DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HOUSING

FHA--GENERAL AND SPECIAL RISK INSURANCE ACCOUNT

PROGRAM PERFORMANCE

STRATEGIC GOAL/OBJECTIVE	ACTUAL 2002	ESTIMATE 2003	ESTIMATE 2004
Strategic Goal EM: Embrace high standards of ethics, management, and accountability.			
Discretionary BA (Dollars in Thousands)	$33,116	$34,825	$35,117
FTE			
Headquarters	80	83	82
Field	19	38	38
Subtotal	99	121	120
S&E Cost (Dollars in Thousands)			
Personal Services	$8,884	$10,992	$11,192
Travel	41	53	50
Transportation of Things	0	0	0
Rent, Communications & Utilities	1	1	1
Printing	53	68	69
Other Services	486	283	265
Supplies	29	22	21
Furniture & Equipment	0	0	0
Claims & Indemnities	0	0	0
Subtotal	9,494	11,419	11,598
Strategic Objective EM.2: Improve HUD's management, internal controls and systems and resolve audit issues.			
Indicator: Exceed the rate of net recovery received on the sale of Single Family property through the Accelerated Claim Program Demonstration (Section 601).	70.5%	No less than 70.5%	No less than 70.5%
Indicator: FHA will continue to address financial management and system deficiencies through the phased implementation of an integrated financial system to support FHA functions to be completed by December 2006.	Not Available	a/	Integrate Funds Control and Cash Mgmt
Strategic Objective EM.3: Improve accountability, service delivery, and customer service of HUD and our partners.			
Indicator: HUD will continue to implement procedures to hold single family lenders accountable for the	N/A	Publish Proposed Rule	Appraiser Watch Rule Issued

STRATEGIC GOAL/OBJECTIVE	ACTUAL 2002	ESTIMATE 2003	ESTIMATE 2004
selection and performance of appraisers for FHA-insured mortgages.			
Indicator: Process 200,000 mortgage insurance applications through TOTAL Scorecard.	0	40000	200000
Indicator: Credit Watch	Credit Watch Implemented	Not Applicable	Not Applicable

a/ FHA Subsidiary Ledger System included in A-127 Report to OMB.

EXPLANATION OF PERFORMANCE

Performance/Means and Strategies

Funding in the amount of $35.1 million in program funding and $11.6 million in Salaries and Expenses for a total of $46.7 million supports Strategic Goal EM: Embrace high standards of ethics, management and accountability.

GI/SRI Insurance Programs. The Department will continue to offer a range of alternative loan guarantee programs to address specialized mortgage financing needs. These products include mortgage insurance for rehabilitating, developing, and refinancing of apartment buildings, nursing home facilities, nonprofit hospitals and Title I loans. The Department's insurance programs will continue to meet the Nation's need for decent, safe and affordable housing.

Multifamily Credit Subsidy Rates. The Department continuously devotes significant efforts in updating and refining credit subsidy estimates. The credit subsidy estimates were developed after extensive consultation with OMB by FHA and reflect substantial additional analysis by the Department. Each year the extensive statistical base, from which projections of future loan performance is calculated, is updated for an additional year of actual data. The Department and the Office of Management and Budget (OMB) continue to examine the data, assumptions, and calculations, which are used to estimate loan program cash flows and subsidy rates in order to eliminate errors, and to seek improvements in the accuracy and reliability of the analysis.

The multifamily credit subsidy rates used in previous years reflected historic performance data for similar loans made over the past 40 years. Concerns were raised over the accuracy of these assumptions based on historical data in light of recent improvements in underwriting, program monitoring, and asset management, as well as unprecedented changes in tax law in the 1980's adversely affecting the performance of loans in the FHA portfolio at that time.

In the fiscal year 2003 Budget, the Department and OMB agreed to change the methodology used to calculate new construction conditional claim and prepayment rates for credit subsidy rate estimates through the application of new econometric analyses applied to loan level data. For the fiscal year 2004 Budget, updated loan performance data combined with the improvement of the recovery lag calculations in the cash flow model itself yield a break-even premium at 50 basis points for the section 221(d)(4) program that serves as the primary apartment development program of FHA. This is a seven basis point reduction in the premium in effect for the current fiscal year. In addition, FHA will reduce the premium for section 207 manufactured home parks and section 220 development loans to 50 basis points, which is an eleven basis point reduction. This is also a break-even premium rate for this risk category requiring no appropriated credit subsidy. Positive credit subsidy continues to be required for the section 221(d)(3), 223(d) and 241(a) loan programs so no reduction in the applicable 80 basis point insurance premium is proposed.

