed in the loan performance forecasts. This year, the MMI Fund LLG includes an assumption that 56,000 of those loans will go to conveyance claim in FY 2013, apart from normal model predictions out of the seriously delinquent inventory. While that might result in an overprediction of near-term claims, it is done to avoid the possibility that the LLG calculations might underpredict claims over the next three years because the forecasting equations cannot accurately measure the decline in cure potential for loans in serious delinquency for multiple years.

There are also many loans still subject to servicer review of previous foreclosure actions, under the National Mortgage Settlement. That Settlement was reached in mid 2012. In addition to requirements for new evaluations of borrower assistance and review of previous foreclosure actions, the Settlement resulted in payments of $1.1 billion to HUD for anticipated costs of faulty foreclosures and claims. Though such funds do not directly reduce the LLG, they provide a cash offset. Likewise, the primary effect of premium rate increases in 2012 is not on the 2012 LLG calculation, but rather on future LLG calculations and HUD's ability to re-establish the statutory two percent capital ratio for the MMI Fund. Internal calculations show that premium rate changes since 2009 have resulted in a $10 billion improvement in MMI Fund financial status at this time. The effect of the current premium structure as opposed to that which existed prior to 2009 on just the upcoming FY2013 cohort is estimated to be another $10 billion.

GI/SRI Home Equity Conversion Mortgage (HECM) - HECM endorsements from fiscal years 1990-2008 remain in the GI/SRI Fund. The liability for these loans increased from $7,865 million at the end of FY 2011 to $12,242 million at the end of FY 2012. This change was primarily due to the same factors mentioned above for MMI Fund HECM loans. Loans remaining in the GI/SRI fund did benefit this year from continued slower UPB (Unpaid Principal Balance) growth due to lower current and future (projected) interest rates for adjustable-rate mortgages. Over 99 percent of the remaining GI/SRI HECM loans have adjustable interest rates.

GI/SRI Section 223(f) - Section 223(f) of the National Housing Act permits FHA mortgage insurance for the refinance or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure up to 85 percent of the lesser of the project's appraised value or its replacement cost. Projects insured under the program must be at least three years old. The Section 223(f) program is the largest multifamily program in the GI/SRI Fund with an insurance-in-force of $20 billion. The Section 223(f) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(f) liability decreased this year by $246 million, from ($280) million to ($526) million, and principally due to lower claim expectations and an additional $5.8 billion of FY 2012 endorsements.

GI/SRI Section 223(a)(7) - Section 223(a)(7) gives HUD authority to insure refinance mortgages that replace loans currently guaranteed by FHA. Under this program, the principal amount of the new mortgage may be no more than the lesser of the original amount of the prior mortgage and the remaining unpaid principal balance of that loan. Commercial property loans insured under any sections of the National Housing Act may be refinanced under 223(a)(7), including those already under 223(a)(7). The Section 223(a)(7) program is the second largest multifamily program with an insurance-in-force of $15.5 billion. The Section 223(a)(7) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(a)(7) liability decreased this year by $170 million, from ($273) million to ($443) million, principally due to lower claim expectations and an additional $4.3 billion of endorsements in FY 2012.

GI/SRI Section 221(d)(4) - Section 221(d)(4) of the National Housing Act authorizes FHA mortgage insurance for the construction or substantial rehabilitation of multifamily rental properties with five or more units. Under this program, FHA may insure up to 90 percent of the total project cost. This is the third largest multifamily program in the GI/SRI Fund, with an insurance-in-force of $12 billion. The Section 221(d)(4) liability increased by $24 million this year, from ($10) million to $14 million. This was principally due to lower premium revenue expectations resulting from increased projected prepayment speeds caused by historically low interest rates.

GI/SRI Section 232 Healthcare New Construction (NC)- The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of $4 billion. The Section 232 NC liability decreased by $22 million from ($16) million in FY 2011 to ($38) million in FY 2012 due to improved recovery rate expectations and lower projected prepayments. A negative LLG value means that FHA anticipates that future premium revenues will be larger than net credit expenses o the current, active insured portfolio.

GI/SRI Section 232 Healthcare Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of $17 billion. Its LLG decreased by $115 million, from ($143) million in FY 2011 to ($258) million in FY 2012, due to lower claim expectations and significantly increased insurance-in-force. New insurance commitments in FY 2012 were for $5.2 billion.

GI/SRI Section 242 Hospitals - The Section 242 Hospitals program provides mortgage insurance for the construction, substantial rehabilitation, or refinance of hospitals and/or the purchase of major hospital equipment to either private, for-profit businesses, or non-profit associations. FHA insures a maximum of 90 percent of the estimated replacement cost of the hospital, including the installed equipment. The Section 242 program has an insurance-in-force of $8.6 billion. The Section 242 liability decreased by $23 million from ($193) million in FY 2011 to ($216) million in FY 2012 due to revised loan performance modeling and a slightly higher insurance-in-force.

Risks to LLG Calculations

LLG calculations for most major programs now use Monte Carlo simulations and stochastic economic forecasts. What is booked as an LLG value is the average or arithmetic "mean" value from a series of projections that view loan portfolio performance under a large variety of possible economic circumstances. The individual economic-scenario forecasts are designed to mimic the types of movements in factors such as home prices, interest rates, and apartment vacancy rates that have actually occurred in the historical record. By creating a large number of these scenarios, each independent of the others, one creates a universe of potential outcomes that define the possible set of LLG values in an uncertain world. Using the mean value across all forecast scenarios is valuable for providing some consideration for "tail risk." Tail risk occurs in most loan guarantee portfolios because potential losses under the worst scenarios are multiples of potential gains under the best scenarios. The size of that multiple creates an addition to LLG, which is the difference between the mean value from the simulations and the median value. The median is the point at which half of the outcomes are worse and half are better. By booking a mean value rather than a median, FHA is essentially providing some additional protection in its loss reserves against adverse outcomes. At the same time, booking an LLG based on a mean value results in a better than even chance future revisions will be in the downward direction. Comparisons of mean-value results to indicators of the range of possible outcomes from the Monte Carlo simulations for Single Family forward and HECM mortgages in the MMI LLG are shown in the table below. The representative outcomes shown there are for the inter-quartile range (25th and 75th percentiles), and a standard indicator of "tail" outcomes (95th percentile).

Range of LLG Values Found in Monte Carlo Simulations
(*all dollars in millions*)

Program Area	25th Percentile	Mean	75th Percentile	95th Percentile
MMI Fund				
Single-Family Forward Mortgages	$ 30,698	$ 37,105	$ 43,275	$ 53,327
Single Family Reverse Mortgages (HECM)	$ 3,790	$ 5,548	$ 6,815	$ 10,744
Total	$ 34,488	$ 42,653	$ 50,090	$ 64,071

The uncertainty built into Monte Carlo forecasts is only for economic risk, and not for model risk. Model risk is the chance that the actual forecasting equations could be outdated because: 1) borrower behavioral patterns are changing, 2) they might not give the best predictions under economic conditions rare in the past but expected to be more prevalent in the present and/or future, or 3) some mis-specification in how variables are calculated or the types of forecasting equations used. Each year, FHA undergoes an evaluation of these factors with the various contractors that support loan-performance forecast model development. There is a continuous cycle of improvement, whereby lessons learned from the most recent round of annual portfolio valuations—in the independent actuarial study, the LLG valuations, and the President's Budget—are used as a basis for new research and model development in the next year.

