FHA

FEDERAL HOUSING ADMINISTRATION

Annual Management Report
Fiscal Year 2009

Your Door to FHA HOMEOWNERSHIP

U.S. Department of Housing and Urban Development

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

A MESSAGE FROM THE COMMISSIONER

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

I was honored when asked by President Obama to serve as FHA Commissioner. I cannot think of a more challenging – yet exciting – period in the history of FHA to hold such a position. FHA plays a very unique role in supporting the Nation's housing needs. As a mission driven organization, FHA encourages homeownership and facilitates affordable housing opportunities in America's communities.

Our primary goal is to support the President and the Secretary in resolving this housing crisis. To that end, we are focused as an organization on doing everything we can to make sure that families who can afford to stay in their homes are provided the opportunity to do so, and at the same time to protect the supply of safe, affordable rental housing for those who do not choose homeownership.

This year, at this time, we are faced with a very different kind of environment in the marketplace. There is no doubt that FHA has become critical to the recovery and stabilization of the Nation's housing market. Today, FHA's share of the mortgage market is nearly 30 percent – up from 3 percent just two years ago. The pace of growth over such a short period of time has created stress on FHA's operational environment, which has for some time been in need of both system enhancements and process changes to ensure program viability for the long term.

Like most mortgage lenders and insurers, FHA is not immune to adverse changes in economic conditions. In this economy, we have seen increased delinquencies and foreclosures to the FHA Fund. However, the FHA profile is far stronger now than it was in the past. The credit scores, known as FICO scores, of new FHA borrowers are generally higher than those of earlier borrowers. Today, the average FICO score is 693 compared to 633 just two years ago.

Our recent actuarial review projects economic weakness and significant house price declines continuing into Fiscal Year 2010. These forecasts have significantly impacted the estimated economic net worth of FHA's Mutual Mortgage Insurance (MMI) Fund, causing the capital ratio to fall below 2 percent. Nevertheless, the MMI Fund has over $30 billion in reserves to cover projected losses over a 30-year term. This means while FHA has sufficient cash-on-hand to pay any and all anticipated future losses on current books of business, the MMI Fund has only a small additional margin of resources remaining should economic conditions and guaranteed loan performance become even worse than is now projected.

The study also projects the reserve fund will rise above the mandated 2 percent level on its own in just a few years. But, we are not waiting. We have already begun taking action to improve future books of business by instituting tighter risk management and credit policy changes. It's not just about protecting the financial health of the FHA insurance fund – it's about protecting each and every family that looks to the FHA for safe, sustainable mortgage financing.

Therefore, my immediate priorities for FHA are, first, to preserve the solvency of the MMI fund and ensure that FHA does not require any taxpayer assistance. This can be done by balancing our mission as a public agency with prudent risk management, and it starts with a thorough review of all FHA programs to identify areas where risk can be mitigated. Lender monitoring must also be enhanced to ensure their accountability. Identifying lenders with poor performance and disqualifying them from participating in FHA programs is "job one" to protect new business. And, we must invest in state-of-the-art technology to improve both automated underwriting quality and data integrity to properly manage FHA's business.

Second, we must ensure housing programs adequately support the President's housing priorities – specifically, the Homeowner Affordability and Stability Plan and an updated and enhanced HOPE for Homeowners program.

Third, we must continue to strengthen FHA's role in the marketplace. In addition to modernizing our core technology systems, we must continue providing consumer protections, enhancing our programs, and finding innovative solutions to mitigate losses and market disruptions during periods of adverse economic conditions.

I can assure you the Nation's economic problems would be even worse today, were it not for FHA. Any hope for housing recovery, and for our economy, would clearly be stalled if it wasn't for the critical role we play.

David H. Stevens
Assistant Secretary for Housing –
FHA Commissioner

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INTRODUCTION

In 1934 Congress enacted the National Housing Act, which created the Federal Housing Administration (FHA) to enhance opportunities for homeownership by providing mortgage insurance to private lenders. FHA was made a part of the Department of Housing and Urban Development (HUD) when HUD was created in 1965. FHA now provides mortgage insurance to lenders that finance single family homes, multifamily housing, health care facilities, property improvements, and manufactured homes. FHA's headquarters is located in Washington, D.C. Field offices, consisting of 4 Single Family Homeownership Centers, 18 Multifamily Hubs, and 47 Multifamily Production Offices are located throughout the country.

The availability of FHA mortgage insurance encourages the provision of mortgage credit by lenders and provides liquidity and stability for the mortgage market. For the lending community, loans meeting certain FHA requirements qualify for FHA mortgage insurance, which protects them against losses as a result of default by homeowners thereby reducing lenders risk. FHA also serves borrowers that the conventional market does not adequately provide for including first-time homebuyers, minorities, low-income families and residents of underserved communities. Under FHA programs, homebuyers are more likely to qualify for an FHA-insured loan which requires a smaller down payment and provides more flexibility in income and debt ratios compared with conventional mortgages.

The current economic environment and inflexible credit requirements have attested to the significance of FHA's role in stabilizing the mortgage market in times of economic disruption. Keeping with its proactive role in previous economic crisis, FHA positioned itself quickly to respond to the market needs. However, FHA has not been immune to the adverse conditions of the housing market and has experienced an increase in loan defaults which is primarily the result of economic factors such as job loss. In addition, higher claims and lower recoveries have increased projected liabilities and decreased the Mutual Mortgage Insurance (MMI) capital ratio, which is one measure of the financial soundness of the MMI fund. To address this issue, FHA is undergoing a number of credit policy initiatives to preserve the liquidity of the MMI fund.

Moreover, with the passage of recent legislation and the directive of the Administration's "Making Home Affordable Program", FHA now offers special programs with incentives to lenders for modifying and refinancing existing mortgages with homeowners facing imminent foreclosure. "Making Home Affordable" is on pace to help up to 4 million homeowners over the next three years. Throughout its history, FHA has been successful in its endeavors and continues to play a critical role in the overall Federal strategic recovery plan devised by the current Administration and Congress to stimulate the economy, stabilize neighborhoods hard hit by foreclosures, prevent homelessness, and catalyze housing construction and renovation.

MISSION AND ORGANIZATIONAL STRUCTURE

FHA was created to address a set of prevalent economic conditions during the Great Depression era that were 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 credit crisis by bridging the gap between lenders and homeowners so that families can have access to new ways of financing their homes with longer-term affordable mortgages.

Since its inception, FHA has continued to:

- Contribute to sustainable homeownership and maintain and expand rental housing and health care opportunities;
- Contribute to building and preserving healthy neighborhoods and communities;
- Stabilize credit markets in times of economic disruption;
- Operate with a high degree of public and fiscal accountability; and
- Recognize and value its customers, staff, constituents and partners.

FHA works with Congress and the Administration to ensure that it provides healthy program mixes, pricing structure with sound actuarial basis, and adequate organizational capacity to provide access to mortgages and affordable homeownership to families traditionally underserved by the private market. During fiscal year 2009, FHA implemented several program changes approved by Congress to assist the mortgage community. These programs provide more

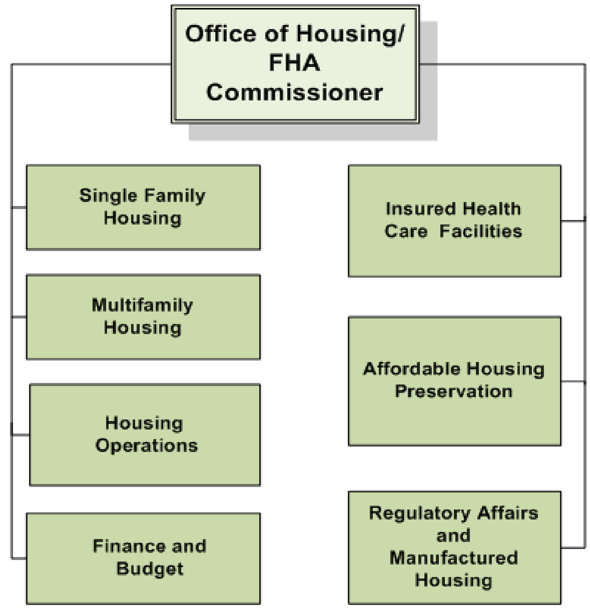
Summary of Recent Legislative Changes

- American Recovery and Reinvestment Act of 2009 (ARRA)
  - Provides for affordable housing modification program
- Helping Families Save Their Homes Act of 2009
  - Assists FHA mortgagors who are in default to modify their mortgage to an affordable payment.
  - Improves the FHA's HOPE for Homeowners program
- Real Estate Settlement Procedures Act (RESPA) 2009 Update
  - Rules updated to standardize the Good Faith Estimate to provide better information on loan costs
- Housing and Economic Recovery Act of 2008 (HERA)
  - Housing Assistance Tax Act that provides benefit to first-time homebuyers and grants to rebuild communities impacted by foreclosures
  - Secure and Fair Enforcement (S.A.F.E.) Mortgage Licensing Act of 2008 requires mandatory registration of loan originators helping to ensure that they "act in the best interests of the consumer"
  - Hope for Homeowners – Provides for troubled loans modification wherever possible to help families keep their homes
- Housing Tax Credit Coordination Act of 2008
  - Facilitates the combination of Low Income Housing Tax Credits with FHA Multifamily insurance

favorable loan terms with higher loan limits, flexible down payment options, extended repayment term, and modification of FHA insurance rules that make it easier to combine FHA multifamily insurance with Low Income Housing Tax Credits (LIHTC).

FHA's programs are administered through seven functional areas under the direction of the Federal Housing Commissioner. All functional areas collaborate in supporting FHA's goals and mission. During fiscal year 2009, FHA continued its investment in technology, staffing and training to maintain a sustainable environment for their mortgage insurance programs under Single Family, Multifamily, Health Care, and Title I Manufactured Housing and Property Improvement.

FHA Functional Organizational Chart



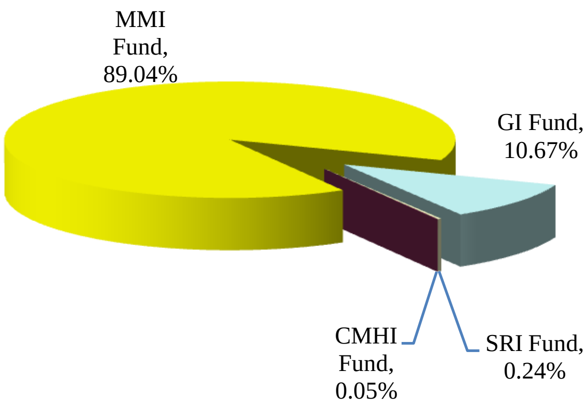
Information contained in this document is considered "forward-looking" as defined by the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 15, "Management's Discussion and Analysis," and Statement of Federal Financial Accounting Concepts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

FHA Insurance Funds

FHA operates its programs primarily through four insurance funds: *Mutual Mortgage Insurance (MMI), General Insurance (GI), Special Risk Insurance (SRI), and Cooperative Management Housing Insurance (CMHI)* supported by premium, fee and interest income, Congressional appropriations, borrowing from the U.S. Treasury, and other miscellaneous sources. There is a fifth fund, *Hope for Homeowners (H4H),* which became operational in fiscal year 2009 with minimal activity.

The total mortgage Insurance-In-Force (IIF) in the FHA Insurance Funds was $757.2 billion, an increase of $225.5 billion or 42.4 percent, compared to fiscal year 2008. Specifically, the MMI Fund increased by $226.9 billion, the GI Fund decreased by $1.2 billion, the SRI Fund decreased by $199 million, and the CMHI Fund, the smallest of the four, increased by $26 million. The following chart provides the IIF distribution by Fund.

FHA Insurance In Force by Fund



FHA's single family mortgage insurance business comprised 92 percent of its total IIF. The multifamily and health care insurance comprised 7.9 percent of total IIF and Title I property improvement and manufactured housing insurance covered 0.9 percent of total IIF. During fiscal year 2009, FHA's endorsements and overall IIF increased substantially due to the activity in the MMI fund which included the transfer of Home Equity Conversion Mortgages (HECM) from GI fund. Additionally, higher FHA loan limits and flexible down payment options continue to encourage low and moderate-income buyers to obtain mortgages guaranteed by FHA.

Office of Single Family Housing

FHA encourages homeownership by making loans readily available to low and moderate-income homebuyers through its FHA Single Family Housing mortgage insurance programs handled by HUD-approved mortgage lenders.

Single Family Housing Programs

Single Family Housing programs are the most visible evidence of FHA's success in maintaining homeownership opportunities for all Americans. Through these programs, FHA targets households that otherwise would have difficulty obtaining mortgages. During fiscal year 2009, its programs insured 1,947,158 loans, of which 995,695 were initial purchase endorsements. Of these purchase endorsements, 781,789 were loans made to first-time homebuyers and 233,120 loans were made to minority first-time homebuyers.

Since inception, FHA's single family housing programs have made substantial contributions to the national homeownership rate of 67.4 percent as of second quarter of fiscal year 2009. Despite a decrease in homeownership rate from 68.1 percent as of the second quarter of fiscal year 2008, FHA experienced an increase in market share.

Three of Single Family Housing's more popular programs, Section 203(b), Section 234(c), and Home Equity Conversion Mortgages (HECM) – Reverse Mortgages, are described below.

Section 203(b)

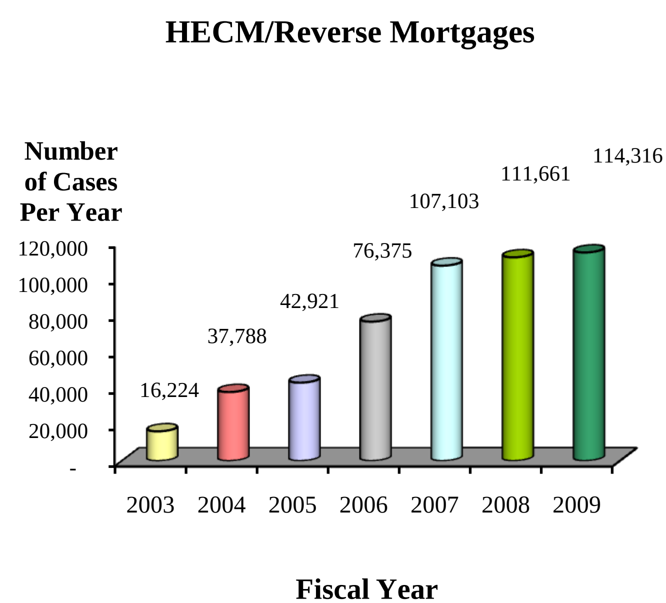
Section 203(b) is the largest of FHA's single family programs covering 94.1 percent of total single family insurance-in-force for homes with up to four housing units. FHA established this program to support a stable mortgage finance market and to serve otherwise underserved borrowers by providing low down payment mortgages. These mortgages can be packaged into mortgage-backed securities, guaranteed by Government National Mortgage Association (Ginnie Mae), and backed by the full faith and credit of the U.S. Government. As a result, lenders are more inclined to make loans to underserved borrowers because these securities provide easy liquidity. During fiscal year 2009, FHA insured 1,718,301 Section 203(b) mortgages of which 712,636 were first-time homebuyers and 215,997 were minority first-time homebuyers.