Title I Program Subsidy Rates. The fiscal year 2004 estimates for the Title I Programs reflect the loan characteristics of the property improvement and the manufactured housing program, which are incorporated into the cash flows used to calculate the subsidy rate for loan programs, in accordance with the Federal Credit Reform Act of 1990.

Title II Program Single Family Subsidy Rates. The GI/SRI single-family credit subsidy estimates also reflect review of loan performance. This includes updated loan performance data and assumptions of the major GI/SRI single family programs that are currently active. Those mortgage insurance programs are 234(c) Condominium Housing and 203(k) Purchase/Rehabilitation. Premium policy changes for the 203(k) program in the 2004 budget include cancellation of annual premium when loan to value reaches 65 percent, rather than 78 percent. On an average 203(k) loan, it is estimated that annual premium will be required for the first 17 years of a 30-year term. With this slight alteration of the premium structure, this program is expected to break even and require no positive credit subsidy appropriations. Other small programs that do not have sufficient volume to model and estimate individually are included in the Section 234(c) risk category for budgetary purposes.

Office of Multifamily Housing Assistance Restructuring (OMHAR). The Multifamily Assisted Housing Reform and Affordability Act of 1997 was included in the 1998 Appropriations Act. The initial legislative authority establishing OMHAR ended September 30, 2001. Prior to expiration, Public Law 107-116 extended OMHAR as an entity within the Office of Housing for an additional 3 years through fiscal year 2004 and extended the attendant mortgage restructuring authorities for another 5 years through fiscal year 2006. The restructuring process is expected to preserve over 174,000 units of affordable housing stock through long-term use agreements.

The restructurings are performed through oversight of a national network of 13 public Participating Administrative Entities (PAEs), and 8 private partners. OMHAR staff is currently located in a central District of Columbia office and three satellite field offices, located in Chicago, New York and San Francisco, which oversees the program through nationally consistent guidelines, which provide for local flexibility to the extent possible.

As of December 1, 2002, OMHAR reported completing over 1,600 restructurings, averaging 35-40 per month, and resulting in an annual reduction of Section 8 outlays of $115,096,455. The average rent reduction is $93 per unit per month. The reductions in future Section 8 outlays and expected recoveries of second mortgage payments exceed the one-time costs of restructuring for FHA claims and PAE costs. In addition to ensuring long-term financial viability and achieving Section 8 savings, physical and managerial assessments are conducted for each property to assure the long-term viability of the portfolio. Expenses are analyzed to ensure efficient operations. Immediate capital needs are addressed through repair escrows. Long-term physical needs are provided for through increased deposits to reserve for replacement accounts. Initial deposits to these accounts were increased on average from $1,343 to $2,329 per unit, and annual deposits increased on average from $297 to $439 per unit per year.

The Mark-to-Market program (M2M) realigns the owners' and HUD's interest by providing a return on the owner's equity through a capital recovery payment, an incentive performance fee, and 25 percent of net cash flow. The financial structure of the properties is designed to ensure efficient operations and maintenance of the properties. HUD is closely monitoring the performance of restructured properties through a portfolio management contract and through a "watch list" for at-risk properties which had rents reduced without a debt restructuring.

A significant amount of work still remains to be completed. Over 600 deals are currently in various stages of restructuring. There are another 2,600 Section 8 contracts expiring through fiscal year 2006, at least a third of which are estimated to be above market and eligible for M2M.

Mortgage Note Sales. FHA successfully executed GI/SRI Multifamily Mortgage Note Sales in fiscal year 2002 which will continue into 2005. In 2002, FHA sold 114 unsubsidized mortgage notes with an unpaid principal balance (UPB) of $502 million. These notes were valued to HUD at $177 million. The net sales proceeds amounted to $287 million. Negative subsidies realized from the sales amounted to $110 million.