This fiscal year, the Mutual Mortgage Insurance Fund capital reserve ratio fell below zero to -1.44 percent. While this point-in-time valuation of the economic net worth of FHA's portfolio is obviously of concern, it does not mean that FHA will have to request permanent indefinite authority from the Treasury. Any required draw would

be determined not by the economic assumptions of this review but those used in the President's budget released in February. The FY 2012 year-end capital reserve balance was $3.3 billion. It should be noted that the economic value of the MMI fund does not take into consideration revenues generated after FY 2012. Any upward re-estimate of the FY 2012 LGL using the economic assumptions from the budget would be paid for in FY 2013 with the balance of funds in the capital reserve plus the negative subsidy that will be generated from the FY 2013 book of business.

At this point in the economic cycle, with demand for rental units high, and loans refinancing to historically low interest rates, near term risks to the multifamily LLG calculation appear to be low. However, over the longer term, risks come from many sources--changes in population growth and household formation, the supply of rental housing in each market where FHA has a presence, and local employment conditions. Risks also come from FHA's policy of insuring loans pre-construction in its 221(d)(4) program. LLG calculations are then subject to risk from the abilities of new projects to find viable markets when they do come on-line. New construction loans approved in 2007 – 2009 have now gone through several annual rounds of rentals to prove market viability. The combined 2010-2012 cohorts, which are just now starting to come into rent-up, are more than twice as large as 2007-2009, by dollar volume. Valuations of the newer portfolio are dependent upon continued trends in rental vacancy rates and rental-price growth.

For Healthcare programs (Sections 232 and 242), LLG risk comes principally from health-care reimbursement rates from Medicare and Medicaid. In addition, the financial health of State and Municipal government entities also is a source of LLG risk, as many of the FHA-insured projects benefit, in part, from periodic cash infusions from those entities. Risk also varies as does the quality of business management at each facility, and from the supply of medical care in each community relative to demand and the abilities of facility management to adapt to changing technologies and the competitive landscape. These are factors for which it is difficult to predict future trends.

Pre-Credit Reform Valuation Methodology

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

MMI Single Family LLR For the single family portfolio, the remaining insurance-in-force for pre-credit reform loans is $3.5 billion. The aggregate liability for the remaining pre-credit reform loans in FY 2012 is $11 million, which is a $7 million decrease from the $18 million estimate in FY 2011.

GI/SRI Multifamily & Healthcare LLR - For the Multifamily and Healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is $1.2 billion. The aggregate liability for the remaining pre-credit reform loans in FY 2012 is ($1.5) million, which is a $6.5 million decrease from the $5 million estimate in FY 2011. The year-over-year decrease in aggregate liability is due to lower prepayment expectations for the remaining loans compared with those for loans that terminated or matured in the past year.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2012 and 2011:

(Dollars in millions)

	FY 2012	FY2011
Intragovernmental:		
Advances to HUD for Working Capital Fund Expenses	$ 3	$ 3
Total	**$ 3**	**$ 3**
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 55	$ 66
Deposits in Transit	5	3
Total	**$ 60**	**$ 69**

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, 2012 and 2011 are as follows:

(Dollars in millions)

	FY 2012	FY2011
Intragovernmental:		
Claims Payable to Ginnie Mae	$6	$ -
Total	$6	$0

	FY 2012	FY2011
With the Public:		
Claims Payable	$503	$ 474
Premium Refunds Payable	143	142
Single Family Property Disposition Payable	42	79
Miscellaneous Payables	33	28
Total	**$721**	**$ 723**

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, 2012 and 2011:

(Dollars in millions)

	FY2011			FY 2012	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt:					
Debentures Issued to Claimants	$ 10	$ -	$ 10	$ (10)	$ -
Other Debt:					
Borrowings from U.S. Treasury	4,749	1,283	6,032	5,495	11,527
Total	**$ 4,759**	**$ 1,283**	**$ 6,042**	**$ 5,485**	**$ 11,527**

	FY 2012	FY2011
Classification of Debt:		
Intragovernmental Debt	$ 11,527	$ 6,032
Debt Held by the Public	-	10
Total	**$ 11,527**	**$ 6,042**

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. There are no debentures outstanding at the end of FY 2012. The interest rates related to the outstanding debentures in FY 2011 ranged from 4.00 percent to 13.375 percent. 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 30, 2011 was $10.3 million. The fair value for fiscal year 2011 was $21 million.

Borrowings from U.S. Treasury

In accordance with Credit Reform accounting, FHA borrows from the U.S. Treasury when cash is needed in its financing accounts. Usually, the need for cash arises when FHA has to transfer the negative credit subsidy amounts related to new loan endorsements 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 when available cash is less than claim payments due.

During fiscal year 2012, FHA's U.S. Treasury borrowings carried interest rates ranging from 1.68 percent to 7.39 percent. In fiscal year 2011, they carried interest rates ranged from 2.42 percent to 7.59 percent. The maturity dates for these borrowings occur from September 2017 – September 2032. 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, 2012 and 2011:

(Dollars in millions)

FY 2012		Current
Intragovernmental:		
Receipt Account Liability		3,473
Total	**$**	**3,473**
With the Public:		
Trust and Deposit Liabilities	$	88
Multifamily Notes Unearned Revenue		234
Miscellaneous Liabilities		74
Total	**$**	**396**

FY2011		Current
Intragovernmental:		
Receipt Account Liability		3,051
Total	**$**	**3,051**
With the Public:		
Trust and Deposit Liabilities	$	111
Multifamily Notes Unearned Revenue		230
Disbursements in Transit		75
Miscellaneous Liabilities		14
Total	**$**	**430**

Receipt Account Liability

The receipt account liability is created from negative credit subsidy from new endorsements, downward credit subsidy reestimates, loan modifications, and unobligated balances from the liquidating account in the GI/SRI receipt account. A corresponding amount of Fund Balance with Treasury is classified as a non-entity asset.

Trust and Deposit Liabilities

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

Disbursements in Transit

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

Multifamily Notes Unearned Revenue

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

Miscellaneous Liabilities

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

Note 11. Commitments and Contingencies

Litigation

FHA is party in various legal actions and claims brought by or against it. In the opinion of management and general counsel, the ultimate resolution of these legal actions will not have a material effect on FHA's consolidated financial statements as of September 30, 2012. There are pending or threatened legal actions where judgment against FHA is reasonably possible with an estimated potential loss of $101 million or more. In addition, there are legal actions where judgment is probable but FHA is unable to estimate the amount or range of the potential loss. Therefore, no amount is being accrued.