Section 234(c)

Section 234(c) provides mortgage insurance for individual condominium units and covers five percent of FHA's total single family insurance-in-force. During fiscal year 2009, FHA insured mortgages for 96,784 condominium units. Origination and underwriting process for Section 234(c) loans are simplified under HERA, as these loans are no longer subject to the more complex requirements of multifamily housing loans. The FHA Modernization Act under HERA also contains a provision that moves Section 234(c) loans from the General Insurance Fund to the Mutual Mortgage Insurance Fund.

Home Equity Conversion Mortgages (HECM) - Reverse Mortgages

FHA was the first entity to promote and insure reverse mortgages on a national scale. The HECM program provides eligible homeowners access to the equity in their property with very flexible terms either as a lump sum, monthly payments, line of credit, or a combination thereof. The program is limited to homeowners 62 years of age and older and is designed for those with limited income. HECM loans continue to be a growing product and garnered more attention with the increase in loan limit to $625,500 in fiscal year 2009. Since its inception, FHA has endorsed 571,709 HECM loans. The number of reverse mortgages per year insured by FHA has increased over the past seven years, from 16,224 cases in fiscal year 2003 to 114,316 in fiscal year 2009.



The Housing and Economic Recovery Act (HERA) contains a provision that moves HECM from the General Insurance Fund to the Mutual Mortgage Insurance Fund for fiscal year 2009 endorsements and beyond.

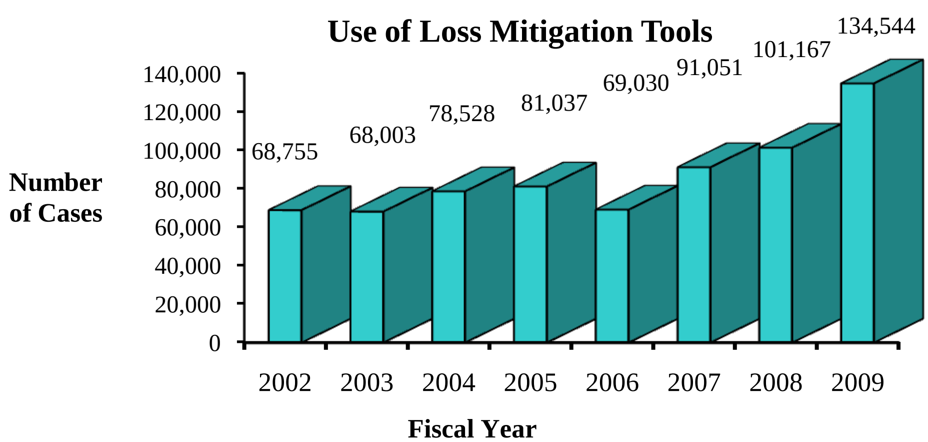
Additional details on these and other Single Family loan programs are available at http://www.hud.gov/offices/hsg/sfh/ins/singlefamily.cfm

Management Initiatives and Program Improvements

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

- *Loss Mitigation Tools.* FHA assists homeowners facing financial difficulties to remain in their homes through increased access to its loss mitigation programs. In the past, homeowners have been denied the opportunity to qualify for loss mitigation after foreclosure had been initiated due to a lack of sufficient funds to reimburse mortgagees the related foreclosure costs and legal fees. In response to these challenges that homeowners faced in qualifying for loss mitigation, effective August 2008, FHA began allowing mortgagees to incorporate legal fees and foreclosure costs related to a canceled foreclosure action into either the partial claim or loan modification.

  In addition, under the FHA-Home Affordable Modification Program (FHA-HAMP) the maximum partial claim amount has been increased from 12 months of monthly mortgage payments to 30% of the unpaid principal balance (UPB). The new claim amount, commonly referred to as super partial, will be converted into an interest-free second-lien, due at sale, refinance or maturity. To qualify a loan for the super partial program, a lender must prove that all other loss mitigation options, including special forbearance, mortgage modification and original partial claim tools, are not viable methods to prevent default.



As a result of current market conditions and new FHA initiatives, participation in the loss mitigation program increased from 68,755 cases in fiscal year 2002 to 134,544 in fiscal year 2009.

- *HOPE for Homeowners (H4H).* H4H was authorized by Title IV of HERA and was administered by the Secretary of HUD pursuant to standards and requirements established by a Board of Directors consisting of the Secretaries of HUD and the Treasury and the chairperson of the Board of Governors of the Federal Reserve System and the chairperson of the Board of Directors of the Federal Deposit Insurance Corporation. The goal of the program is to help distressed homeowners refinance their mortgages into safer and sustainable FHA-insured mortgages by writing down the principal of the loan amount to an affordable level. HUD, along with its partner agencies met the statutory deadline to implement the program by October 1, 2008. However, since the program was not cost-effective to the lenders they were reluctant to commit the resources necessary to participate in the program.

  As a result, the program was amended twice by Congress to address the challenges that lenders faced during the initial implementation. Under the Helping Families Save Their Home Act, Congress revised the role of the Board of Directors, making it advisory in its capacity, reduced the costs to borrowers and made it easier for lenders to offer the program. FHA is working diligently to issue a new mortgagee letter and reintroduce the H4H program at the beginning of fiscal year 2010.

- *Green Initiative*. Introduced in 2008, Section 2123 of the HERA increased the maximum additional amount that can be added to an FHA insured mortgage for energy efficient improvements, also known as Energy Efficient Mortgages (EEMs). The maximum dollar amount of cost effective energy improvements that may be added to the mortgage increased to the lesser of:
  - 5% of the value of the property, or
  - 115% of the median area price of a single family dwelling, or
  - 150% of the conforming Freddie Mac limit.

- *Lender Insurance (LI).* This initiative, started in fiscal year 2006, allows high performing mortgagees to endorse FHA loans without a pre-endorsement review conducted by FHA. LI provides lenders with prompt acceptance or denial of the endorsement package and saves borrowers and lenders time and money during the loan process. During fiscal year 2009, loans endorsed under LI accounted for approximately 70.2 percent of FHA insured mortgages.

- *FHA Modernization.* Implemented in 2008, FHA modernization, which includes completed administrative and legislative changes, has streamlined the insurance process and made FHA products more attractive to mortgagees and consumers alike. Changes in the programs include more favorable loan terms with higher loan limits, extended repayment time, and flexible down payment options.

- *Additional Single Family Improvements.* Program enhancements to improve all stages of the single family mortgage insurance process:

  - Re-engineering and Integration

    Single Family Housing continued its comprehensive systems re-engineering and integration efforts in fiscal year 2009. Such efforts assist FHA to comply with federal legislation, address identified audit weaknesses, improve overall monitoring and oversight, and adhere to HUD's Enterprise Architecture Framework. The implementation and integration of Single Family's systems will simplify systems administration, reduce total cost of ownership and maintenance, and provide flexible and adaptable business processes and functionalities. These enhancements will continually meet and comply with industry standards while improving program oversight and furthering consumer and stakeholder support.

  - Overall Risk Management

    To improve its overall risk management, FHA used monitoring tools such as a Risk-Based Targeting Model (RBTM), Post Endorsement Technical Review Process (PETR) and Appraiser Watch to better monitor program performance and enhance oversight of lenders, Management & Marketing (M&M) contractors, and appraisers. In addition, FHA revised its delinquency rate reporting standards and took corrective action against problem lenders, underwriters and appraisers. During fiscal year 2009, FHA removed 2,382 appraisers from the FHA roster based on extensive risk analysis.

    FHA also controls and manages its risks by taking into account the effect of new market and economic conditions on its programs and future liabilities. For example, FHA recognized that new initiatives such as FHASecure and the Hope for Homeowners program increased the number of higher risk borrowers that may affect future liabilities. As a result, FHA has considered the impact of these initiatives to manage and mitigate risks.

  - Fraud and Identity Theft

    In response to the rising volume of mortgage business and a general increase in the number of mortgage fraud, FHA has increased its funding of fraud detection. FHA is training industry partners in fraud detection and utilizes state-of-the art fraud detection techniques such as automated valuation for verifying appraisals and income. These tools, when applied to all phases of the mortgage insurance process, give FHA the ability to identify misrepresentation at the consumer, application, and property levels through automated checks and analysis of multiple data sources. For example, lenders are provided the capability to use FHA Connection to validate Social Security Numbers (SSN) through other governmental agencies.

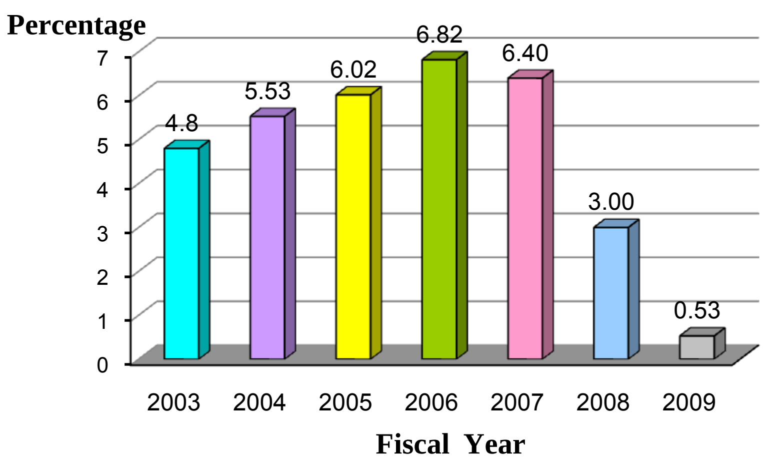
- Distressed Communities

  HUD's Asset Control Areas (ACA) program was created by Congress to energize areas that have low homeownership rates, combat real estate speculators and their practices, reduce the number of government foreclosed homes, and provide stability to the surrounding communities. Under the program, FHA sells a limited number of its REO inventory at deep discounts to nonprofits, states and units of local government. Other similar discount sales initiatives to individuals are administered under the Bulk Sales Initiative, Dollar Homes, and Good Neighbor Next Door programs. During fiscal year 2009, FHA sold 1,475 properties under these initiatives.

MMI Capital Ratio

The MMI Fund encompasses nearly all of FHA's single family business, with 96.8 percent of the total single family Insurance-in-Force dollars. One measure of the fund's financial soundness is the MMI capital ratio, which is described in section 205 of the National Housing Act. This ratio compares the "economic net worth" of the MMI Fund to the balance of active, insured loans, at a point in time. Economic net worth is defined as a net asset position, after booking the present value of all expected future revenues and net claim expenses, and then adding that to current cash resources. The Act requires that the estimate of economic net worth used in the capital ratio calculation be based on an annual, independent actuarial analysis of the future performance of insured loans. It further mandates that the MMI Fund maintain a capital ratio of at least 2 percent.

MMI Capital Ratio



Note: The FY 2003 – FY 2008 ratios are based on unamortized IIF and do not include HECM loans. The FY 2009 ratio calculation uses amortized IIF and includes FY 2009 HECM loans.

Continued economic weakness and projections of additional, significant house price declines into Fiscal Year 2010, have reduced the economic net worth of the MMI Fund which is now estimated to be less than 2 percent of insurance-in-force. That means while FHA has sufficient cash-on-hand to pay for all expected net future losses on current books of business, the MMI Fund has only a small additional margin should economic conditions and guaranteed-loan performance be even worse than is now projected. The fiscal year 2009 actuarial study projects that, as the economy stabilizes, new business will generate net income that can also be used to fund any additional, unforeseen losses on current books of business.

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

Starting in fiscal year 2009, FHA is using the amortized value of the insured loans to calculate both the forward and reverse mortgage portions of the capital ratio. At the end of fiscal year 2009, the MMI Fund capital ratio for forward mortgages is 0.42 percent, and the reverse mortgages is 3.17 percent. The combined MMI capital ratio is 0.53 percent. That represents a decline from the amortized fiscal year 2008 capital ratio of 3.22 percent (3.0 percent unamortized). FHA is undergoing a number of credit policy initiatives to strengthen the MMI Fund and minimize the chance of any further declines in its economic net worth.

Multifamily Housing Programs

Multifamily Housing provides FHA insurance for construction, rehabilitation/repair, refinancing, and purchase of apartment rentals, cooperatives, mobile home parks and health care facilities. Multifamily Housing also offers risk sharing on loans originated by state Housing Finance Agencies (HFAs), Freddie Mac and Fannie Mae on multifamily rental properties. During fiscal year 2009, Multifamily Housing initially endorsed 661 FHA loans totaling $5.1 billion through 48 lenders. In addition, Multifamily endorsed 52 Risk Sharing loans totaling $311 million.

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

Sections 221(d)3 and 221(d)4

These programs provide mortgage insurance on construction loans and permanent financing for construction or substantial rehabilitation of cooperatives and apartment rentals. For-profit owners and sponsors applying under the 221(d)4 program can be insured up to 90 percent of the project's estimated replacement cost and approve fixed-rate loans with up to 40-year loan terms. For non-profit owners applying under the 221(d)3 program, FHA can insure up to 100% of replacement cost. While both programs offer only market-rate loans, these programs can be combined with federal and state housing initiatives such as Low Income Housing Tax Credits (LIHTC), tax exempt bonds and rental subsidies for low and moderate income families.

Sections 223(f) and 223(a)7

The 223(f) program insures loans for purchase or refinancing of existing rental properties financed with conventional or FHA loans and 223(a)7 program insures refinancing of loans currently insured by FHA. In addition, the 223(a)7 program offers expedited processing that can reduce debt service and free up operating income to the owners for other project needs.

Section 232

The 232 program insures loans for construction, substantial rehabilitation, purchase or refinancing of nursing homes, assisted living facilities, and board & care homes. The program was administered by the Office of Multifamily Housing until it was transferred to the Office of Insured Health Care Facilities at the beginning of April 2009. However, applications and loans in the pipeline as of April 9, 2009 continue to be processed through final endorsement by the Office of Multifamily Housing.

Section 542(b) and 542(c)

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

Multifamily Endorsements by Program

Section of the Act	Endorsements for fiscal year 2009		
	Dollars (millions)	Percentage	# of Mortgages
Section 221(d)3 & 221(d)4	$ 1,292	23.77%	79
Section 223(f) & 223(a)(7)	$ 1,697	31.22%	307
Section 232	$ 2,036	37.44%	251
Section 542(b) & (c)	$ 311	5.73%	52
Other Programs	$ 99	1.84%	24

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

Multifamily Housing Development's Fiscal Year 2009 Accomplishments

The Office of Multifamily Housing Development provides direction and oversight for FHA mortgage insurance loan origination. During fiscal year 2009, the Office of Multifamily Housing endorsed 625 loans. These loans provided the public with a variety of shelter options that included 449 rental projects, 91 nursing homes, 77 assisted living facilities, seven cooperatives, and one board and care facility. Multifamily Housing Development initial endorsements totaled $4.9 billion covering 79,656 units/beds and exceeded the fiscal year 2008 level of $3.7 billion and 70,914 units/beds.