FHA plans to continue selling Multifamily unsubsidized mortgage notes in fiscal years 2003 through 2005. Currently, large portions of the remaining multifamily notes are subsidized. Therefore, FHA is also planning to sell the subsidized inventory starting in fiscal year 2003. Ongoing note sale activity in the future will be driven by the amount of salable notes entering the inventory.

Multifamily Enforcement. The Department's multifamily housing enforcement strategy reflects the integrated and coordinated efforts of the Real Estate Assessment Center (REAC) within the Office of Public and Indian Housing and the Departmental Enforcement Center (DEC), an element of the Office of the General Counsel. REAC is completing a comprehensive and uniform portfolio wide assessment of the physical and financial condition of all the properties. Results are being forwarded to Housing's Multifamily Hubs for additional actions. The Multifamily Hubs are responsible for servicing the loans and overseeing subsidy contracts. In those cases where there appear to be severe performance problems, cases are referred to the DEC. The DEC evaluates each case it receives and, where the DEC decides that severe problems exist, the DEC provides an action plan to be implemented by the Hubs to address the problem(s). Qualitative improvement in the assessment and enforcement effort is being realized through the centralization and specialization of these staff. The ultimate goal, however, is improved living conditions for residents, improved neighborhoods, communities, and improved financial performance for FHA because performance standards for participants are raised.

FHA is committed to improving management and internal controls and resolving audit issues. While FHA has a long record of clean audit opinions by outside auditors, its business systems are, for the most part, outdated, cumbersome to operate, and do not produce management information in a timely manner. Much of the work required for audit and record keeping has entailed extensive manual efforts by FHA staff and contractors. The 2001 FHA audit report identified the HUD/FHA ADP systems environment as a material weakness. Many prior analyses and audits have also cited problems in the areas of financial reporting and business systems, including reports from the HUD IG and GAO.

To remedy these deficiencies, FHA is modernizing its financial systems and operations, and is developing a new core financial system, with a phased roll-out to replace the current legacy system. The present system predates many of recent financial reforms, including the US standard general ledger (SGL) and credit reform. The current system also requires that data from many of the subsidiary systems be manually entered, rather than electronically transferred. When fully implemented, the new system is expected to reduce the manual efforts required, improve data quality, and comply with current accounting regulations and standards.

In October 2002, the new general ledger system will come into use; this system is USSGL and JFMIP compliant, and supports FEDGAAP accounting. This new system will automate input from subsidiary systems. The roll-out of the system will be fully completed in 2006, according to current plans, with complete integration of the insurance systems with this core financial system.

In addition to improving the accounting, FHA is undertaking to improve the performance of the Fund in line with a goal in the President's Management Agenda: to eliminate most falsely inflated appraisals in 2004.

The demonstration program now underway for accelerated claims processing is expected to increase the recoveries to the Fund on defaulted properties, both by shortening the time these properties are in default prior to claim processing, and by taking mortgage notes from the lenders rather than foreclosed properties, thus avoiding the time and cost of the foreclosure process.

FHA is also instituting a program to identify appraisers involved in questionable transactions, similar to the Credit Watch program for lenders since accurate appraisals are essential to prevent undue risk to the Fund. FHA will hold lenders accountable for the performance of the appraisers they select for FHA-insured mortgages.

Additional efforts to improve appraisals and their usefulness are underway, such as issuance of a new appraiser handbook for FHA loans, examination to test appraisers' knowledge of new requirements, and requiring appraiser to disclose readily observable defects. These disclosures by appraisers, in combination with a new disclosure form, provide better information to homebuyers prior to purchase, and should reduce defaults due to poor condition of the home.

Further efforts to more closely monitor appraisers are being examined.

FHA also plans to increase property sales to owner-occupants by 5 percent between 2002 and 2003, at a time when the number of properties available for sale is expected to be dropping, as the accelerated claims demonstration project is expected to be expanded to a nationwide program. This increase is expected to provide one measure of FHA's success in reducing "flipping" and other predatory lending practices. Purchases by owner occupants are heavily influenced, as are the single family real estate market sector, by macro-economic factors, and by local economic trends. It is assumed that the percentage of available properties sold to owner occupants in fiscal year 2004 will remain at the fiscal year 2003 level.

Resource Management Information

Discretionary BA is expected to increase in fiscal year 2004 over fiscal year 2003. Staffing decreases slightly from fiscal years 2003 to 2004 to realign FTE based on Departmental programmatic priorities.