Related Party

As of September 30, 2012 and 2011, the Government National Mortgage Association (Ginnie Mae), another component of HUD, held defaulted FHA-insured mortgage loans. These loans, acquired from defaulted mortgage-backed securities issuers, had the following balances:

	FY 2012 (in millions)	FY 2011 (in millions)
Mortgages Held for Investment	$6,210	$5,886
Foreclosed Properties (Pre-Claim)	$829	$568
Short Sale Claims Receivable	$15	$25

Ginnie Mae may submit requests for foreclosure on short sale claim payments to FHA for some or all of these loans. The foreclosure properties represent post foreclosure FHA insured loans where properties have not yet been conveyed and the claims filled. Subject to all existing claim verification controls, FHA would pay such claims to Ginnie Mae upon conveyance of the foreclosed property to FHA. Any liability for such claims, and offsetting recoveries, has been reflected in the Loan Guaranty Liability on the accompanying financial statements based on the default status of the insured loans.

Note 12. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2012 and 2011 are as follows:

(Dollars in millions)

	FY2012 Total	FY2011 Total
Intragovernmental:		
Interest Expense	$ 463	$ 412
Imputed Cost	15	18
Other Expenses	14	5
Total	**$ 492**	**$ 435**
With the Public:		
Salary and Administrative Expense	$ 633	$ 668
Subsidy Expense	14,653	605
Interest Expense	6,532	2,658
Interest Accumulation Expense	1,417	1,388
Bad Debt Expense	(303)	(160)
Loan Loss Reserve	(16)	(20)
Other Expenses	115	123
Total	**$ 23,031**	**$ 5,262**
Total Gross Costs	**$ 23,523**	**$ 5,697**

Interest Expense

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

Interest Accumulation Expense

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

Imputed Costs/Imputed Financing

Imputed costs represent FHA's share of the departmental imputed cost calculated and allocated to FHA by the HUD CFO office. Federal agencies are required to report imputed costs under SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards,* and SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts to account for costs assumed by other Federal organizations on their behalf.* The HUD CFO receives its imputed cost data from the Office of Personnel Management (OPM) for pension costs, federal employee health benefits (FEHB) and life insurance costs. It also

receives Federal Employees' Compensation Act (FECA) costs from the Department of Labor (DOL). Subsequently, using its internally developed allocation basis, HUD CFO allocates the imputed cost data to each of its reporting offices. The imputed costs reported by FHA in its Statements of Net Cost are equal to the amounts of imputed financing in its Statements of Changes in Net Position.

Salary and Administrative Expenses

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

Subsidy Expense

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

Bad Debt Expense

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

Loan Loss Reserve Expense

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

Other Expenses

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

Note 13. Earned Revenue

Earned revenues generated by FHA for the period ended September 30, 2012 and 2011 are as follows:

(Dollars in millions)	FY 2012 Total	FY 2011 Total
Intragovernmental:		
Interest Revenue from Deposits at U.S. Treasury	$ 1,881	$ 1,799
Interest Revenue from MMI/CMHI Investments	117	173
Gain on Sale of MMI/CMHI Investments	1,116	133
Total Intragovernmental	**$ 3,114**	**$ 2,105**
With the Public:		
Insurance Premium Revenue	$ 9	$ 13
Income from Notes and Properties	82	$ 55
Other Revenue	21	$ 5
Total With the Public	**$ 112**	**$ 73**
Total Earned Revenue	**$ 3,226**	**$ 2,178**

Interest Revenue

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

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

Gain on Sale of MMI/CMHI Investments

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

Premium Revenue

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

Up-front Premiums

The up-front premium rates vary according to the mortgage type and the year of origination. The FHA up-front premium rates in fiscal year 2012 were:

	Upfront Premium Rates
Single Family:	
10/1/2011 - 4/9/2012	1.00%
4/9/2012 - Current	1.75%
Multifamily	0.25% , 0.45% , 0.50% ,0.80% or 1.00%
HECM Standard	2.00% (Based on Maximum Claim Amount)
HECM Saver	0.01% (Based on Maximum Claim Amount)

Annual Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums. These rates also vary by mortgage type and program. The FHA annual periodic premium rates in fiscal year 2012 were:

	Annual Periodic Premium Rates
Single Family:	
10/1/2011 - 6/10/2012	1.10% or 1.15%
6/11/2012 -9/30/2012	1.20% , 1.25% , 1.45% , or 1.50%
Multifamily	0.45% , 0.50% ,0.570% or 0.80%
HECM (Standard and Saver)	1.25%

For Title I, the maximum insurance premium paid for guaranteed cases endorsed in years 1992 through 2001 is equal to 0.50 percent of the loan amount multiplied by the number of years of the loan term. The annual insurance premium for a Title I Property Improvement loan is 0.50 percent of the loan amount until the maximum insurance charge is paid. The annual insurance premium of a Title I Manufactured Housing loan is calculated in tiers by loan term until the maximum insurance charge is paid. For guaranteed cases endorsed in fiscal year 2012, 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, 2012 and 2011 are as follows:

(Dollars in millions)

Budgetary Financing Sources		Cumulative Results of Operations		Unexpended Appropriations		Total
Treasury	$	(395)	$	-	$	(395)
HUD		-		(72)		(72)
FY 2012 Total	**$**	**(395)**	**$**	**(72)**	**$**	**(467)**

Other Financing Sources		Cumulative Results of Operations		Unexpended Appropriations		Total
Treasury	$	(1,025)	$	-	$	(1,025)
HUD		544		-		544
FY 2012 Total	**$**	**(481)**	**$**	**-**	**$**	**(481)**

Budgetary Financing Sources		Cumulative Results of Operations		Unexpended Appropriations		Total
Treasury	$	(492)	$	-	$	(492)
HUD		-		(72)		(72)
FY2011 Total	**$**	**(492)**	**$**	**(72)**	**$**	**(564)**

Other Financing Sources		Cumulative Results of Operations		Unexpended Appropriations		Total
Treasury	$	(1,796)	$	-	$	(1,796)
HUD		567		-		567
FY2011 Total	**$**	**(1,229)**	**$**	**-**	**$**	**(1,229)**

Transfers Out to U.S. Treasury

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

Transfers In/Out From HUD

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

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2012 and 2011 are as follows:

(Dollars in millions)

FY 2012	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 465	$ -	$ -	$ (1)	$ -	$ 464
Working Capital and Contract Expenses	317	207	(24)	(119)	(72)	309
Reestimates	-	746	-	(746)	-	-
GI/SRI Liquidating	68	30	-	(9)	-	89
Total	**$ 850**	**$ 983**	**$ (24)**	**$ (875)**	**$ (72)**	**$ 862**

FY2011	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 468	$ 9	$ -	$ (12)	$ -	$ 465
Working Capital and Contract Expenses	314	207	(25)	(106)	(72)	318
Reestimates	-	3,024	-	(3,024)	-	-
GI/SRI Liquidating	98	71	-	(102)	-	67
Total	**$ 880**	**$ 3,311**	**$ (25)**	**$ (3,244)**	**$ (72)**	**$ 850**

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

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

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

Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2011 have been reconciled to the fiscal year 2011 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 2012 Statement of Budgetary Resources will be presented in the fiscal year 2014 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2013 and will be available from the Government Printing Office and online at that time.