Despite the significant challenges in the housing market, the dollar volume for endorsements increased by 31.29% and units/beds by 12.33% which represented a significant achievement in the face of a major economic downturn. Moreover, Multifamily supports special initiatives directed to elderly and underserved areas having high concentrations of low income and/or minority families. Several of these initiatives are highlighted below.

Special Initiative Loan	Number of Loans
Low Income Housing Tax Credits (LIHTC)	71
Refinance on Section 202 Elderly Housing	133
Decoupling of Interest Reduction Payment (IRP) Contracts	6
Loans made in Underserved Areas	418

Management Tools for Multifamily Housing Development

The Office of Multifamily Housing Development has a number of tools in place to expedite and manage the development process.

- *Development Application Processing (DAP) Tracking Module.* Multifamily's DAP system tracks a loan from receipt of the lender's application through processing of commitments, endorsements and completion of construction and repairs for all of FHA's basic, risk sharing and hospital programs ensuring that the same data are used by all divisions of HUD.

- *Multifamily Accelerated Processing (MAP).* 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, 93 lenders are approved to process loans under MAP. Participating MAP lenders are required to perform yearly internal control reviews of at least 10 percent of the MAP loans HUD endorses. If the reviews disclose weaknesses in processing procedures, FHA's Lender Quality and Monitoring Division (LQMD) works with the lender to improve internal control procedures and ensures that lender's staff receives training on the new processes. In addition, LQMD conducts annual in-depth reviews of loans processed by MAP lenders to provide assurance on the general loan quality. In fiscal year 2009, LQMD completed reviews of 12 MAP cases.

Multifamily Asset Management

At the end of fiscal year 2009, FHA's Multifamily portfolio has 11,971 insured mortgages that covered 1.4 million units, with a total outstanding principal balance of over $59.9 billion. In addition, FHA held 2,814 notes in inventory, with a total outstanding principal balance of $3.3 billion. However, the majority of these notes are subordinate liens.

Management Initiatives and Tools for Multifamily Asset Management

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

- *Note Sales.* To dispose of multifamily assets, HUD can either sell a property through foreclosure or sell the mortgage note. Note sales have historically demonstrated a greater return to the FHA Insurance Fund as compared to foreclosures. FHA conducted two Multifamily and Health Care Loan Sales during fiscal year 2009 that sold 31 first and second lien mortgage notes to successful bidders. The recovery proceeds from these sales were $ 94,920,542.

  Additionally, using authority provided in the 2009 Omnibus Appropriations Act which allowed repair estimates to be included in the market value of the assets, HUD sold a portfolio of ten mortgages for subsidized assets to New York City in August and one mortgage to the City of Chicago in September. By doing so, HUD preserved the affordability of 2,267 units in these two cities while ensuring that the units are repaired, safe and sanitary.

- *Lead-based paint.* FHA has been an active leader in the fight against lead-based paint. Property owners are required to comply with the Department's Lead Safe Housing Rule. Multifamily refers owners who fail to comply with the regulations to HUD's Departmental Enforcement Center for enforcement action. During fiscal year 2009, the lead-based paint compliance rate reached 95 percent which exceeded the established 80 percent goal. Currently, there are 945 properties in compliance with HUD's Lead-Based Paint regulations.

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

Office of Insured Health Care Facilities

The Office of Insured Health Care Facilities (OIHCF) administers the following programs that enable the affordable financing of health care facility projects by reducing the cost of capital and improving access to quality health care.

Section 232

Residential Care Facilities program insures loans to finance the construction, substantial rehabilitation, acquisition or refinancing of health care facilities. Eligible facilities include nursing homes, intermediate care facilities, board and care homes and assisted living facilities. Effective July 2008, OIHCF began administering the Section 232 program in phases and completely assumed the responsibility for the program in April 2009. During fiscal year 2009, OIHCF endorsed 88 loans totaling $532 million for 8,891 units/beds. At the end of September 30, 2009, the portfolio contained 2,305 loans with an unpaid principal balance of $14.3 billion. Due to significant industry demand, the portfolio is growing rapidly.

Section 242

Mortgage Insurance for Hospitals provides hospitals access to affordable financing for capital projects, including new construction or modernization. Clients range from small rural hospitals to major medical centers. Hospitals with FHA-insured loans serve as community anchors, providing jobs as well as health care services. FHA currently has 89 active hospital loans with unpaid principal balance totaling over $7.3 billion. In fiscal year 2009, FHA's issued insurance commitments totaled $1.1 billion for 10 hospitals in 7 states. The unpaid principal balance of insured loans has grown by over 97 percent from $3.7 billion in fiscal year 2003 to $7.3 billion in fiscal year 2009. HUD attributes this significant growth to an amendment to Section 242 of the National Housing Act that made it easier for critical access hospitals and hospitals in states without certificate of need requirements to qualify for insurance under the program. Other factors contributing to the growth include the significant decrease in application processing time, marketing efforts for the program, and the overall market conditions.

Section 223(f)

While there was statutory authority for purchasing or refinancing of hospitals under Section 223(f), it had not been implemented prior to fiscal year 2009. In response to the credit crisis HUD issued an emergency public notice in July 2009 providing implementation guidance and rules for the program. Since then HUD received 6 requests for preliminary reviews for Section 223(f) applications in fiscal year 2009 and expects to more than double the loan endorsements in fiscal year 2010.

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). OAHP administers restructuring of existing debt for privately owned multifamily properties to levels supportable by the reduced rents being charged to tenants. OAHP also provides assistance for oversight and preservation of a wide spectrum of affordable housing programs.

Mark-to-Market (M2M) Program

Under the M2M program, OAHP analyzes 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 2009, OAHP completed restructuring on 68 properties covering 6,268 units under the M2M program of which 45 properties or 66.2 percent resulted in reduced rents and Section 8 savings. Out of the 45 properties, 26 resulted in full debt restructuring, contributing to the long-term preservation of 1,839 units and represented an annual Section 8 savings (non-incurrence of cost) of $13 million. Another 14 properties consisting of 1,316 units charged reduced rents only, representing an annual Section 8 savings (non-incurrence of cost) of over $8.8 million. In total 3,499 units received reduced rents, resulting in annual savings (non-incurrence of cost) to FHA of over $25 million.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The Government Performance and Results Act (GPRA) and the Government Management Reform Act (GMRA) mandate that Federal agencies improve their financial and program accountability. GPRA requires Federal agencies to develop multiyear strategic plans, set program goals, measure performance against the goals, and publicly report the findings. GMRA mandates improvements and reforms to promote better accountability and financial management of the Federal government. FHA has outlined a series of reforms designed to improve efficiency, responsiveness to clients, and accountability to the public.

Performance information contained in this Management's Discussion & Analysis (MD&A) was obtained from operational and management sources and schedules prepared by management. The appropriate levels of Federal Housing Administration (FHA) management reviewed the information and data to provide reasonable assurance that reported performance information is relevant and reliable.

Office of Single Family Housing Programs

The following sections summarize the Office of Single Family Housing's achievements in meeting its fiscal year 2009 performance goals.

A. Strategic Goal: Increase Homeownership Opportunities

- *Endorse at least 1,432,000 FHA single family mortgages nationwide.*

  Although FHA did not establish an output goal in the Annual Performance Plan for the number of single family endorsements nationwide, the agency established an internal field-planning target of 1,432,000 endorsements. Homeownership Centers used this target to allocate processing and underwriting workload across the nation to help increase single family homeownership rates. During fiscal year 2009, FHA endorsed 1,947,158 single family mortgages for insurance, exceeding the internal field-planning target by 515,158 endorsements.

  The increase in the total volume of single family mortgage insurance endorsements from 1,200,111 in fiscal year 2008 to 1,947,158 in fiscal year 2009 is largely attributable to the credit contraction resulting from the collapse of the sub-prime mortgage market. In fiscal year 2008, the Department and the Congress put in place several initiatives to deal with the crosscurrents in the mortgage markets and in particular the high rates of foreclosure. These initiatives, including the FHA Modernization Act of 2008 have made FHA mortgage insurance a more prominent portion of the nation's overall mortgage market. Other contributing factors to the increase in FHA endorsement levels include a rise in the number of mortgage refinance transactions, a continued significant volume of reverse mortgage endorsements, and an overall strong homebuyer acceptance of FHA products.

- *Endorse 73 percent of FHA-insured single family home purchase mortgages to first-time homebuyers.*

  To help increase the number of families able to secure financing for their first home, FHA established a target of 73 percent for single family home purchase mortgage endorsements to first-time homebuyers. During fiscal year 2009, 78.5 percent of FHA-insured single family home purchase mortgages were to first-time homebuyers, compared with the target of 73 percent and the 77.9 percent achieved in fiscal year 2008. This comparable level of home purchase mortgages endorsed to first-time homebuyers for fiscal year 2009 may be attributable to the first-time homeowner tax credit and FHA's commitment to reaching first-time homebuyers. FHA will continue its efforts to reach potential first-time homebuyers through participation in conferences, seminars and other outreach events.

- *Endorse* 33 *percent of FHA-insured first-time single family home purchase mortgages to minorities.*

  To help increase the number of minority families able to secure financing for their first home, FHA established a target of 33 percent for its Homeownership Centers for single family home purchase mortgage endorsements to minority first-time homebuyers. During fiscal year 2009, FHA insured 32.0 percent of single family home purchase mortgages to first-time homebuyers who were minorities, compared with the 31.2 percent achieved in fiscal year 2008. FHA continues with its major program efforts in increasing new minority homebuyers while also minimizing attrition of existing minority homeowners during stressful market conditions. FHA will continue to pursue the President's commitment to reaching minorities and increasing the minority homeownership rate through housing counseling outreach programs and print and radio advertising.

- *Resolve 55 percent of total claims on FHA-insured single family mortgages through loss mitigation.*

  FHA established a national goal of resolving 55 percent of single family mortgage defaults through loss mitigation techniques. During fiscal year 2009, Single Family Housing surpassed this goal, resolving 66.2 percent of claims through loss mitigation techniques, compared to the 64.5 percent attained in fiscal year 2008. The high achievement rate of loss mitigation is due to FHA's new initiatives and heightened emphasis on loss mitigation programs to help homeowners facing imminent foreclosure.

- *Sell 90 percent of FHA Real Estate Owned (REO) properties to owner-occupants.*

  During fiscal year 2009, FHA Single Family Housing surpassed the goal of selling 90 percent of REO properties to owner-occupants by achieving a rate of 98.5 percent. FHA sold 18,065 of 18,337 REO properties that it held to owner-occupants. The high success rate achieved can be attributed to the increase in mortgage limits and decreased property value over the past year.

B. Strategic Goal: Strengthen Communities

- *Endorse 35 percent of FHA-insured single family mortgages in underserved communities.*

  FHA established a national goal to ensure that at least 35 percent of single family mortgages endorsed for insurance are in underserved communities, thereby enhancing homeownership opportunities in these neighborhoods. During fiscal year 2009, FHA endorsed 668,030 out of 1,881,803 single family mortgages in underserved communities, representing 35.5 percent. Factors such as the high volume of foreclosed properties selling at lower prices, availability of first-time homebuyer tax credits, and increased promotion of FHA's first-time homebuyer program by other organizations helped FHA in attaining the set goal.

C. Strategic Goal: Embrace High Standards of Ethics, Management and Accountability

- *Average* 45 *percent net recovery rate per property sale.*

  FHA established a net recovery rate goal of 45 percent per HUD Real Estate Owned (REO) property sale to reduce insurance claim losses associated with foreclosures. During fiscal year 2009, the average net recovery rate per sale was 39.6 percent. The 39.6 percent actual recovery rate falls short of the goal set for this performance indicator in fiscal year 2009.

- *Conduct 300 lender-monitoring reviews of FHA-approved lenders.*

  HUD set a national goal to conduct 300 lender-monitoring reviews of FHA-approved lenders in fiscal year 2009. HUD exceeded that goal by conducting 302 reviews in fiscal year 2009.

Office of Multifamily Housing Programs

The following sections summarize the Office of Multifamily Housing's achievements in meeting its fiscal year 2009 performance goals.

A. Strategic Goal: Increase the Availability of Affordable Rental Housing

- *Complete 626 initial endorsements.*

  The number of loans endorsed for HUD's FHA and Risk Sharing programs are determined by such economic factors as interest rates, availability of debt and equity financing, demand and supply for specific housing types, demographics, and construction and operating costs. During FY 2009, FHA initially endorsed 713 multifamily apartment, coop, and health care loans: 625 through the Office of Multifamily Housing and 88 through the Office of Insured Health Care Facilities.

B. Strategic Goal: Improve Management Accountability for Assisted Housing

- *Ensure 98 percent of the active inventory of Multifamily properties has no compliance flags or have their findings closed.*

  Multifamily Housing continues to improve the financial condition of properties by assuring that all property owners submit Annual Financial Statements (AFS) including agreement, mortgage note and subsidy contracts to the Real Estate Assessment Center and HUD field offices for review. Data are validated, analyzed, and scored for evaluating project operation and serve to protect subsidies and FHA funds. 92.0 percent of the properties in the multifamily inventory exhibit no compliance flags or had their findings closed in fiscal year 2009.

- *Bring at least* 75 *percent HUD-held loans that are 90 days or more delinquent under control.*

  HUD-held loans are placed under a workout plan when delinquent. Delinquent loans that do not have a workout plan are recommended for foreclosure, put in the mortgage sale, or referred to the Departmental Enforcement Center for further action. During fiscal year 2009, 82.7 percent of the HUD-held loans that are 90 days or more delinquent were brought under control.

C. Strategic Goal: Help Communities Access Revitalization Resources to Become More Livable

- *Maintain a 40% share of initial endorsement on multifamily properties in underserved areas.*

  FHA established a goal of endorsing 40% of initial endorsements on properties located in underserved areas as noted on the census with concentrations of low and moderate income and/or minority families. FHA exceeded the goal as of the end of the year and endorsed 418 multifamily properties in underserved areas equaling 58.6 percent of its initial endorsement. This was a result of efforts taken by the Department to increase liquidity in the credit markets and effectiveness of the Department's Mortgage insurance programs by streamlining procedures and aligning the programs with Low-Income Housing Tax Credits.

2009 Schedule of Performance Goals and Actual Result

Strategic Goals and Performance Objectives	*Goals*	*Actual Results*	*Goal Met (Yes/No)*
Office of Single Family Housing Programs			
A. Increase Homeownership Opportunities			
Endorse mortgages nationwide (in thousands)	1,432	1,947	Yes
Endorse mortgages to first-time homebuyers	73.0%	78.5%	Yes
Endorse mortgages to first-time minority home buyers	33.0%	32.0%	No
Resolve claims on FHA-insured mortgages through loss mitigation	55.0%	66.2%	Yes
Sell REO Properties to owner-occupants	90.0%	98.5%	Yes
B. Strengthen Communities			
Endorse FHA-insured mortgages in underserved communities	35.0%	35.5%	Yes
C. Embrace High Standards of Ethics, Management and Accountability			
Achieve property sale recovery rate	45.0%	39.6%	No
Perform FHA-approved lenders monitor reviews	300	302	Yes
Office of Multifamily Housing Programs			
A. Enhance the Availability of Affordable Rental Housing			
Complete Initial Endorsements	626	713	Yes
B. Improve Management Accountability for Assisted Housing			
Ensure properties have no compliance flags or have their finding closed	98.0%	92.0%	No
Bring delinquent HUD-held loans 90 days or more under control	75.0%	82.7%	Yes
C. Help Communities Access Revitalization Resources			
Maintain Initial endorsements in underserved areas	40.0%	58.6%	Yes

FINANCIAL STATEMENTS

Credit Reform Accounting

The financial statements have been prepared in accordance with the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS). The authoritative guidance for the statements are contained primarily in: SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees,* as amended; by SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees;* SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees;* the Federal Credit Reform Act (FCRA) of 1990.