Obligated balances as of September 30, 2012 and 2011 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders	**FY 2012**	**FY2011**
MMI/CMHI	$ 1,631	$ 1,495
GI/SRI	403	403
H4H	1	1
EI	40	12
TI	3	12
Undelivered Orders Subtotal	**$ 2,078**	**$ 1,923**
Accounts Payable		
MMI/CMHI	$ 613	$ 813
GI/SRI	514	321
H4H	-	-
EI	-	-
TI	-	-
Accounts Payable Subtotal	**$ 1,127**	**$ 1,134**
Total	**$ 3,205**	**$ 3,057**

Note 18. Budgetary Resources – Collections

During fiscal year 2012, FHA collected funds received from the National Servicing Settlement with the Nation's five largest loan servicers, as well as settlements from lenders as a result of increased monitoring and enforcement actions.

The following table presents the composition of FHA's collections for the period ended September 30, 2012 and 2011:

(Dollars in Millions)

FY 2012	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 8,827	$ 803	$ 1	$ 9,631
Notes	41	522	-	563
Property	6,656	322	-	6,978
Interest Earned from U.S. Treasury	2,747	405	1	3,153
Subsidy	5,582	1	-	5,583
Reestimates	19,523	746	-	20,269
Collections from settlements	1,119	-	-	1,119
Other	54	11	-	65
Total	**$ 44,549**	**$ 2,810**	**$ 2**	**$ 47,361**

FY2011	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 7,745	$ 784	$ 2	$ 8,531
Notes	123	438	-	561
Property	6,158	310	-	6,468
Interest Earned from U.S. Treasury	1,588	540	-	2,128
Subsidy	6,739	1	11	6,751
Reestimates	8,449	3,024	-	11,473
Other	48	77	1	126
Total	**$ 30,850**	**$ 5,174**	**$ 14**	**$ 36,038**

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, 2012 and 2011:

(Dollars in Millions)

FY 2012	MMI/CMHI	Total
Transfers:		
Working Capital and Contract Expenses	$ (72)	$ (72)

(Dollars in Millions)

FY2011	MMI/CMHI	Total
Transfers		
Working Capital and Contract Expenses	$ (72)	$ (72)

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2012 and 2011:

(Dollars in Millions)

FY 2012	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 18,104	$ 2,196	$ 1	$ -	$ 20,301
Property Expenses	1,460	80	-	-	1,540
Interest on Borrowings	305	159	-	-	464
Subsidy	5,582	438	-	-	6,020
Downward Reestimates	5,655	2,216	-	-	7,871
Upward Reestimates	13,868	746	-	-	14,614
Admin, Contract and Working Capital	124	-	-	31	155
Other	1	109	-	-	110
Total	**$ 45,099**	**$ 5,944**	**$ 1**	**$ 31**	**$ 51,075**

FY2011	MMI/CMHI	GI/SRI	H4H	EI/TI	Total
Obligations					
Claims	$ 15,130	$ 1,840	$ -	$ -	$ 16,970
Property Expenses	1,505	89	-	-	1,594
Interest on Borrowings	236	177	-	-	413
Subsidy	6,740	511	11	-	7,262
Downward Reestimates	847	542	-	-	1,389
Upward Reestimates	7,601	3,024	-	-	10,625
Admin, Contract and Working Capital	113	-	-	29	142
Other	(1)	127	-	-	126
Total	**$ 32,171**	**$ 6,310**	**$ 11**	**$ 29**	**$ 38,521**

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, 2012 and 2011:

(Dollars in Millions)	FY 2012	FY 2011
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred - SBR	$ 51,075	$ 38,521
Spending Authority from Offsetting Collections and Recoveries - SBR	$ (47,490)	(33,481)
Offsetting Receipts - SBR	$ (2,611)	(1,033)
Transfers In / Out - NP	$ (25,267)	(1,229)
Imputed Financing from Costs Absorbed by Others	$ 15	18
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ (24,278)**	**$ 2,796**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS		
Undelivered Orders and Adjustments	$ (154)	$ (327)
Revenue and Other Resources	46,767	34,926
Purchase of Assets	(10,261)	(11,781)
Appropriation for prior year Re-estimate	(14,614)	(10,625)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$ 21,738**	**$ 12,193**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ (2,540)**	**$ 14,989**
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	$ 31,423	$ 14,973
Downward Re-estimate of Credit Subsidy Expense	(4,260)	(4,494)
Changes in Loan Loss Reserve Expense	(3)	(28)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	(303)	(159)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(5,977)	(7,228)
Gains or Losses on Sales of Credit Program Assets	31	85
Other	1,926	(14,619)
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ 22,837**	**$ (11,470)**
NET COST (SURPLUS) OF OPERATIONS	**$ 20,297**	**$ 3,519**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows on September 30, 2012 and 2011:

(Dollars in Millions)

FY 2012	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 47,640	$ 2,775	$ -	$ -	$ 50,415
HUD	-	-	-	3	3
Total	**$ 47,640**	**$ 2,775**	**$ -**	**$ 3**	**$ 50,418**

FY2011	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Accounts Receivable	Other Assets	Total
U.S. Treasury	$ 42,006	$ 4,135	$ -	$ -	$ 46,141
HUD	-	-	-	3	3
Total	**$ 42,006**	**$ 4,135**	**$ -**	**$ 3**	**$ 46,144**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2012 and 2011:

(Dollars in Millions)

FY 2012	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 11,527	$ 3,473	$ 15,000
HUD	6	-	-	6
Total	**$ 6**	**$ 11,527**	**$ 3,473**	**$ 15,006**

FY2011	Accounts Payable	Borrowings from U.S. Treasury	Other Liabilities	Total
U.S. Treasury	$ -	$ 6,032	$ 3,051	$ 9,083
HUD	-	-	-	-
Total	**$ -**	**$ 6,032**	**$ 3,051**	**$ 9,083**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2012:

	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance brought forward, October 1	$ 4,685	$ 58	$ 51	$ 771	$ 5,565
Unobligated balance brought forward, October 1, as adjusted	4,685	58	51	771	5,565
Recoveries of prior year unpaid obligations	-	10	6	10	26
Other changes in unobligated balance (+ or -)	(4,685)	4,677	(16)	(252)	(276)
Unobligated balance from prior year budget authority, net	-	4,744	41	530	5,315
Appropriations (discretionary and mandatory)	-	135	746	31	912
Spending authority from offsetting collections (discretionary and mandatory)	3,309	9,185	-	243	12,737
Total budgetary resources	**$ 3,309**	**$ 14,064**	**$ 787**	**$ 804**	**$ 18,964**
Status of Budgetary Resources:					
Obligations incurred	-	13,991	746	153	14,890
Unobligated balance, end of year:					
Apportioned	-	-	16	43	59
Unapportioned	3,309	72	25	609	4,015
Total unobligated balance, end of year	3,309	73	41	651	4,074
Total budgetary resources	**$ 3,309**	**$ 14,064**	**$ 787**	**$ 804**	**$ 18,964**
Change in Obligated Balance:					
Unpaid obligations, brought forward, October 1 (gross)	-	145	16	576	737
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(19)	-	-	(1)	(20)
Obligated balance, start of year (net), before adjustments (+ or -)	(19)	145	16	575	717
Obligated balance, start of year (net), as adjusted	(19)	145	16	575	717
Obligations incurred	-	13,991	746	153	14,890
Outlays (gross) (-)	-	(13,970)	(749)	(149)	(14,868)
Change in uncollected customer payments from Federal sources (+ or -)	18	-	-	-	18
Recoveries of prior year unpaid obligations (-)	-	(10)	(6)	(10)	(26)
Unpaid obligations, end of year (gross)	-	157	8	568	733
Uncollected customer payments from Federal sources, end of year	(1)	-	-	(1)	(2)
Obligated balance, end of year (net)	**$ (1)**	**$ 157**	**$ 8**	**$ 567**	**$ 731**
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	3,309	9,320	746	274	13,649
Actual offsetting collections (discretionary and mandatory) (-)	(12,510)	-	-	(256)	(12,766)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	18	-	-	-	18
Budget authority, net (discretionary and mandatory)	(9,183)	9,319	746	19	901
Outlays, gross (discretionary and mandatory)	-	13,970	749	149	14,868
Actual offsetting collections (discretionary and mandatory) (-)	(12,510)	-	-	(256)	(12,766)
Outlays, net (discretionary and mandatory)	(12,510)	13,969	749	(106)	2,102
Distributed offsetting receipts (-)	-	-	-	2,611	2,611
Agency outlays, net (discretionary and mandatory)	**$ (12,510)**	**$ 13,969**	**$ 749**	**$ 2,505**	**$ 4,713**

Required Supplementary Information

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

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

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2012:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total Total
Budgetary Resources:				
Unobligated balance brought forward, October 1	$ 27,044	$ 9,181	$ 24	$ 36,249
Unobligated balance brought forward, October 1, as adjusted	27,044	9,181	24	36,249
Recoveries of prior year unpaid obligations	103	19	-	122
Unobligated balance from prior year budget authority, net	27,147	9,199	25	36,371
Borrowing authority (discretionary and mandatory)	5,200	560	-	5,760
Spending authority from offsetting collections (discretionary and mandatory)	31,887	2,440	2	34,329
Total budgetary resources	**$ 64,234**	**$ 12,199**	**$ 27**	**$ 76,460**
Status of Budgetary Resources:				
Obligations incurred	31,067	5,117	1	36,185
Unobligated balance, end of year:				
Apportioned	17,169	1,167	10	18,346
Unapportioned	15,998	5,915	16	21,929
Total unobligated balance, end of year	33,167	7,082	26	40,275
Total budgetary resources	**$ 64,234**	**$ 12,199**	**$ 27**	**$ 76,460**
Change in Obligated Balance:				
Unpaid obligations, brought forward, October 1 (gross)	2,007	313	-	2,320
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	-	(1)	-	(1)
Obligated balance, start of year (net), before adjustments (+ or -)	2,007	312	-	2,319
Obligated balance, start of year (net), as adjusted	2,007	312	-	2,319
Obligations incurred	31,067	5,117	1	36,185
Outlays (gross) (-)	(31,041)	(4,870)	-	(35,911)
Change in uncollected customer payments from Federal sources (+ or -)	-	1	-	1
Recoveries of prior year unpaid obligations (-)	(103)	(19)	-	(122)
Unpaid obligations, end of year (gross)	1,931	541	-	2,472
Obligated balance, end of year (net)	**$ 1,931**	**$ 541**	**$ -**	**$ 2,472**
Budget Authority and Outlays, Net:				
Budget authority, gross (discretionary and mandatory)	37,087	3,000	2	40,089
Actual offsetting collections (discretionary and mandatory) (-)	(32,017)	(2,575)	(3)	(34,595)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	-	1	-	1
Budget authority, net (discretionary and mandatory)	5,070	425	-	5,495
Outlays, gross (discretionary and mandatory)	31,041	4,870	-	35,911
Actual offsetting collections (discretionary and mandatory) (-)	(32,017)	(2,575)	(3)	(34,595)
Outlays, net (discretionary and mandatory)	(976)	2,294	(2)	1,316
Agency outlays, net (discretionary and mandatory)	**$ (976)**	**$ 2,294**	**$ (2)**	**$ 1,316**

Required Supplementary Information

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

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

Other Accompanying Information

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
SCHEDULE OF SPENDING
As of September 30 2012
in millions

		FY 2012
What Money is Available to spend?		
Total Resources		$95,424
Less Amount Available but Not Agreed to be Spent		$18,405
Less Amount Not Available to be Spent		$25,944
Total Amounts Agreed to be Spent		$51,075
How was the Money Spent?		
Category*		
Claims	$	20,269
Property Expenses	$	1,341
Interest on Borrowings	$	464
Subsidy	$	5,978
Downward Reestimates	$	7,872
Upward Reestimates	$	14,614
Admin, Contract and Working Capital	$	116
Other	$	125
Total Spending	$	50,779
Amounts Remaining to be Spent	$	296
Total Amounts Agreed to be Spent		**$51,075**
Who did the Money go to?		
For Profit	$	22,147
Government	$	28,928
Total Amounts Agreed to be Spent	**$**	**51,075**

AUDITOR'S REPORT

This report was issued separately in November 2012 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2012 and 2011" (2013-FO-0002). The report is available at HUD, OIG's internet site at: http://www.hudoig.gov/pdf/Internal/2013/ig12f0002.pdf

Issue Date: November 9, 2012

Audit Report Number: 2013-FO-0002

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

//s//

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

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2012 and 2011

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 firms of CliftonLarsonAllen LLP (CLA) to audit the fiscal year 2012 and Clifton Gunderson LLP[1] to audit the fiscal year 2011 financial statements of the Federal Housing Administration (FHA). The contracts required that the audit be performed according to Generally Accepted Government Auditing Standards (GAGAS).

In connection with the contract, we reviewed CLA's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with U.S. GAGAS, was not intended to enable us to express, and we do not express, opinions on FHA's financial statements or internal controls or conclusions on compliance with laws and regulations. CLA is responsible for the attached Independent Auditor's Report dated November 9, 2012 and the conclusions expressed in the report. Our review disclosed no instances where CLA did not comply, in all material respects, with U.S. GAGAS.

This report includes both the Independent Auditors' Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. FHA plans to separately publish an annual report for fiscal year 2012 that conforms to FASAB standards.