Before the enactment of the FCRA, credit program costs were recorded in the budget of the U.S. federal government on a cash basis. While this accurately reflected the actual cash flows, it did not reflect the ultimate costs of credit programs, and thus hindered the comparison between the costs of these programs with those of other federal programs. Beginning in fiscal year 1992, the FCRA requires that the ultimate costs of a credit program be calculated, and the budgetary resources obtained, before new direct loan obligations are incurred and new loan guarantee commitments are made. The cost of loan guarantee programs is the net present value of the estimated future cash flows from payments (for claims, interest rate subsidies, and other payments) and collections (for loan origination and other fees, penalties and recoveries) by credit agencies.

SFFAS No. 2, which generally mirrors the requirements of the FCRA, established guidance for estimating the cost of direct and guaranteed loan programs, as well as for recording direct loans and the liability for loan guarantees for financial reporting purposes. SFFAS No. 2 states that the actual and expected costs of federal credit programs should be fully recognized in both budgetary and financial reporting. To accomplish this, agencies first predict or estimate the future performance of direct and guaranteed loans when preparing their annual budgets. The data used for these budgetary estimates are re-estimated after the fiscal year-end to reflect changes in actual loan performance and the actual interest rate in effect when the loans were insured. This re-estimated data is then used to report the cost of the loans disbursed under the direct or guaranteed loan program as a "Program Cost" on the agencies' Statement of Net Costs.

The FCRA establishes budgetary and financing control for each credit program through the use of the program, financing, and negative subsidy receipt accounts for loan guarantee commitments and direct loans obligated after September 30, 1991. It also establishes the liquidating account for any loan guarantee commitments and direct loans obligated before October 1, 1991. For further information regarding the FCRA and credit reform accounting, refer to Notes 1 and 6 of the Notes to Principal Financial Statements.

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. During fiscal year 2009, FHA received appropriations of $7,554 million, borrowings of $470 million, spending authority from offsetting collections of $33,596 million, and recoveries of prior year obligations of

$36 million. Additionally, FHA's budgetary resources were increased by $27,695 million of unobligated balances carried forward from fiscal year 2008 and reduced by repayment 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.

For fiscal year 2009, $195 million in appropriations were received for contract expenses. The MMI/CMHI fund transferred $58 million to the working capital fund and obligated $72 million for contract expenses in fiscal year 2009. The GI/SRI program received $6,793 million in appropriations for subsidy and obligated $52 million for contract expenses in fiscal year 2009. The H4H program obligated $5 million for contract expenses in fiscal year 2009.

During the year, FHA used its borrowing authority to obtain approximately $470 million from the U.S. Treasury and the public. These funds were used to pay for loan guarantee claims and for negative credit subsidy.

Spending authority of $24,980 million, $8,615 million and $1 million was received from offsetting collections in the MMI/CMHI, GI/SRI funds, and H4H funds respectively. These offsetting collections include collections of premiums, fees, interest, sales proceeds of credit program assets and credit subsidy transferred between different FHA accounts.

These funds provided FHA the resources to cover the fiscal year 2009 obligations totaling $29,695 million. These obligations included: payments on defaulted guaranteed loans; the cost of acquiring, maintaining and disposing of foreclosed properties; and the transfers of credit subsidies.

Assets and Liabilities

FHA maintains a highly liquid balance sheet with the majority of its assets consisting of fund balances with the U.S. Treasury and investments in non-marketable, market-based securities issued by the U.S. Treasury. The nature of FHA's business requires it to carry, or acquire through borrowing, the assets necessary for claim payments on defaulted guaranteed loans. Additionally, FHA must meet credit reform requirements of transferring out negative subsidy and downward credit subsidy re-estimates from the financing accounts. The negative subsidy and downward re-estimate calculations are based on various assumptions about premium and fee collections, prepayments, claims, and recoveries on credit program assets. Accordingly, FHA's total assets and financial leverage can fluctuate significantly depending largely on economic and market conditions, volume of activity, and customer demand.

As of September 30, 2009 FHA had total assets of $45,517 million, an increase from the September 30, 2008 total asset balance of $37,681 million. Total liabilities as of September 30, 2009 were $41,424 million as compared to $26,923 million as of September 30, 2008. The increase in the assets is primarily due to an increase in the fund balance with U.S. Treasury as a result of increased premium collections and a large upward re-estimate of credit subsidy expense in the GI/SRI financing account. The increase in premium collections is a result of an increase in endorsements resulting in more collections of upfront premiums and an increase in overall insurance in force which increased the annual premium collections. An upward re-estimate of credit subsidy expense in the GI/SRI financing account requires an appropriation to cover expenses related to the increase in the liability for loan guarantee. The increase in liabilities is primarily attributable to an increase in loan guarantee liability.

Schedule of Balance Sheet
As of September 30th
(Dollars in millions)

	2006	2007	2008	2009
Assets	$ 37,293	$ 37,165	$ 37,681	$ 45,517
Liabilities	13,294	16,590	26,923	$ 41,424
Net Position	$ 23,999	$ 20,575	$ 10,758	$ 4,093

As of September 30, 2009, FHA assets consisted of: investments in U.S. Treasury securities totaling $10,635 million; a fund balance with U.S. Treasury of $30,130 million; loan receivables and related foreclosed properties, net totaling $4,446 million; other receivables and assets totaling $306 million. FHA liabilities as of September 30, 2009 consisted of: loan guarantee liability totaling $34,022 million; borrowings from the U.S. Treasury of $4,420 million; payables to the public totaling $639 million; debentures issued to claimants totaling $14 million; other liabilities to federal agencies and to the public totaling $2,329 million.

Secretary-Held Mortgage Notes

A note is assigned to the Secretary when FHA pays a claim prior to foreclosure and takes possession of the mortgage note for servicing. Between fiscal years 2008 and 2009, the overall unpaid principal balance of Secretary-held mortgage notes, had an increase from $4,194 million to $4,670 million. The number of multifamily notes in inventory decreased 3 percent from 2,894 notes in fiscal year 2008 to 2,814 notes in fiscal year 2009. The number of single-family notes increased by 62 percent from 70,559 notes in fiscal year 2008 to 114,206 notes in fiscal year 2009 due to an increase in the number of notes associated with partial claims.

For the single family programs, mortgage notes in default were assigned to FHA for servicing until 1996 when the program was terminated due to the high cost of servicing assigned notes. However, eligible borrowers in older cohorts who applied for the program before April 26, 1996 may still receive such benefits.

Legislation passed in 1999 allows FHA to accept mortgage note assignments for single family properties again. FHA can either service the notes directly or transfer them to a third party for servicing.

Schedule of Secretary-Held Mortgage Notes
As of September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Single Family	$ 631	$ 698	$ 1,038	$ 1,395
Multifamily	3,265	3,165	3,156	3,275
Total	$ 3,896	$ 3,863	$ 4,194	$ 4,670

The growth in single-family notes is mostly attributable to a $207 million increase in the gross value of HECM notes in the GI/SRI financing account.

<u>Secretary - Held Property</u>

FHA acquires single family and multifamily properties through conveyance claims. Secretary-held property increased 16 percent in fiscal year 2009 to $5,207 million from $4,482 million in fiscal year 2008 due to an increase in the claims.

Schedule of Secretary-Held Property
As of September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Single Family	$ 2,939	$ 3,060	$ 4,480	$ 5,207
Multifamily	1	1	2	-
Total	$ 2,940	$ 3,061	$ 4,482	$ 5,207

<u>Loan Guarantee Liability</u>

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.

In fiscal year 2009, the LLG increased by $14,582 million from $19,304 million to $33,886 million. The single family LLG increased from a balance of $19,662 million in fiscal year 2008 to a balance of $34,049 million in fiscal year 2009. The $14,387 million single family LLG increase can be mostly attributed to increased claim rates due to the nationwide decrease in projected house price appreciation, which results in increased claims and lower proceeds from the sale of foreclosed properties.

The multifamily LLG increased from a balance of $(358) million in fiscal year 2008 to a balance of $(163) million in fiscal year 2009. The increase can be attributed to an increase in active insurance in force for the Mark to Market program.

Schedule of FHA Liability for Loan Guarantees
As of September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Single Family	$ 3,028	$ 7,483	$ 19,662	$ 34,049
Multifamily	(44)	(423)	(358)	(163)
Total	$ 2,984	$ 7,060	$ 19,304	$ 33,886

Pre-1992 Loan Loss Reserve (LLR)

The liability associated with pre-Credit Reform endorsements is computed by estimating the LLR. FHA maintains loss reserves for the estimated costs of future mortgage insurance claims resulting from defaults that have occurred or are likely to occur among insured single family and multifamily mortgages and Title I loans. FHA records a loss reserve allowance for its pre-Credit Reform insured mortgages to provide for anticipated losses which may occur on claims for defaults that have taken place but have not yet been filed. The LLR is computed using 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 present value of anticipated cash inflows such as premium receipts, proceeds from property sales and principal and interest on Secretary-held notes. Overall, loss reserve allowance decreased by $46 million from $182 million in fiscal year 2008 to $136 million in fiscal year 2009. The majority of the decrease can be attributed to a decrease in the Mark to Market program.

Schedule of FHA Loan Loss Reserves
As of September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Single Family	$ 52	$ 97	$ 21	$ 15
Multifamily	446	274	161	121
Total	$ 498	$ 371	$ 182	$ 136

Net Cost/ (Surplus)

FHA's program costs exceeded revenues in fiscal year 2009, thus resulting in a net cost. The most important facet of FHA's cost and revenue activity is the treatment of loan guarantee subsidy cost. Loan guarantee subsidy cost is the estimated long-term cost to FHA of a loan guarantee calculated on a net present value basis, excluding administrative costs. The cost of a loan guarantee is the net present value, at the time the loan is disbursed by the lender, of the estimated cash flows paid by FHA to cover claims, interest subsidies, and other requirements. Payments made to FHA, including origination premiums, penalties, and recoveries are also included in the calculation.

FHA had positive net program costs for 2009. This is due to a net $12 billion upward re-estimate of the loan guarantee credit subsidy expense.

Schedule of FHA Net Cost (Surplus)
For the year ended September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Program Cost	$ (380)	$ 3,890	$ 11,378	$ 14,689
Less: Program Revenues	1,701	1,521	$ 1,471	2,266
Net Cost (Surplus)	$ (2,081)	$ 2,369	$ 9,907	$ 12,423

Net Position

FHA's Net Position decreased to $4,093 million at the end of fiscal year 2009 from $10,758 million at the end of fiscal year 2008, a decrease of 62 percent, due to the $7,086 million decrease in Cumulative Results of Operations and offset by the $421 million increase in Unexpended Appropriations.

Schedule of Statement of Changes in Net Position
As of September 30th
(Dollars in Millions)

	2006	2007	2008	2009
Net Position, Beginning of Year	$ 23,155	$ 23,999	$ 20,575	$ 10,758
Net Change in Cumulative Results of Operations	859	(3,374)	(9,684)	(7,086)
Net Change in Unexpended Appropriations	(15)	(50)	(133)	421
Net Position, End of Year	$ 23,999	$ 20,575	$ 10,758	$ 4,093

SYSTEMS, CONTROLS, AND COMPLIANCE

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

The independent auditors for FHA's fiscal year 2007 and 2008 Financial Statements identified a significant deficiency in the systems and recommended that FHA continues "to enhance and modernize its information systems." In fiscal year 2008, the auditors also noted several key improvements by FHA to the systems' overall general control environment, "including (a) reductions in the number of system security vulnerabilities, (b) progress in implementing a new user access management system, (c) a new automated interface between FHA's reverse mortgage notes management system and the core financial management system, and (d) improved security controls at the single family property management contractors."

The auditors further recommended "the FHA Commissioner, Assistant Secretary for Housing, coordinate with the HUD Secretary and the HUD CIO to conduct a risk assessment of the various system initiatives and required corrective actions in connection with the OCIO Strategic Plan and document how HUD's/FHA's information technology (IT) resources will be appropriately allocated in fiscal year 2009 to address the Department's and FHA highest system priorities."

Accordingly, FHA developed their strategic management plan to implement corrective actions by assessing the capabilities FHA can provide to respond to the recent, rapid decline in the economy with the available allocated IT resources from HUD. FHA acquired professional services to analyze and evaluate FHA's IT capacity, strategies, priorities and risks. Thus far FHA has received reports on "Risk Capacity Study: Single Family Housing Application and Endorsement Processes" and "FHA IT Modernization Strategy". A risk assessment of the IT modernization program is planned for April 2010.

Fiscal Year 2009 Material Weaknesses

There were no material weaknesses identified for fiscal year 2009.

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

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

In addition, FHA conducted its assessment of the effectiveness of internal control over financial reporting in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHA can provide reasonable assurance that its internal control over financial reporting as of June 30, 2009 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Fiscal Year 2009

Annual Assurance Statement on Internal Control over Financial Reporting

The Federal Housing Administration (FHA) management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. FHA conducted its assessment of the effectiveness of the FHA internal control over financial reporting in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHA can provide reasonable assurance that internal control over financial reporting as of June 30, 2009 was operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

David H. Stevens
Assistant Secretary for Housing,
Federal Housing Commissioner

Improper Payments Information Act of 2002

In accordance with the Improper Payments Information Act, enacted on November 26, 2002, and the OMB Memorandum M-03-13, dated May 21, 2003 (now subsumed into OMB Circular A-123 as Appendix C), FHA continued to comply with the requirements of the Act and determined which of its active inventory required review this year. Pursuant to the Act, FHA has determined the total dollar amount of each disbursement system for nine months (October 1, 2008 through June 30, 2009) of fiscal year 2009 and compared them to the $40 million threshold. Single

Family Distributive Shares and Premium Refunds (DSRS) has been one of the four disbursement systems FHA analyzed annually, but it has fallen well below the threshold, and has been dropped from the list of systems to be considered. During fiscal years 2009 the disbursements from the other three systems listed below exceeded the threshold.

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

During fiscal year 2009, limited risk assessments were made on all the systems to assure that there were no changes that might be vulnerable to improper payments. We have conducted limited risk assessments of all systems including statistical testing of the Single Family Insurance Claims (SFIC) disbursements. In addition, FHA's internal control review required by OMB Circular A-123, Appendix A concluded that each of these systems has adequate internal controls that are fully documented and implemented to control fraud, waste and abuse.

LIMITATIONS OF FINANCIAL STATEMENTS

The following limitations apply to the preparation of the fiscal year 2009 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.

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PRINCIPAL FINANCIAL STATEMENTS

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FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2009 and 2008
(Dollars in Millions)

	FY 2009	FY 2008
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 30,130	$ 12,590
Investments (Note 4)	10,635	19,254
Other Assets (Note 7)	16	21
Total Intragovernmental	40,781	31,865
Investments (Note 4)	145	48
Accounts Receivable, Net (Note 5)	16	128
Loans Receivable and Related Foreclosed Property, Net (Note 6)	4,446	5,506
Other Assets (Note 7)	129	134
TOTAL ASSETS	**$ 45,517**	**$ 37,681**
LIABILITIES		
Intragovernmental		
Borrowings from U.S. Treasury (Note 9)	$ 4,420	$ 4,832
Other Liabilities (Note 10)	1,913	1,530
Total Intragovernmental	6,333	6,362
Accounts Payable (Note 8)	639	585
Loan Guarantee Liability (Note 6)	34,022	19,486
Debentures Issued to Claimants (Note 9)	14	52
Other Liabilities (Note 10)	416	438
TOTAL LIABILITIES	**41,424**	**26,923**
NET POSITION		
Unexpended Appropriations (Note 16)	832	411
Cumulative Results of Operations	3,261	10,347
TOTAL NET POSITION	**4,093**	**10,758**
TOTAL LIABILITIES AND NET POSITION	**$ 45,517**	**$ 37,681**

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
As of September 30, 2009 and 2008
(Dollars in Millions)

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

FY 2008	**MMI/CMHI**	**GI/SRI**	**H4H**	**Total**
Intragovernmental Gross Costs (Note 12)	$ 175	$ 138	$ -	$ 313
Less: Intragovernmental Earned Revenue (Note 13)	1,320	73	-	1,393
Intragovernmental Net Costs	(1,145)	65	-	(1,080)
Gross Costs with the Public (Note 12)	9,495	1,569	-	11,064
Less: Earned Revenue from the Public (Note 13)	9	68	-	77
Net Costs with the Public	9,486	1,501	-	10,987
NET PROGRAM COST (SURPLUS)	**$ 8,341**	**$ 1,566**	**$ -**	**$ 9,907**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET POSITION
As of September 30, 2009 and 2008
(Dollars in Millions)

	FY 2009 Cumulative Results of Operations	FY 2009 Unexpended Appropriations	FY 2008 Cumulative Results of Operations	FY 2008 Unexpended Appropriations
BEGINNING BALANCES	**$ 10,347**	**$ 411**	**$ 20,031**	**$ 544**
BUDGETARY FINANCING SOURCES				
Appropriations Received (Note 16)	-	7,554	-	627
Other Adjustments (Note 16)	-	(59)	-	(49)
Appropriations Used (Note 16)	6,929	(6,929)	435	(435)
Transfers-Out (Note 15 and Note 16)	(347)	(145)	(613)	(276)
OTHER FINANCING SOURCES				
Transfers In/Out (Note 15)	(1,260)	-	387	-
Imputed Financing (Note 12)	15	-	14	-
TOTAL FINANCING SOURCES	**$ 5,337**	**$ 421**	**$ 223**	**$ (133)**
NET (COST) SURPLUS OF OPERATIONS	**(12,423)**	**-**	**(9,907)**	**-**
ENDING BALANCES	**$ 3,261**	**$ 832**	**$ 10,347**	**$ 411**

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
As of September 30, 2009
(Dollars in Millions)

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

The accompanying notes are an integral part of these statements

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
As of September 30, 2008
(Dollars in Millions)

	FY 2008 Budgetary	FY 2008 Non-Budgetary	FY 2008 Total
BUDGETARY RESOURCES			
Unobligated Balance, brought forward, October 1	$ 22,843	$ 4,077	$ 26,920
Recoveries of prior year unpaid obligations	72	19	91
Budget Authority:			
Appropriations	627	-	627
Borrowing authority	3	940	943
Spending authority from offsetting collections (gross):			
Earned			
Collected (Note 18)	1,636	14,160	15,796
Change in receivables from Federal sources	(25)	(42)	(67)
Nonexpenditure transfers, net (Note 19)	(41)	-	(41)
Permanently not available	(294)	(690)	(984)
TOTAL BUDGETARY RESOURCES	**$ 24,821**	**$ 18,464**	**$ 43,285**
STATUS OF BUDGETARY RESOURCES			
Obligations incurred, Direct (Note 20)	$ 5,274	$ 10,316	$ 15,590
Unobligated balance-Apportioned	365	2,622	2,987
Unobligated balance-Not available	19,182	5,526	24,708
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 24,821**	**$ 18,464**	**$ 43,285**
Change in Obligated Balances			
Obligated balance, net:			
Unpaid obligations, brought forward, October 1	$ 954	$ 1,342	$ 2,296
Uncollected customer payments from Federal sources, brought forward, October 1	(263)	(44)	(307)
Total, unpaid obligated balance, brought forward, net	691	1,298	1,989
Obligations incurred (Note 20)	5,274	10,316	15,590
Gross outlays	(5,293)	(10,043)	(15,336)
Recoveries of prior-year unpaid obligations, actual	(72)	(19)	(91)
Change in uncollected customer payments-Federal sources	25	42	67
Total, unpaid obligated balance, net, end of period	625	1,594	2,219
Obligated balance, net, end of period:			
Unpaid obligations (Note 17)	863	1,596	2,459
Uncollected customer payments from Federal sources	(238)	(2)	(240)
Total, unpaid obligated balance, net, end of period	625	1,594	2,219
Net outlays:			
Gross outlays	$ 5,293	$ 10,043	$ 15,336
Offsetting collections (Note 18)	(1,636)	(14,160)	(15,796)
Less: Distributed offsetting receipts	1,511	-	1,511
NET OUTLAYS	**$ 2,146**	**$ (4,117)**	**$ (1,971)**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2009

Note 1. Significant Accounting Policies

Entity and Mission

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

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

FHA categorizes its 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 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. Beginning in Fiscal Year 2009, activities related to most Single Family programs, including HECM, 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 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 requires FHA to modify existing programs and initiated the H4H program.

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 three principal program funds, six revolving funds, two general funds and a deposit fund. All inter-fund accounts receivable, accounts payable, transfers in and transfers out within these TAFSs have been eliminated to prepare the consolidated balance sheets, statements of net cost, and statements of changes in net position. The SBR is prepared on a combined basis as required by OMB Circular A-136, *Financial Reporting Requirements*.

Fund Balance with U.S. Treasury

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

Investments

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

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

FHA implemented the Accelerated Claims Disposition Demonstration program (the 601 program) to shorten the claim filing process, obtain higher recoveries from its defaulted guaranteed loans, and support the Office of Housing's mission of keeping homeowners in their home. To achieve these objectives, FHA transfers assigned mortgage notes to private sector entities in exchange for cash and equity interest. With the transfer of assigned mortgage notes under the 601 program, FHA obtains ownership interest in the private-sector entities. To comply with the requirement of Opinion No. 18 issued by the Accounting Principles Board (APB 18), FHA uses the equity method of accounting to measure the value of its investments in these entities. The equity method of accounting requires FHA to record its investments in the entities at cost initially. Periodically, the carrying amount of the investments is adjusted for cash distributions to FHA and for FHA's share of the entities' earnings or losses.

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 claim amount paid by FHA on defaulted insured loans. If FHA's risk is over 50%, HUD must review and approve the underwriting standards, terms, and conditions of the loan. If the loan defaults FHA pays the lender the initial settlement. On the settlement date the lender issues FHA a debenture for the amount of the settlement at the note rate (determined by the U.S. Treasury) thus sharing the risk in the property.

Credit Reform Accounting

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

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

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

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

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, and purchase money mortgages (PMM). 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.

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

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

General Property, Plant and Equipment

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

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

Appropriations

FHA receives annual appropriations for Working Capital and Administrative Contract expenses for its MMI/CMHI, GI/SRI, and H4H program activities. 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. The MMI/CMHI fund obtains appropriations for upward reestimates from the Capital Reserve account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, requires that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. For purposes of HUD's consolidated financial statements, HUD identifies 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 2009 and $14 million for fiscal year 2008, 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.

In a separate effort, FHA conducts time allocation surveys of all Office of Housing operational managers. These surveys determine FHA's direct personnel costs associated with the Housing Salaries and Expenses (S&E) transfer in from HUD and where to allocate these costs between the MMI/CMHI and GI/SRI programs. The HUD Chief Financial Officer (CFO) office also conducts surveys to determine how the department's fiscal year overhead, Office of Inspector General, and Working Capital Fund costs should be accounted for by responsibility segments. This data is an integral part of the FHA direct cost S&E allocation prepared for financial statement reporting.

Distributive Shares

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

Liabilities Covered by Budgetary Resources

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

Statement of Budgetary Resources

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

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

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

Note 2. Non-entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2009 and 2008 are as follows:

(Dollars in Millions)	FY 2009	FY 2008
Intragovernmental:		
Fund Balance with U.S. Treasury	$ 202	$ 1,551
Investments in U.S. Treasury Securities	4	8
Total Intragovernmental	206	1,559
Other Assets	92	103
Total Non-entity Assets	298	1,662
Total Entity Assets	45,219	36,019
Total Assets	**$ 45,517**	**$ 37,681**

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

According to the FCRA, FHA transfers negative credit subsidy from new endorsements and downward credit subsidy reestimates from the GI/SRI financing account to the GI/SRI general fund receipt account. At the beginning of each fiscal year, fund balance in the GI/SRI general fund receipt account is transferred into the U.S. Treasury's general fund.

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

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2009 and 2008:

(Dollars in Millions)		FY 2009		FY 2008
Fund Balances:				
Revolving Funds	$	29,141	$	10,746
Appropriated Funds		750		308
Other Funds		239		1,536
Total	**$**	**30,130**	**$**	**12,590**
Status of Fund Balance with U.S. Treasury:				
Unobligated Balance:				
Available	$	6,450	$	2,987
Unavailable		21,376		7,144
Obligated Balance not yet Disbursed		2,304		2,459
Total	**$**	**30,130**	**$**	**12,590**

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

Other Funds

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

Status of Fund Balance with U.S. Treasury

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

Note 4. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2009 were as follows:

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

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2008 were as follows:

(Dollars in Millions)	Cost	Amortized (Premium)/ Discount, Net	Investment, Net	Market Value
MMI/CMHI Investments	$ 18,958	$ 55	$ 19,013	$ 20,214
GI/SRI Investments	8	-	8	8
Subtotal	$ 18,966	$ 55	$ 19,021	$ 20,222
MMI/CMHI Accrued Interest	-	-	$ 233	$ 233
Total	**$ 18,966**	**$ 55**	**$ 19,254**	**$ 20,455**

Investments in Private-Sector Entities

The following table presents financial data on FHA's investments in Section 601 and Risk Sharing Debentures as of September 30, 2009 and 2008:

(Dollars in Millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Return of Investment	Redeemed	Ending Balance
FY 2009						
601 Program	$ 18	$ -	$ (4)	$ (2)	$ -	$ 12
Risk Sharing Debentures	30	137	-	-	(34)	133
Total	**$ 48**	**$ 137**	**$ (4)**	**$ (2)**	**$ (34)**	**$ 145**
FY 2008						
601 Program	$ 41	$ -	$ (4)	$ (19)	$ -	$ 18
Risk Sharing Debentures	80	-	-	-	(50)	30
Total	**$ 121**	**$ -**	**$ (4)**	**$ (19)**	**$ (50)**	**$ 48**

The fiscal year for the Section 601 Program investments is from December 1 to November 30 for 2008. The condensed, audited financial statements reported $58 million in assets, $58 million in liabilities and partner's capital, and ($17) million in net income for these investments.

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2009 and 2008 are as follows:

	Gross		Allowance		Net	
(Dollars in Millions)	**FY 2009**	**FY 2008**	**FY 2009**	**FY 2008**	**FY 2009**	**FY 2008**
With the Public:						
Receivables Related to Credit Program Assets	$ 17	$ 55	$ (7)	$ (3)	$ 10	$ 52
Premiums Receivable	2	2	-	-	2	2
Generic Debt Receivables	75	72	(75)	-	-	72
Miscellaneous receivables	4	2	-	-	4	2
Total	**$ 98**	**$ 131**	**$ (82)**	**$ (3)**	**$ 16**	**$ 128**

Receivables Related to Credit Program Assets

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

Premiums Receivable

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

Generic Debt Receivables

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

Miscellaneous Receivables

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

Allowance for Loss

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

Reclassification of HECM Credit Reform Asset Receivables and Generic Debt Allowance

In Fiscal Year 2009, HECM Fee Receivables were reclassified from the Accounts Receivable in Note 5 to the Defaulted Guaranteed Loans in Note 6 to better reflect the nature of the receivables. The Generic Debt Allowance was reclassified from the Allowance for Subsidy in Note 6 to the Allowance for Loss in Note 5 to better reflect the value of the Generic Debt Receivables.

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

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and Loan Guarantee Liability as of September 30, 2009 and 2008 are as follows:

Direct Loan and Loan Guarantee Programs Administered by FHA Include:

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

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

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

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

Direct Loan Program

(Dollars in Millions)	MMI/CMHI - Single Family	GI/SRI - Multifamily	Total
FY 2009			
Direct Loans			
Loan Receivables	$ -	$ 13	$ 13
Interest Receivables	1	4	5
Allowance	(4)	(9)	(13)
Total Direct Loans	**$ (3)**	**$ 8**	**$ 5**
FY 2008			**Total**
Direct Loans			
Loan Receivables	$ 1	$ 13	$ 14
Interest Receivables	-	4	4
Allowance	(4)	(5)	(9)
Total Direct Loans	**$ (3)**	**$ 12**	**$ 9**

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

(Dollars in Millions)

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

(Dollars in Millions)

FY 2008	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family (Excluding HECM)			
Loan Receivables	$ 16	$ 9	$ 25
Interest Receivables	3	3	6
Allowance for Loan Losses	(2)	(6)	(8)
Foreclosed Property	9	6	15
Subtotal	**$ 26**	**$ 12**	**$ 38**
Multifamily			
Loan Receivables	$ -	$ 2,787	$ 2,787
Interest Receivables	-	179	179
Allowance for Loan Losses	-	(738)	(738)
Subtotal	**$ -**	**$ 2,228**	**$ 2,228**
HECM*			
Loan Receivables	$ -	$ 5	$ 5
Interest Receivables	-	2	2
Allowance for Loan Losses	-	-	-
Foreclosed Property	-	1	1
Subtotal	**$ -**	**$ 8**	**$ 8**
Total Guaranteed Loans	**$ 26**	**$ 2,248**	**$ 2,274**

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

(Dollars in Millions)

FY 2008	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family (Excluding HECM)			
Loan Receivables	$ 403	$ 39	$ 442
Interest Receivables	-	1	1
Foreclosed Property	4,053	398	4,451
Allowance for Subsidy Cost	(2,219)	(313)	(2,532)
Subtotal	**$ 2,237**	**$ 125**	**$ 2,362**
Multifamily			
Loan Receivables	$ -	$ 356	$ 356
Foreclosed Property	-	2	2
Allowance for Subsidy Cost	-	(263)	(263)
Subtotal	**$ -**	**$ 95**	**$ 95**
HECM*			
Loan Receivables	$ -	$ 565	$ 565
Interest Receivables	-	277	277
Foreclosed Property	-	13	13
Allowance for Subsidy Cost	-	(89)	(89)
Subtotal	**$ -**	**$ 766**	**$ 766**
Total Guaranteed Loans	**$ 2,237**	**$ 986**	**$ 3,223**