The report contains one significant deficiency in FHA's internal control and one reportable instance of non-compliance with laws and regulations. The report contains four new recommendations. Within 120 days of the report issue date, FHA is required to provide its final management decision which includes the corrective action plan for each recommendation. As part of the audit resolution process, we will record four new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking system (ARCATS). We will also

[1] In early 2012, Clifton Gunderson LLP merged with another firm and became CliftonLarsonAllen LLP.

endeavor to work with FHA to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plans will be reviewed and evaluated for OIG concurrence.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

Within 60 days of this report, CLA expects to issue a separate letter to management dated November 9, 2012 regarding other matters that came to its attention during the audit.

We appreciate the courtesies and cooperation extended to the CLA and OIG audit staffs during the conduct of the audit. If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

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CliftonLarsonAllen LLP

www.cliftonlarsonallen.com

INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Department of Housing and Urban Development

Acting Commissioner
Federal Housing Administration

We have audited the accompanying balance sheets of the Federal Housing Administration (FHA) as of September 30, 2012 and 2011, and the related statements of net cost and changes in net position, and the combined statements of budgetary resources ("financial statements") for the years then ended. The objective of our audit was to express an opinion on the fairness of these financial statements. In connection with our audit, we also considered the internal control over financial reporting and considered FHA's compliance with laws and regulations. In our audit, we found:

- The financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America (U.S.);
- One significant deficiency in internal control over financial reporting (including safeguarding of assets) and compliance with laws and regulations; and
- One instance of reportable noncompliance with selected provisions of laws and regulations tested.

The following sections and Exhibits A through C discuss in more detail: (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis (MD&A), and other required supplementary information included in the Annual Management Report, (3) our responsibility for the audit, (4) management's responsibility for the financial statements, (5) FHA's response and our evaluation of their response, and (6) the current status of prior year findings and recommendations.

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FHA as of September 30, 2012 and 2011, and its net costs; changes in net position; and budgetary resources for the years then ended in conformity with accounting principles generally accepted in the U.S.

As discussed in Note 6 to the financial statements, the Loan Guarantee Liability (LGL) is an actuarially determined estimate of the net present value of future claims, net of premiums and recoveries, from loans insured as of the end of the fiscal year. This estimate is developed using econometric models that integrate historical loan-level program and economic data with regional

INDEPENDENT AUDITORS' REPORT (Continued)

house price appreciation forecasts to develop assumptions about future portfolio performance. This year's estimate is the mean value from a series of projections using numerous economic scenarios. This stochastic analysis projects a 25% probability that the Single Family Liability for Loan Guarantee may be overstated by $8 billion or understated by $7.5 billion, depending on which economic outcome ultimately prevails. This forecast method helps control the risk that the estimate will be affected by an adverse economic scenario but does not reduce the risk that the models may not accurately reflect current borrower behavior or contain technical errors.

As also discussed in Note 6, the MMI Fund includes a Capital Reserve account from which increases in funding to cover additional claim losses have historically been drawn. As of September 30, 2012, this Capital Reserve account had less funds available than the MMI Fund FY2012 upward reestimate. The Credit Reform Act of 1990 provides for permanent, indefinite budget authority to fund such deficiencies. However, the amount of funds to be transferred from the Capital Reserve account to the MMI Financing Fund will be determined by the FY2013 annual budgeting process. The transfer amount may differ from the amount reported in the financial statements due to differences in the requirements of the budget process and the different timing of the calculation. Once determined, the funds will be transferred in the latter half of FY2013. The budgeting process may also consider projected excess subsidy from FY2013 endorsements deposited into the Capital Reserve account in determining whether permanent, indefinite budget authority will be required to fund the FY2012 reestimate transfer.

Report on Internal Control

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

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

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

FHA Management and HUD OCIO Should Mitigate Persistent IT Control Deficiencies

INDEPENDENT AUDITORS' REPORT (Continued)

FHA has over forty individual information technology (IT) applications including one core financial system and fifteen mixed financial systems. Those applications use a mix of old and new software languages (from COBOL to Cold Fusion) that are connected to each other, customers, and FHA's core financial general ledger through hundreds of electronic interfaces. To manage this complex application environment, the Office of Housing (Housing), which owns and operates FHA applications, has implemented expensive and manual compensating controls, including monthly reconciliations of data among the interfaced systems to ensure the reliability of its day-to-day financial transaction processing and reporting.

For many years, we (and the HUD OIG) have reported various weaknesses in security and access controls, as well as in configuration management and contingency planning. These issues have been found not only in FHA applications, but also in the general support systems owned by the Office of the Chief Information Officer (OCIO). HUD IT policy defines roles and responsibilities for Executive IT Investment Owners as well as for individual "system owners", who manage the operations and security of the individual applications. The day-to-day management of the FHA portfolio of financial systems has been performed by the Office of Systems and Technology under the Office of the Comptroller, but the lack of such an Executive IT Investment Owner has contributed to the ineffective and untimely remediation of application control weaknesses and repeat deficiencies identified across multiple applications.

During the past year, OCIO implemented a new IT portfolio structure that grouped applications into "investments" according to their functions. Each investment was aligned to a functional business "Segment." Each Segment is lead by a Segment Sponsor at an executive level. This new structure has the potential to provide the needed strategic IT management.

The operational and systemic limitations discussed above impact Housing's ability to ensure FHA systems "continue to operate in an effective and efficient manner" and support Housing's "changing business practices" as required by OMB Circular No. A-127, *Financial Management Systems* and the Federal Manager's Financial Integrity Act of 1982 (FMFIA). These control deficiencies and system limitations also affect FHA's overall information security that could ultimately affect the reliability of FHA's financial reporting.

We recommend that the Assistant Secretary for Housing:

1a. Work with the HUD Chief Information Officer to continue the development of the IT portfolio management structure, establish clear roles and responsibilities for remediating the identified control deficiencies in Housing's applications, and monitor the effectiveness of that structure in managing IT investments. (New)

1b. Assign a Housing representative to oversee and report on the remediation of control deficiencies in general support systems that affect Housing systems and data. (New)

INDEPENDENT AUDITORS' REPORT (Continued)

1c. Clarify the future role of Housing's Office of Risk Management and Assessment with regard to the IT risk assessment process for FHA applications. (New)

We recommend that the HUD Chief Information Officer:

1d. Assign a senior OCIO manager to document the plan of action and to provide regular status reports on the progress toward mitigation of the outstanding control deficiencies reported for the general support systems and the applications affecting Housing data. (New)

Report on Compliance and Other Matters

In connection with our audit, we performed tests of FHA's compliance with certain provisions of laws and regulations. The results of our tests disclosed one instance of noncompliance that is required to be reported in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States or OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* as amended (OMB Bulletin 07-04). However, the objective of our audit was not to provide an opinion on compliance with laws and regulations. Accordingly, we do not express such an opinion.