*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,**		**Amount of Outstanding Principal Guaranteed**
Guaranteed Loans Outstanding (FY 2009)				
MMI/CMHI				
Single Family	$	711,426	$	674,263
Multifamily		401		375
MMI/CMHI Subtotal	**$**	**711,827**	**$**	**674,638**
GI/SRI				
Single Family		25,898		23,088
Multifamily		66,463		59,515
GI/SRI Subtotal	**$**	**92,361**	**$**	**82,603**
H4H				
Single Family - 257		4		4
H4H Subtotal	**$**	**4**	**$**	**4**
FY 2009 Total	**$**	**804,192**	**$**	**757,245**
Guaranteed Loans Outstanding (FY 2008)				
MMI/CMHI				
Single Family	$	479,579	$	447,299
Multifamily		416		353
MMI/CMHI Subtotal	**$**	**479,995**	**$**	**447,652**
GI/SRI				
Single Family		30,346		27,685
Multifamily		62,855		56,384
GI/SRI Subtotal	**$**	**93,201**	**$**	**84,069**
FY 2008 Total	**$**	**573,196**	**$**	**531,721**

New Guaranteed Loans Disbursed:

(Dollars in Millions) **Loan Guarantee Programs**		**Outstanding Principal of Guaranteed Loans,**		**Amount of Outstanding Principal Guaranteed**
New Guaranteed Loans Disbursed (FY 2009)				
MMI/CMHI				
Single Family	$	330,342	$	328,054
Multifamily		43		43
MMI/CMHI Subtotal	**$**	**330,385**	**$**	**328,097**
GI/SRI				
Single Family		234		232
Multifamily		6,708		6,690
GI/SRI Subtotal	**$**	**6,942**	**$**	**6,922**
H4H				
Single Family - 257		4		4
H4H Subtotal	**$**	**4**	**$**	**4**
FY 2009 Total	**$**	**337,331**	**$**	**335,023**
New Guaranteed Loans Disbursed (FY 2008)				
MMI/CMHI				
Single Family	$	171,811	$	167,338
Multifamily		14		14
MMI/CMHI Subtotal	**$**	**171,825**	**$**	**167,352**
GI/SRI				
Single Family		9,449		9,204
Multifamily		3,458		3,446
GI/SRI Subtotal	**$**	**12,907**	**$**	**12,650**
FY 2008 Total	**$**	**184,732**	**$**	**180,002**

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 571,709 HECM loans with a maximum claim amount of $123 billion. Of these 571,709 HECM loans insured by FHA, 452,196 loans with a maximum claim amount of $103 billion are still active. As of September 30, 2009 the insurance in force (the outstanding balance of active loans) was $60 billion. The insurance in force includes balances drawn by the mortgagee; interest accrued on the balances drawn, service charges, and mortgage insurance premiums. The maximum claim amount is the dollar ceiling to which the outstanding loan balance can grow before being assigned to FHA.

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

(Dollars in Millions)

			Cumulative	
Loan Guarantee Programs		**Current Year Endorsements**	**Outstanding Balance**	**Potential Liability**
FY 2009	MMI/CMHI	$ 30,080	$ 15,524	$ 29,442
	GI/SRI	$ -	$ 44,353	$ 73,058
	Total	**$ 30,080**	**$ 59,877**	**$ 102,500**
FY 2008	GI/SRI	$ 24,166	$ 43,741	$ 77,736
	Total	**$ 24,166**	**$ 43,741**	**$ 77,736**

Loan Guarantee Liability, Net:

(Dollars in Millions)

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

FY 2008	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family (Excluding HECM)	$ 20	$ 2	$ -	$ 22
Multifamily	-	160	-	160
Subtotal	**$ 20**	**$ 162**	**$ -**	**$ 182**
LLG				
Single Family (Excluding HECM)	$ 17,384	$ 757	$ -	$ 18,141
Multifamily	(4)	(354)	-	(358)
HECM	-	1,521	-	1,521
Subtotal	**$ 17,380**	**$ 1,924**	**$ -**	**$ 19,304**
Loan Guarantee Liability Total	**$ 17,400**	**$ 2,086**	**$ -**	**$ 19,486**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

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

FY 2008	MMI/CMHI	GI/SRI	H4H	Total
Single Family (Excluding HECM)				
Defaults	$ 4,545	$ 284	$ -	$ 4,829
Fees and Other Collections	(6,600)	(339)	-	(6,939)
Other	1,620	-	-	1,620
Subtotal	**$ (435)**	**$ (55)**	**$ -**	**$ (490)**
Multifamily				
Defaults	$ 1	$ 151	$ -	$ 152
Fees and Other Collections	(1)	(227)	-	(228)
Other	-	-	-	-
Subtotal	**$ -**	**$ (76)**	**$ -**	**$ (76)**
HECM				
Defaults	$ -	$ 486	$ -	$ 486
Fees and Other Collections	-	(948)	-	(948)
Other	-	-	-	-
Subtotal	**$ -**	**$ (462)**	**$ -**	**$ (462)**
Total	**$ (435)**	**$ (593)**	**$ -**	**$ (1,028)**

Subsidy Expense for Modifications and Reestimates:

(Dollars in millions) **FY 2009**		**Total Modifications**		**Technical Reestimate**
MMI/CMHI	$	(362)	$	7,275
GI/SRI		(6)		3,139
Total	**$**	**(368)**	**$**	**10,414**
FY 2008				
MMI/CMHI	$	-	$	8,650
GI/SRI		-		1,709
Total	**$**	**-**	**$**	**10,359**

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)		**FY 2009**		**FY 2008**
MMI/CMHI	$	6,347	$	8,215
GI/SRI		2,987		1,116
H4H		1		-
Total	**$**	**9,335**	**$**	**9,331**

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

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

(Percentage)	Defaults	Fees and Other Collections	Other	Total
Budget Subsidy Rates for FY 2008 Loan Guarantees:				
MMI/CMHI				
Single Family - Section 203(b) (October 1 - July 13)	2.45	(3.71)	0.95	(0.31)
Single Family - Section 203(b) (July 14 - September 30)	2.99	(4.07)	0.93	(0.15)
Multifamily - Section 213	1.96	(3.86)	1.00	(0.90)
GI/SRI				
Multifamily - Section 221(d)(4)	4.46	(5.29)	-	(0.83)
Multifamily - Section 207/223(f)	1.98	(4.73)	-	(2.75)
Multifamily - Section 223(a)(7)	1.98	(4.73)	-	(2.75)
Multifamily - Section 232	3.73	(5.31)	-	(1.58)
Section 242	2.33	(4.99)	-	(2.66)
Single Family - HECM	2.00	(3.90)	-	(1.90)
Single Family - Section 234(c)	2.68	(3.56)	-	(0.88)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2009		FY 2008	
	LLR	LLG	LLR	LLG
Beginning Balance of the Loan Guarantee Liability	**$ 182**	**$ 19,304**	**$ 371**	**$ 7,060**
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	11,238	-	5,467
Fees and Other Collections	-	(15,446)	-	(8,115)
Other Subsidy Costs	-	3,497	-	1,620
Total of the above subsidy expense components	**-**	**(711)**	**-**	**(1,028)**
Adjustments:				
Fees Received		8,771		5,468
Foreclosed Property and Loans Acquired		3,907		4,683
Claim Payments to Lenders		(10,481)		(8,486)
Interest Accumulation on the Liability Balance		1,079		161
Other		(254)		(66)
Ending Balance before Reestimates	**182**	**21,615**	**371**	**7,792**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component	(46)	5,364	(189)	10,369
Interest Expense Component	-	1,367	-	1,141
Adjustment of prior years' credit subsidy reestimates	-	5,540	-	2
Total Technical/Default Reestimate	**(46)**	**12,271**	**(189)**	**11,512**
Ending Balance of the Loan Guarantee Liability	**$ 136**	**$ 33,886**	**$ 182**	**$ 19,304**

Administrative Expense:

(Dollars in Millions)	FY 2009	FY 2008
MMI/CMHI	$ 275	$ 228
GI/SRI	294	277
H4H	16	-
Total	**$ 585**	**$ 505**

Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2009 and 2008 is as follows:

	FY 2009	FY 2008
Number of properties in the foreclosure process	66	67
Number of properties held	39,671	37,890
Average holding period for properties held	7 Months	7 Months

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. In fiscal year 2009, FHA refined the methodology used to value its Multifamily GI/SRI Pre-Credit Reform notes to better reflect the Allowance for Loan Losses. Prior to 2009, FHA used one loss rate for all Multifamily notes to calculate the allowance. Beginning in 2009, a separate loss rate was used for the Mark-to-Market program notes. This change in rate resulted with a much larger allowance these notes.

The majority of FHA's Pre-Credit Reform liability relates to the Mark-to-Market program. A separate analysis was conducted to adjust the loan loss estimate for anticipated reductions for these project-based Section 8 rental assistance subsidies administered by the Office of Affordable Housing Preservation (OAHP). All projects that are required to submit financial statements and have submitted annual financial statements within the past two years, received Section 8 assistance, expected to expire in the next five years, and had contract rents exceeding 100 percent of fair market value were included. In the analysis, the gross rent for these projects was reduced to bring the contract rent for assisted units to fair market levels. The effects of this rent reduction on projects' financial health was assessed and a revised loan principal balance was computed based on a sustainable debt service level. A potential claim was calculated based on this reduction of loan principal.

Credit Reform Valuation Methodology

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

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

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

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

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

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

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

Additional information about loan performance assumptions is provided below:

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

Economic assumptions: Forecasts of economic conditions used in conjunction with loan-level data to generate Single Family and Multifamily claim and prepayment rates were obtained from Global Insights (formerly DRI) forecasts of U.S. annual economic figures. OMB provides other economic assumptions used, such as discount rates.

Actuarial Review: An independent actuarial review of the MMI fund each year produces conditional claim and prepayment rates that are used as inputs to the Single Family LLG calculation.

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

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

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

Impact of Economic Conditions on the LLG

Projections of future economic conditions directly impact the valuation of FHA’s Credit Reform LLG. As identified and described in the FY 2009 Actuarial Review of MMIF Excluding HECMs, different future economic paths create different expectations for the performance of the MMI Fund over time. The Actuarial Review presents a base case and five alternative economic scenarios, each with different outcomes for the economic value of the MMI Fund. This economic sensitivity analysis illustrates the risks involved in estimating the value of the Fund in a declining economic environment. FHA management recognizes the potential for alternative outcomes from what is represented in the Credit Reform LLG value represented here. The LLG was derived using the Actuarial Review base case scenario, which uses IHS Global Insight’s August 2009 economic forecasts.

Analysis of Change in the Liability for Loan Guarantees

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

FHA estimated the credit subsidy rates for the 2009 cohort in December 2007. At the time of budget submission, the rates reflected prevailing policy and loan performance assumptions based on the most recent information available at that time. The annual credit subsidy reestimates allow FHA to adjust the LLG and subsidy expense to reflect the most current and accurate credit subsidy rate.

Described below are the programs that comprise the majority of FHA's fiscal year 2009 business. These descriptions highlight the factors that contributed to changing credit subsidy rates and the credit subsidy reestimates. Overall, FHA's liability increased from the fiscal year 2008 estimates.

Mutual Mortgage Insurance (MMI) –During fiscal year 2009, FHA continued to experience increased claim rates due to the nationwide decrease in house price appreciation, which resulted in increased claims and lower proceeds from the sale of foreclosed properties. Moreover, due to the HECM and 234(c) programs moving from GI/SRI to MMI and shrinkage of capital availability in the conventional mortgage market, the MMI fund has experienced a surge in new endorsements during fiscal year 2009. This caused a significant increase in the volume of insurance-in-force, coupled with the increase in expected claims and lowered sales proceeds, the liability for MMI increased from $17,384 million at the end of fiscal year 2008 to $28,456 million at the end of fiscal year 2009.

GI/SRI Home Equity Conversion Mortgage (HECM) - The HECM activity from fiscal years 1992-2008 remains in the GI/SRI fund. The HECM liability for these years increased from $1,521 million at the end of fiscal year 2008 to $4,753 million at the end of fiscal year 2009. This increase in liability is primarily due to the drop in house price appreciation projections. The drop in house price appreciation projections results in lower recoveries from future HECM assigned assets which increases the liability.

GI/SRI Section 221(d)(4) - The Section 221(d)(4) program was established to provide mortgage insurance for the construction or substantial rehabilitation of Multifamily rental properties with five or more units. Under this program, HUD may insure up to 90 percent of the total project cost and is prohibited from insuring loans with HUD-subsidized interest rates. The Section 221(d)(4) program is the largest Multifamily program in the GI/SRI fund. The Section 221(d)(4) liability increased by $26 million in FY 2009.

Mark-to-Market - The Mark to Market (M2M) program was established by legislation to assess rents at the time of Section 8 Assistance contract renewal. If rents are above market levels, the project is referred to OAHP. OAHP then evaluates the project for potential financial restructuring to determine if the project could survive given the lower revenues from reduced rents. The pool of loans eligible for M2M restructuring is comprised of active insured loans with Section 8 Assistance contracts, which also meet all eligibility requirements such as financial statements submitted within the last 2 years and assistance contracts expiring within the next 5 years. While new Section 8 assistance contracts are not being offered to any properties, which reduces the number of active insured loans with section 8 contracts, the number of projects that meet M2M eligibility criteria may actually increase from year to year. A loan can fail one or more of the eligibility criteria one year but become eligible the following year. During fiscal year 2009, the M2M liability increased primarily due to an increase in the active insurance in force for the program.

GI/SRI Section 234(c) - The Section 234(c) program insures loans for condominium purchases. Like HECM, the activity from fiscal year 1992-2008 remains in the GI/SRI fund. One of the many purposes of FHA's mortgage insurance programs is to encourage lenders to make affordable mortgage credit available for non-conventional forms of ownership. Condominium ownership, in which the separate owners of the individual units jointly own the development's common areas and facilities, is one particularly popular alternative. In fiscal year 2009, Section 234(c) continued to experience increased claim rates due to the nationwide decrease in house price appreciation, which resulted in increased claims and lower proceeds from the sale of foreclosed properties. This resulted in an increase in the liability from $502 million at the end of fiscal year 2008 to $694 million at the end of fiscal year 2009 in the GI/SRI fund.

Note 7. Other Assets

The following table presents the composition of Other Assets held by FHA as of September 30, 2009 and 2008:

(Dollars in Millions)

	FY 2009		FY 2008	
Intragovernmental:				
Advances to HUD for Working Capital Fund Expenses	$	16	$	21
Total	**$**	**16**	**$**	**21**
With the Public:				
Escrow Monies Deposited at Minority-Owned Banks	$	92	$	103
Undistributed Charges		37		31
Total	**$**	**129**	**$**	**134**

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.

Undistributed Charges

Undistributed charges include FHA disbursements processed by the U.S. Treasury but the identification of the specific FHA operating area associated with the disbursement has not been determined by the end of the reporting period. When the FHA operating area that initiated the disbursement is identified, the undistributed charges are reclassified by recognizing new expenses or by liquidating previously established accounts payable.

Note 8. Accounts Payable

Accounts Payable as of September 30, 2009 and 2008 are as follows:

(Dollars in Millions)

		FY 2009		FY 2008
With the Public:				
Claims Payable	$	331	$	316
Premium Refunds and Distributive Shares Payable		173		174
Miscellaneous Payables		135		95
Total	**$**	**639**	**$**	**585**

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 and Distributive Shares Payable

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. Distributive shares payable represent the amount of excess revenues in the liquidating account of the CMHI fund that is to be distributed to the mortgagors at the discretion of the Secretary of HUD.

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, 2009 and 2008:

(Dollars in Millions)	FY 2008			FY 2009	
	Beginning Balance	**Net Borrowing**	**Ending Balance**	**Net Borrowing**	**Ending Balance**
Agency Debt:					
Debentures Issued to Claimants	$ 70	$ (18)	$ 52	$ (38)	$ 14
Other Debt:					
Borrowings from U.S. Treasury	4,573	259	4,832	(412)	4,420
Total	**$ 4,643**	**$ 241**	**$ 4,884**	**$ (450)**	**$ 4,434**

	FY 2009	**FY 2008**
Classification of Debt:		
Intragovernmental Debt	$ 4,420	$ 4,832
Debt held by the Public	14	52
Total	**$ 4,434**	**$ 4,884**

Debentures Issued to Public

The National Housing Act authorizes FHA, in certain cases, to issue debentures in lieu of cash to settle claims. FHA-issued debentures bear interest at rates established by the U.S. Treasury. Interest rates related to the outstanding debentures ranged from 4.00 percent to 10.375 percent in fiscal year 2009 and 4.00 percent to 12.875 percent in fiscal year 2008. 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, was September 30 was $14 million in fiscal year 2009 and $51 million in fiscal year 2008. The fair values for fiscal years 2009 and 2008 were $15 and $74 million, respectively.

Borrowings from U.S. Treasury

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

During fiscal year 2009, FHA's U.S. Treasury borrowings carried interest rates ranging from 3.71 percent to 7.34 percent. In fiscal year 2008, they carried interest rates ranged from 2.33 percent to 7.34 percent. The maturity dates for these borrowings occur from September 2017 – September 2028. 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, 2009 and 2008:

(Dollars in Millions)

FY 2009		Current		Non-Current		Total
Intragovernmental:						
Receipt Account Liability	$	1,913	$	-	$	1,913
Total	**$**	**1,913**	**$**	**-**	**$**	**1,913**
With the Public:						
Trust and Deposit Liabilities	$	116	$	-	$	116
Undistributed Credits		64		-		64
Miscellaneous Liabilities		236		-		236
Total	**$**	**416**	**$**	**-**	**$**	**416**

FY 2008		Current		Non-Current		Total
Intragovernmental:						
Receipt Account Liability	$	1,530	$	-	$	1,530
Total	**$**	**1,530**	**$**	**-**	**$**	**1,530**
With the Public:						
Trust and Deposit Liabilities	$	152	$	-	$	152
Undistributed Credits		49		-		49
Miscellaneous Liabilities		224		13		237
Total	**$**	**425**	**$**	**13**	**$**	**438**

Special Receipt Account Liability

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

Trust and Deposit Liabilities

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

Undistributed Credits

Undistributed credits represent FHA collections processed by U.S. Treasury, but the identification of the specific operating area associated with the collections has not been determined at the end of the reporting period. When the FHA operating area that is entitled to the collections is identified, the undistributed credits are reclassified by recognizing revenue or by liquidating previously established accounts receivable.

Miscellaneous Liabilities

Miscellaneous liabilities include mainly other unearned revenue from Single Family and Multifamily operations. It also may include loss contingencies that are recognized by FHA for past events that warrant a probable, or likely, future outflow of measurable economic resources.

Note 11. Commitments and Contingencies

Bankrupt Mortgagees

On August 24, 2009, one of FHA's largest mortgage lenders and servicers filed for Chapter 11 bankruptcy protection. The organization was seized on August 4, 2009 by the Federal Bureau of Investigation and other federal and state regulators. The organization originated about 7.5% of FHA's nearly 2.5 million endorsements during FY 2008 and the first ten months of FY2009. A review of the lender's endorsement files by FHA's Quality Assurance Division (QAD) completed in July 2009 detected 28 types of loan origination deficiencies that will be presented to the FHA Mortgagee Review Board. As of May 31, 2009, over 28% of their portfolio was in default, significantly higher than other lenders. Other federal investigators are continuing their review of allegations of corporate and loan file fraud. The ultimate resolution of these actions cannot be determined at this time and the accompanying financial statements do not include any specific provisions related to this closure.

During FY2009, various financial institutions, mortgage brokers and servicers ceased operations due to their weak financial condition. The mortgage loans held by these institutions are transferred to other accredited servicers without material cost to FHA.

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, 2009. However, there are pending or threatened legal actions where judgment against FHA is reasonably possible with an estimated potential loss of $23 million.

Pending or Threatened Litigation Against FHA

(Dollars in millions)

	FY 2009	**FY 2008**
Expected Outcome	Estimated Loss	Estimated Loss
Probable	-	-
Reasonably Possible	$23	$3

Note 12. Gross Costs

Gross costs incurred by FHA for the fiscal years ended September 30, 2009 and 2008 are as follows:

(Dollars in Millions)	FY 2009			FY 2008		
	MMI/CMHI	GI/SRI	H4H	MMI/CMHI	GI/SRI	H4H
Intragovernmental:						
Interest Expense	$ 160	$ 123	$ -	$ 167	$ 127	$ -
Imputed Costs	7	8	-	6	8	-
Other Expenses	-	-	5	2	3	-
Total	**$ 167**	**$ 131**	**$ 5**	**$ 175**	**$ 138**	**$ -**
With the Public:						
Salary and Administrative Expenses	$ 275	$ 294	$ 11	$ 226	$ 274	$ -
Subsidy Expense	6,347	2,987	1	8,215	1,116	-
Interest Expense	2,398	563	-	1,108	251	-
Bad Debt Expense	(7)	1,438	-	5	(49)	-
Loan Loss Reserve Expense	(5)	(44)	-	(69)	(123)	-
Other Expenses	64	64	-	10	100	-
Total	**$ 9,072**	**$ 5,302**	**$ 12**	**$ 9,495**	**$ 1,569**	**$ -**

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.

Imputed Costs/Imputed Financing

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

Salary and Administrative Expenses

Salary and administrative expenses include FHA's reimbursement to HUD for FHA personnel costs and FHA's payments to third party contractors for administrative contract expenses.

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. Subsidy expense incurred by the Church Arson program is the expense of a HUD program administered by the Office of Community Planning and Development (CPD) even though its cost is funded through a FHA program account.

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 fiscal years ended September 30, 2009 and 2008 are as follows:

(Dollars in Millions)	FY 2009		FY 2008	
	MMI/CMHI	GI/SRI	MMI/CMHI	GI/SRI
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 990	$ 392	$ 424	$ 73
Interest Revenue from MMI/CMHI Investments	633	-	896	-
Gain on Sale of MMI/CMHI Investments	133	-	-	-
	$ 1,756	**$ 392**	**$ 1,320**	**$ 73**
With the Public:				
Insurance Premium Revenue	$ 16	$ 20	$ 10	$ 21
Income from Notes and Properties	31	31	(1)	41
Other Revenue	-	20	-	6
Total	**$ 47**	**$ 71**	**$ 9**	**$ 68**

Interest Revenue

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

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

Premium Revenue

According to the FCRA accounting, FHA's premium revenue includes only premiums associated with the pre-1992 loan guarantee business. Premium revenue for post-1991 loan guarantee cases is included in the balance of the LLG. The FHA premium structure, set by the National Affordable Housing Act and published in the Code of Federal Regulations, which became effective July 1991, includes both up-front premiums and annual periodic premiums.

Up-front Premiums

The up-front premium rates, which are set by legislation, vary according to the mortgage type and the year of origination. The pre-1992 up-front premiums in the MMI fund were recorded as unearned revenue upon collection and are recognized as revenue over the period in which losses and insurance costs are expected to occur. Other FHA funds' unearned revenue is recognized monthly as revenue on a straight-line basis.

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.

The FHA up-front premium rates in fiscal year 2009 were:

	Premium Rate
Single Family	1.75%
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%
HECM	2.00% (Based on Maximum Claim Amount)

Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums receivable. These rates, which are also legislated, vary by mortgage type and program. The FHA periodic premium rate in fiscal year 2009 for Single Family and Multifamily were:

	Mortgage Term 15 Years or Less	Mortgage Term More Than 15 Years
Single Family	0.25%	0.50%
Multifamily	0.45 %, 0.50%, 0.57% or 0.80%	0.45 %, 0.50%, 0.57% or 0.80%
HECM	0.50% (All Terms)	

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 2009, 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 fiscal years ended September 30, 2009 and 2008 are as follows:

(Dollars in Millions)

FY 2009

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

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

FY 2008

Budgetary Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (613)	$ (235)	$ (848)
HUD	-	(41)	(41)
Total	**$ (613)**	**$ (276)**	**$ (889)**

Other Financing Sources	Cumulative Results of Operations	Unexpended Appropriations	Total
Treasury	$ (19)	$ -	$ (19)
HUD	406	-	406
Total	**$ 387**	**$ -**	**$ 387**

Transfers Out to U.S. Treasury

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

Transfers In/Out From HUD

FHA does not receive an appropriation for S&E; instead the FHA amounts are appropriated directly to HUD. In order to recognize the S&E in FHA's Statement of Net Cost, a Transfer In from HUD is recorded with the recognition of FHA S&E costs. 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, 2009 and 2008 are as follows:

(Dollars in Millions)

FY 2009	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 15	$ 470	$ -	$ (7)	$ -	$ 478
Working Capital and Contract Expenses	310	195	(59)	(115)	(59)	272
Reestimates	-	6,793	-	(6,793)	-	-
GI/SRI Liquidating	86	96	-	(14)	(86)	82
Total	**$ 411**	**$ 7,554**	**$ (59)**	**$ (6,929)**	**$ (145)**	**$ 832**
FY 2008						
Positive Subsidy	$ 28	$ 8	$ -	$ (21)	$ -	$ 15
Working Capital and Contract Expenses	293	205	(49)	(98)	(41)	310
Reestimates	-	301	-	(301)	-	-
GI/SRI Liquidating	223	113	-	(15)	(235)	86
Total	**$ 544**	**$ 627**	**$ (49)**	**$ (435)**	**$ (276)**	**$ 411**

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

When appropriations are first received, they are reported as unexpended appropriations. As these appropriations are expended, appropriations used are increased and unexpended appropriations are decreased. Additionally, unexpended appropriations are decreased when: administrative expenses, and working capital funds are transferred out to HUD; the year-end unobligated balance in the GI/SRI liquidating account is returned to the U.S. Treasury; appropriations are rescinded; or other miscellaneous adjustments are required.

Note 17. Budgetary Resources

The SF-133 and the Statement of Budgetary Resources for fiscal year 2008 have been reconciled to the fiscal year 2008 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 2009 Statement of Budgetary Resources will be presented in the fiscal year 2011 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2011 and will be available from the Government Printing Office and online at that time.

Obligated balances for the period ended September 30, 2009 and 2008 are as follows:

Unpaid Obligations

(Dollars in Millions)

Undelivered Orders		FY 2009		FY 2008
MMI/CMHI	$	638	$	795
GI/SRI		475		526
H4H		1		-
Undelivered Orders Subtotal	**$**	**1,114**	**$**	**1,321**
Accounts Payable				
MMI/CMHI	$	857	$	793
GI/SRI		333		345
Accounts Payable Subtotal	**$**	**1,190**	**$**	**1,138**
Unpaid Obligations Total	**$**	**2,304**	**$**	**2,459**

Note 18. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2009 and 2008:

(Dollars in Millions)

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

(Dollars in Millions)

FY 2008	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 4,239	$ 1,219	$ -	$ 5,458
Notes	9	331	-	340
Property	2,900	153	-	3,053
Interest Earned from U.S Treasury	1,273	73	-	1,346
Subsidy	435	21	-	456
Reestimates	4,560	301	-	4,861
Other	71	211	-	282
Total	**$ 13,487**	**$ 2,309**	**$ -**	**$ 15,796**

Note 19. Budgetary Resources – Non-expenditure Transfers

The following table presents the composition of FHA's non-expenditure transfers through September 30, 2009 and 2008:

(Dollars in Millions)

FY 2009	MMI/CMHI	GI/SRI	Total
Transfers:			
Working Capital Expenses	$ (58)	$ -	$ (58)
Total	**$ (58)**	**$ -**	**$ (58)**

(Dollars in Millions)

FY 2008	MMI/CMHI	GI/SRI	Total
Transfers:			
Working Capital Expenses	$ (25)	$ (16)	$ (41)
Total	**$ (25)**	**$ (16)**	**$ (41)**

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2009 and 2008:

(Dollars in Millions)

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

(Dollars in Millions)

FY 2008	MMI/CMHI	GI/SRI	H4H	Total
Obligations:				
Claims	$ 6,494	$ 1,146	$ -	$ 7,640
Single Family Property Management Contracts	411	21	-	432
Contract Obligations	47	79	20	146
Subsidy	435	643	-	1,078
Downward Reestimates	5	897	-	902
Upward Reestimates	4,555	301	-	4,856
Interest on Borrowings	167	134	-	301
Other	94	141	-	235
Total	**$ 12,208**	**$ 3,362**	**$ 20**	**$ 15,590**

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 periods ending September 30, 2009 and 2008:

(Dollars in Millions)	FY 2009	FY 2008
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred	$ 29,695	$ 15,590
Spending Authority from Offsetting Collections and Recoveries	(33,481)	(15,820)
Offsetting Receipts	(183)	(1,511)
Transfers In / Out	(1,260)	387
Imputed Financing from Costs Absorbed by Others	15	14
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ (5,214)**	**$ (1,340)**
RESOURCES THAT DO NOT FUND THE NET COST OF OPERATIONS		
Undelivered Orders and Adjustments	$ 209	$ (87)
Revenue and Other Resources	31,343	15,784
Purchase of Assets	(10,903)	(10,419)
Appropriation for prior year Re-estimate	(17,176)	(4,856)
TOTAL RESOURCES NOT PART OF NET COST OF OPERATIONS	**$ 3,473**	**$ 422**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ (1,741)**	**$ (918)**
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Upward Re-estimate of Credit Subsidy Expense	$ 14,054	$ 11,611
Downward Re-estimate of Credit Subsidy Expense	(1,784)	(99)
Changes in Loan Loss Reserve Expense	(49)	(192)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	1,431	(44)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(1,084)	(1,047)
Gains or Losses on Sales of Credit Program Assets	73	101
Other	1,523	495
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ 14,164**	**$ 10,825**
NET COST (SURPLUS) OF OPERATIONS	**$ 12,423**	**$ 9,907**