Capital Ratio: The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance (MMI) Fund maintain a minimum level of capital sufficient to withstand a moderate recession. This capital requirement, termed the Capital Ratio, is defined as capital resources (assets minus current liabilities) less the liability for future claim costs (net of future premiums and recoveries), divided by the value of amortized insurance-in-force. The Act requires FHA to maintain a minimum Capital Ratio of two percent and conduct an annual independent actuarial study to, among other things, calculate this ratio. The Housing and Economic Recovery Act of 2008 requires that the Secretary submit a report annually to the Congress describing the results of the study, assess the financial status of the MMI Fund, recommend program adjustments, and to evaluate the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the MMI Fund. As of the date of our audit, this report had not yet been submitted to Congress, but preliminary FHA data indicated that this ratio remained substantially below the required two percent throughout FY2012.

We noted certain matters that we will report to FHA management in a separate letter.

Status of Prior Year's Control Deficiencies and Noncompliance Issues

As required by *Government Auditing Standards* and OMB Bulletin 07-04, we have reviewed the status of FHA's corrective actions with respect to the findings and recommendations included in the prior year's Independent Auditors' Report, dated November 3, 2011. Exhibit C provides the current status of prior year findings and recommendations.

INDEPENDENT AUDITORS' REPORT (Continued)

Other Information

Accounting principles generally accepted in the U.S. require that FHA's Management Discussion and Analysis (MD&A) and other required supplementary information be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and required supplementary information in accordance with auditing standards generally accepted in the U.S., which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management's Responsibility for the Financial Statements

FHA management is responsible for (1) preparing the financial statements in conformity with accounting principles generally accepted in the United States, (2) designing, implementing, and maintaining internal control to provide reasonable assurance that the broad control objectives of the FMFIA are met, (3) ensuring that FHA's financial management systems substantially comply with the Federal Financial Management Improvement Act (FFMIA) requirements, and (4) complying with other applicable laws and regulations.

Auditor's Responsibility

We are responsible for conducting our audit in accordance with auditing standards generally accepted in the U.S.; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin 07-04. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the U.S. We are also responsible for: (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB Bulletin 07-04 requires testing, and (3) performing limited procedures with respect to certain other information appearing in the Annual Management Report.

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

INDEPENDENT AUDITORS' REPORT (Continued)

and (8) tested compliance with selected provisions of certain laws. The procedures selected depend on the auditors' judgment, including our assessment of risks of material misstatement of the financial statements, whether due to fraud or error. We believe we obtained sufficient and appropriate audit evidence on which to base our opinion.

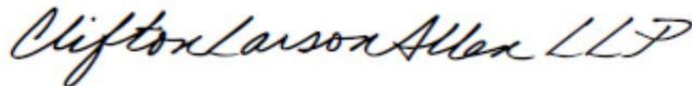
We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance.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

We did not test compliance with all laws and regulations applicable to FHA. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements and those required by OMB Bulletin 07-04 that we deemed applicable to FHA's financial statements for the fiscal year ended September 30, 2012. We caution that noncompliance with laws and regulations may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

Agency Comments and our Evaluation

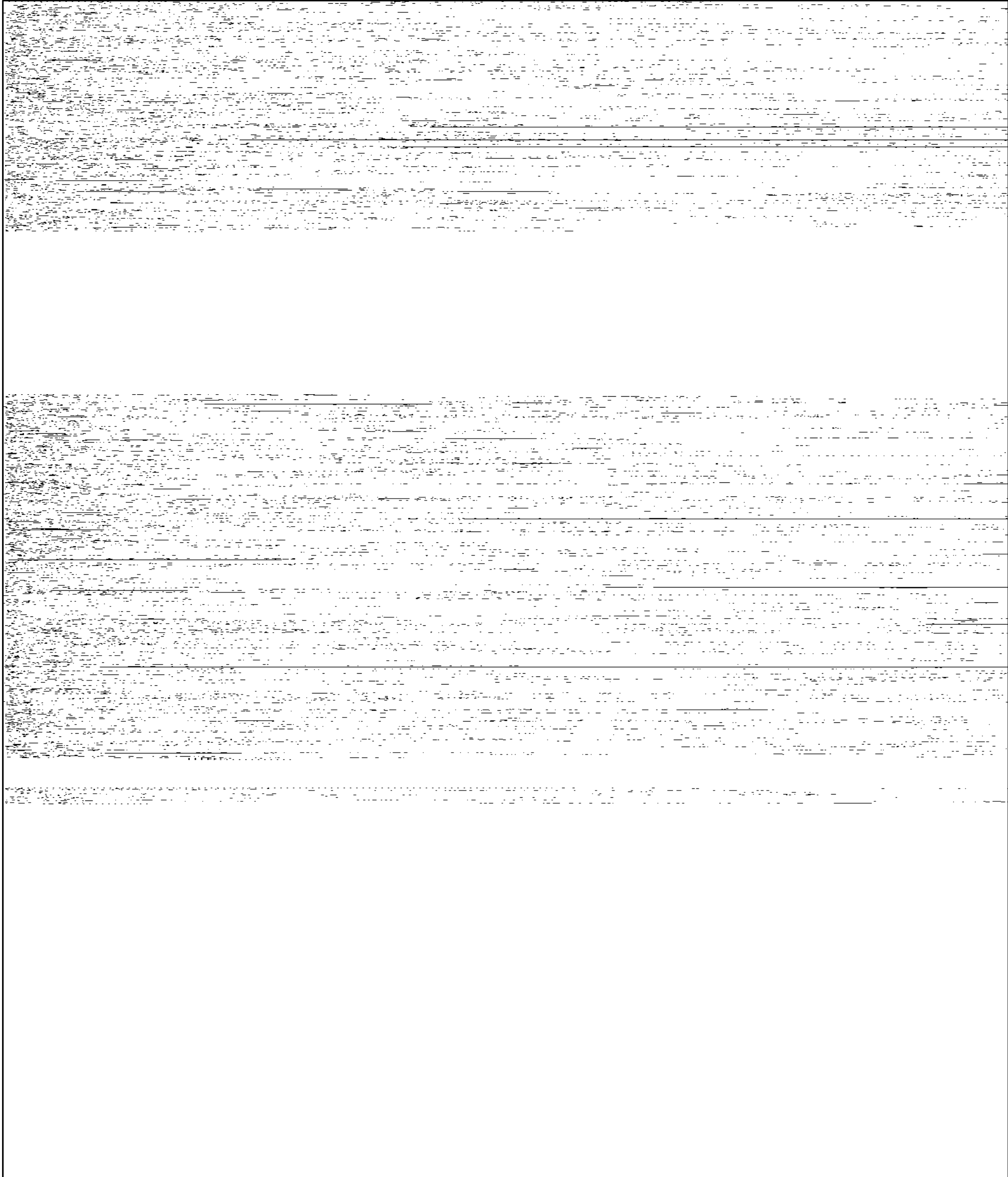
Management's response to our report is presented in Exhibit A. We did not audit FHA's response and, accordingly, we express no opinion on it.

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



Arlington, Virginia
October 29, 2012

Federal Housing Administration
Management's Response
Appendix A



Federal Housing Administration
Management's Response
Appendix A (Continued)

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-3000

CHIEF INFORMATION OFFICER

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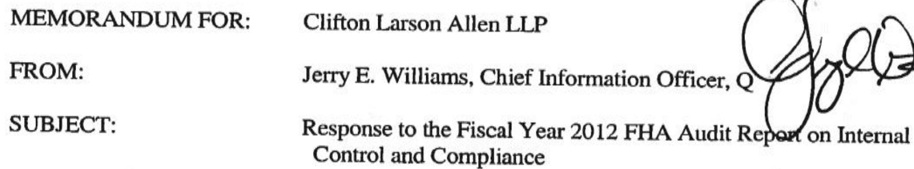


MEMORANDUM FOR: Clifton Larson Allen LLP

FROM: Jerry E. Williams, Chief Information Officer, Q

SUBJECT: Response to the Fiscal Year 2012 FHA Audit Report on Internal Control and Compliance

Thank you for providing us the opportunity to respond to FHA's Independent Audit Report on Internal Control and Compliance. My staff and I have reviewed the subject audit report and concur with the finding and recommendation 1d, which is addressed to the Office of the Chief Information Officer (OCIO).

We look forward to working with you and your staff to resolve and close-out the recommendation. Should you have any questions or need additional information, please contact Joyce Little, Director, Office of Investment Strategies Policy and Management at (202) 402-7404.

Federal Housing Administration
CLA's Assessment of Management Response
Appendix B

We reviewed FHA management's response (see Exhibit A) to the findings and recommendations made in connection with our audit of FHA's 2012 financial statements. We did not perform audit procedures on the response to the findings and recommendations and accordingly, we express no opinion on it. Our assessment of management's response is discussed below.

Assessment of management's response to significant deficiency:

As indicated in Exhibit A, FHA management concurred with our finding and recommendations 1a through 1c, but did not provide specific information regarding planned corrective actions or the information needed to assess whether management will be able to effectively implement the recommendations.

Recommendation 1d is addressed to HUD's Chief Information Officer who concurred with the recommendation but did not provide specific information regarding planned corrective actions or the information needed to assess whether management will be able to effectively implement the recommendation.

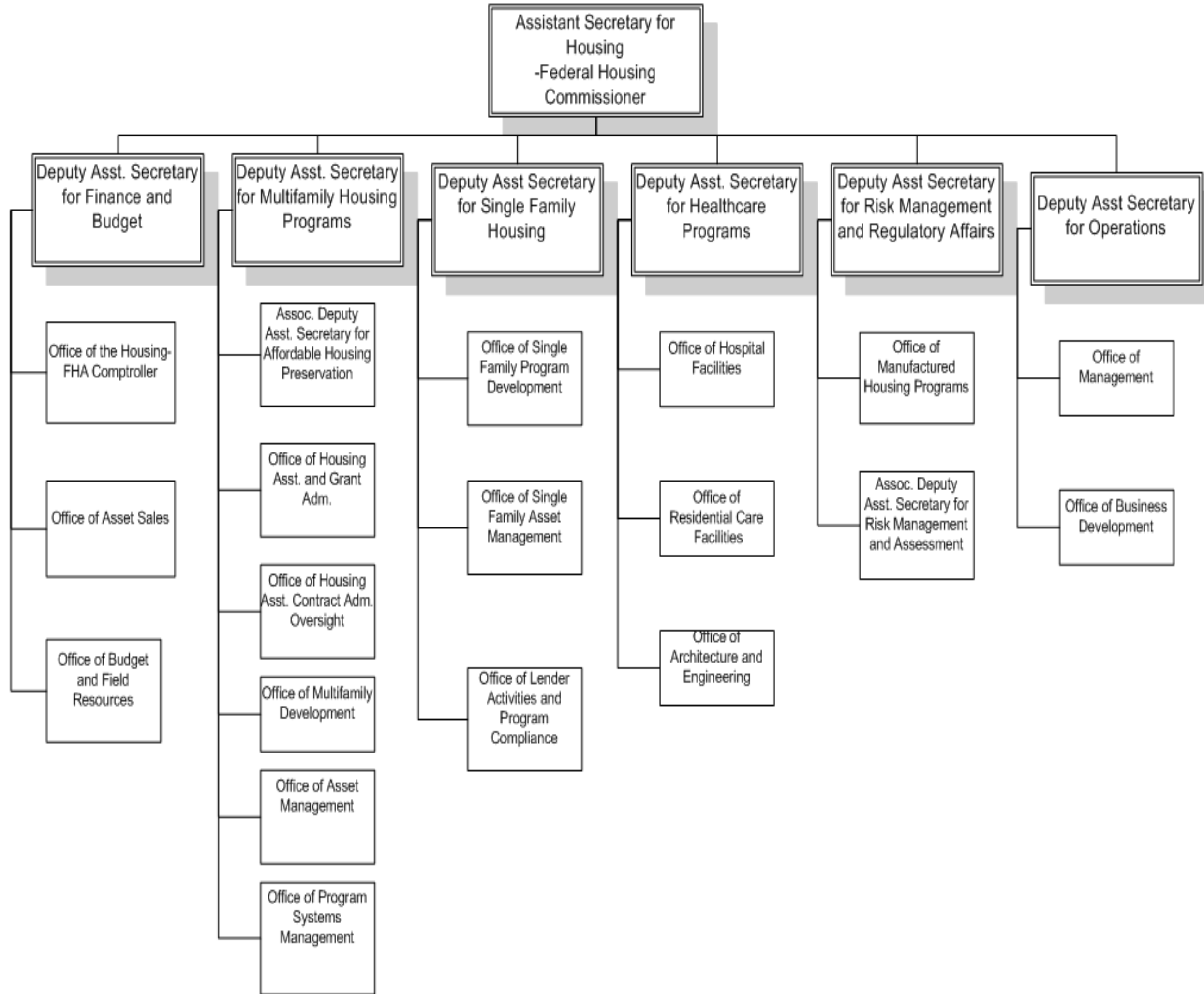
Assessment of management's response to noncompliance with the *Cranston-Gonzales National Affordable Housing Act of 1990*:

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

Federal Housing Administration
Status of Prior Year Recommendations
Appendix C

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

FY 2011 Recommendation	*Type*	*Fiscal Year 2012 Status*
1a. Work with OCIO to develop a process to analyze identified systems control weaknesses for their root causes.	Significant Deficiency 2011	Closed
1b. Work with OCIO to strengthen the POA&M process by ensuring that the status of plans is reviewed regularly by FHA and HUD management with the authority to take action or accept the risks related to the weakness.	Significant Deficiency 2011	Closed
1c. Develop and implement procedures for FHA senior management to acknowledge and accept system risks that cannot be mitigated within the fiscal year.	Significant Deficiency 2011	Closed



http://portal.hud.gov/hudportal/documents/huddoc?id=FHAFY12AnnualMgmntRpt.pdf

NOVEMBER 2012