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intragovernmental assets, by federal entity, are as follows for the periods ending September 30, 2009 and 2008:

(Dollars in millions) Agency		Fund Balance with U.S. Treasury		Investments in U.S. Treasury Securities		Other Assets
FY 2009						
U.S. Treasury	$	30,130	$	10,635	$	-
HUD		-		-		16
Total	**$**	**30,130**	**$**	**10,635**	**$**	**16**
FY 2008						
U.S. Treasury	$	12,590	$	19,254	$	-
HUD		-		-		21
Total	**$**	**12,590**	**$**	**19,254**	**$**	**21**

Schedule B: Intragovernmental Liabilities

FHA's Intragovernmental liabilities, by federal entity, are as follows on September 30, 2009 and 2008:

(Dollars in Millions) Agency		Borrowings from U.S. Treasury		Other Liabilities
FY 2009				
U.S. Treasury	$	4,420	$	1,913
Total	**$**	**4,420**	**$**	**1,913**
FY 2008				
U.S. Treasury	$	4,832	$	1,530
Total	**$**	**4,832**	**$**	**1,530**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program
September 30, 2009 and 2008:

(Dollars in Millions)	MMI/CMHI		GI/SRI		H4H		Total	
	2009	2008	2009	2008	2009	2008	2009	2008
BUDGETARY RESOURCES								
Unobligated Balance Carried Forward								
Beginning of period	$26,833	$25,499	$ 853	$ 1,421	$ 9	$ -	$27,695	$26,920
Recoveries of Prior Year Obligations	17	49	19	42	-	-	36	91
Budget Authority:								
Appropriations received	146	77	6,947	520	461	30	7,554	627
Borrowing Authority	85	235	385	708	-	-	470	943
Spending Authority from Offsetting Collections:								
Earned								
Collected	24,980	13,487	8,615	2,309	1	-	33,596	15,796
Receivable from Federal Sources	(147)	(29)	(4)	(38)	-	-	(151)	(67)
Net Transfers	(58)	(25)	-	(16)	-	-	(58)	(41)
Permanently Not Available	(586)	(252)	(661)	(732)	-	-	(1,247)	(984)
TOTAL BUDGETARY RESOURCES	**$51,270**	**$39,041**	**$16,154**	**$ 4,214**	**$ 471**	**$ 30**	**$67,895**	**$43,285**
STATUS OF BUDGETARY RESOURCES								
Obligations Incurred	$20,647	$12,208	$ 9,042	$ 3,362	$ 6	$ 20	$29,695	$15,590
Unobligated Balance-Apportioned	5,644	2,179	341	798	465	10	6,450	2,987
Unobligated Balance Not Available	24,979	24,654	6,771	54	-	-	31,750	24,708
TOTAL STATUS OF BUDGETARY RESOURCES	**$51,270**	**$39,041**	**$16,154**	**$ 4,214**	**$ 471**	**$ 30**	**$67,895**	**$43,285**
CHANGE IN OBLIGATED BALANCES								
Obligated Balance, Net, Beginning of Period:								
Unpaid Obligations Carried Forward	$ 1,589	$ 1,435	$ 870	$ 861	$ -	$ -	$ 2,459	$ 2,296
Receivable from Federal Sources Carried Forward	(234)	(263)	(6)	(44)	-	-	(240)	(307)
Obligations Incurred	20,647	12,208	9,042	3,362	6	20	29,695	15,590
Gross Outlays	(20,721)	(12,005)	(9,088)	(3,311)	(5)	(20)	(29,814)	(15,336)
Obligated Balance Transfers, Net:								
Recoveries of Prior Year Obligations	(17)	(49)	(19)	(42)	-	-	(36)	(91)
Change in Receivable from Federal Sources	147	29	4	38	-	-	151	67
Obligated Balance, Net, End of Period:								
Unpaid Obligations	1,498	1,589	805	870	1	-	2,304	2,459
Receivable from Federal Sources	(87)	(234)	(2)	(6)	-	-	(89)	(240)
Outlays:								
Disbursements	$20,721	$12,005	$ 9,088	$ 3,311	$ 5	$ 20	$29,814	$15,336
Collections	(24,980)	(13,487)	(8,615)	(2,309)	(1)	-	(33,596)	(15,796)
Subtotal	(4,259)	(1,482)	473	1,002	4	20	(3,782)	(460)
Less: Offsetting Receipts	-	-	183	1,511	-	-	183	1,511
NET OUTLAYS	**$ (4,259)**	**$ (1,482)**	**$ 290**	**$ (509)**	**$ 4**	**$ 20**	**$ (3,965)**	**$ (1,971)**

Required Supplementary Information

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

(Dollars in Millions)

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

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by Appropriation for the MMI/CMHI Program
September 30, 2008:

(Dollars in Millions)

	Program	Liquidating	Financing	Capital Reserve	MMI/CMHI Total
BUDGETARY RESOURCES					
Unobligated Balance Carried Forward					
Beginning of period	$ 47	$ 64	$ 2,993	$ 22,395	$ 25,499
Recoveries of Prior Year Obligations	13	23	13	-	49
Budget Authority:					
Appropriations received	77	-	-	-	77
Borrowing Authority	-	-	235	-	235
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	13	12,185	1,289	13,487
Receivable from Federal Sources	-	-	-	(29)	(29)
Net Transfers	4,531	15	-	(4,571)	(25)
Permanently Not Available	(17)	-	(235)	-	(252)
TOTAL BUDGETARY RESOURCES	**$ 4,651**	**$ 115**	**$ 15,191**	**$ 19,084**	**$ 39,041**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 4,603	$ 65	$ 7,540	$ -	$ 12,208
Unobligated Balance-Apportioned	4	50	2,125	-	2,179
Unobligated Balance Not Available	44	-	5,526	19,084	24,654
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 4,651**	**$ 115**	**$ 15,191**	**$ 19,084**	**$ 39,041**
CHANGE IN OBLIGATED BALANCES					
Obligated Balance, Net, Beginning of Period:					
Unpaid Obligations Carried Forward	$ 71	$ 212	$ 1,152	$ -	$ 1,435
Receivable from Federal Sources Carried Forward	-	-	(2)	(261)	(263)
Obligations Incurred	4,603	65	7,540	-	12,208
Gross Outlays	(4,595)	(49)	(7,361)	-	(12,005)
Obligated Balance Transfers, Net:					
Recoveries of Prior Year Obligations	(13)	(23)	(13)	-	(49)
Change in Receivable from Federal Sources	-	-	-	29	29
Obligated Balance, Net, End of Period:					
Unpaid Obligations	66	205	1,318	-	1,589
Receivable from Federal Sources	-	-	(2)	(232)	(234)
Outlays:					
Disbursements	$ 4,595	$ 49	$ 7,361	$ -	$ 12,005
Collections	-	(13)	(12,185)	(1,289)	(13,487)
Subtotal	4,595	36	(4,824)	(1,289)	(1,482)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 4,595**	**$ 36**	**$ (4,824)**	**$ (1,289)**	**$ (1,482)**

Required Supplementary Information

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

(Dollars in Millions)

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

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program
September 30, 2008:

(Dollars in Millions)

	Program	Liquidating	Financing	GI/SRI Total
BUDGETARY RESOURCES				
Unobligated Balance Carried Forward				
Beginning of period	$ 102	$ 235	$ 1,084	$ 1,421
Recoveries of Prior Year Obligations	9	27	6	42
Budget Authority:				
Appropriations received	407	113	-	520
Borrowing Authority	-	3	705	708
Spending Authority from Offsetting Collections:				
Earned				
Collected	-	334	1,975	2,309
Receivable from Federal Sources	-	4	(42)	(38)
Net Transfers	(16)	-	-	(16)
Permanently Not Available	(32)	(244)	(456)	(732)
TOTAL BUDGETARY RESOURCES	**$ 470**	**$ 472**	**$ 3,272**	**$ 4,214**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 383	$ 203	$ 2,776	$ 3,362
Unobligated Balance-Apportioned	33	269	496	798
Unobligated Balance Not Available	54	-	-	54
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 470**	**$ 472**	**$ 3,272**	**$ 4,214**
CHANGE IN OBLIGATED BALANCES				
Obligated Balance, Net, Beginning of Period:				
Unpaid Obligations Carried Forward	$ 100	$ 571	$ 190	$ 861
Receivable from Federal Sources Carried Forward	-	-	(44)	(44)
Obligations Incurred	383	203	2,776	3,362
Gross Outlays	(376)	(253)	(2,682)	(3,311)
Obligated Balance Transfers, Net:				
Recoveries of Prior Year Obligations	(9)	(27)	(6)	(42)
Change in Receivable from Federal Sources	-	(5)	43	38
Obligated Balance, Net, End of Period:				
Unpaid Obligations	98	494	278	870
Receivable from Federal Sources	-	(5)	(1)	(6)
Outlays:				
Disbursements	$ 376	$ 253	$ 2,682	$ 3,311
Collections	-	(334)	(1,975)	(2,309)
Subtotal	376	(81)	707	1,002
Less: Offsetting Receipts	-	-	-	1,511
NET OUTLAYS	**$ 376**	**$ (81)**	**$ 707**	**$ (509)**

Required Supplementary Information

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

(Dollars in Millions)

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

Required Supplementary Information

Schedule F: Comparative Combining Budgetary Resources by Appropriation for the H4H Program
September 30, 2008:

(Dollars in Millions)

	Program	Financing	H4H Total
BUDGETARY RESOURCES			
Unobligated Balance Carried Forward			
Beginning of period	$ -	$ -	$ -
Recoveries of Prior Year Obligations	-	-	-
Budget Authority:			
Appropriations received	30	-	30
Borrowing Authority	-	-	-
Spending Authority from Offsetting Collections:			
Earned			
Collected	-	-	-
Receivable from Federal Sources	-	-	-
Net Transfers	-	-	-
Permanently Not Available	-	-	-
TOTAL BUDGETARY RESOURCES	**$ 30**	**$ -**	**$ 30**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred	$ 20	$ -	$ 20
Unobligated Balance-Apportioned	10	-	10
Unobligated Balance Not Available	-	-	-
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 30**	**$ -**	**$ 30**
CHANGE IN OBLIGATED BALANCES			
Obligated Balance, Net, Beginning of Period:			
Unpaid Obligations Carried Forward	$ -	$ -	$ -
Receivable from Federal Sources Carried Forward	-	-	-
Obligations Incurred	20	-	20
Gross Outlays	(20)	-	(20)
Obligated Balance Transfers, Net:			
Recoveries of Prior Year Obligations	-	-	-
Change in Receivable from Federal Sources	-	-	-
Obligated Balance, Net, End of Period:			
Unpaid Obligations	-	-	-
Receivable from Federal Sources	-	-	-
Outlays:			
Disbursements	$ 20	$ -	$ 20
Collections	-	-	-
Subtotal	20	-	20
Less: Offsetting Receipts	-	-	-
NET OUTLAYS	**$ 20**	**$ -**	**$ 20**

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OIG REPORT

This report is a condensed version of a more detailed report issued separately on November 13, 2009 by HUD, OIG entitled, "Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2009 and 2008" (2010-FO-0002). The report is available at HUD, OIG's Internet site at http://www.hud.gov/offices/oig/reports/files/ig10F0002.pdf

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audit report

Issue Date
November 13, 2009
Audit Case Number
2010-FO-0002

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

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

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2009 and 2008

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Urbach Kahn and Werlin LLP (UKW) to audit the fiscal year 2009 and 2008 financial statements of the Federal Housing Administration (FHA). The contract required that the audit be performed according to generally accepted government auditing standards (GAGAS).

UKW is responsible for the attached auditor's report dated November 9, 2009 and the conclusions expressed in the report. Accordingly, we do not express an opinion on FHA's financial statements or conclusions on FHA's internal controls or compliance with laws, regulations and government-wide policies. Within 30 days of this report, UKW expects to issue a separate letter to management dated November 9, 2009 regarding other less significant matters that came to its attention during the audit.

This report includes both the Independent Auditor's Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A). The MD&A is not included in this report. FHA plans to separately publish an annual report for fiscal year 2009 that conforms to FASAB standards.

The report contains four significant deficiencies in FHA's internal controls and one reportable instance of noncompliance with laws and regulations. The report contains 15 new recommendations. Within 120 days of the report issue date, FHA is required to provide its final management decision which included a corrective action plan for each recommendation. As part of the audit resolution process, we will record 15 new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking System (ARCATS). We will also endeavor to work with FHA to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plan will be reviewed and evaluated with concurrence from the OIG.

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

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INDEPENDENT AUDITOR'S REPORT

Inspector General
United States Department of Housing and Urban Development

Commissioner
Federal Housing Administration

We have audited the accompanying consolidated balance sheets of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2009 and 2008, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources (Principal Financial Statements) for the years then ended.

Summary

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

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

- Financial system capacity limitations could impact business processing
- Effective FHA modernization is critical to address systems risks
- Economic conditions and inherent model design increase risks to management estimates
- FHA should enhance the general ledger system user access management processes

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

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

Opinion on the Principal Financial Statements

In our opinion, the Principal Financial Statements referred to above present fairly, in all material respects, the financial position of FHA as of September 30, 2009 and 2008, and its net cost, changes in net position, and combined budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in the footnotes to the Principal Financial Statements, the Loan Guarantee Liability (LGL) is a management estimate of the net present value of future claims, net of premiums and recoveries, from loans insured as of the end of the fiscal year. This estimate is developed using econometric models, which integrate historical data with national house price forecasts to develop assumptions about future portfolio performance. Endorsements in the last two years make up over half of FHA's insured single family mortgage loans in the Mutual Mortgage Insurance (MMI) Fund. These loans have very limited claims experience to support management's assumptions regarding their future performance. Because of this limited experience and the impact of the current economy on the housing market, the reliability of the LGL estimate for single family mortgages may be significantly affected.

The MMI Fund includes a Capital Reserve account from which increases in funding to cover accrued claim losses are drawn. As of September 30, 2009, this Capital Reserve account had $2.6 billion available to cover further increases in the MMI Fund's Loan Guarantee Liability. The Credit Reform Act of 1990 provides for permanent, indefinite budget authority should future increases in the Loan Guarantee Liability exceed funds available in the Capital Reserve account.

Consideration of Internal Control

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency in internal control, or a combination of deficiencies, that adversely affects FHA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of FHA's Principal Financial Statements that is more than inconsequential will not be prevented or detected by FHA's internal control. We noted four matters, summarized below and more fully described in Appendix A, involving the internal control and its operation that we consider to be significant deficiencies:

<u>Financial system capacity limitations could impact business processing</u>

The collapse of the commercial subprime mortgage industry has resulted in significant increases in FHA's business volume that strained FHA information technology (IT) system resources. During FY2009, FHA's Office of the Comptroller and the HUD Office of Chief Information Officer (OCIO) upgraded system capacity and developed an informal written short term capacity management plan that identified the actions that had been taken and future activities required. A new mainframe is also scheduled to be installed in FY2010. However, the reliability of FHA's financial reporting systems are still at risk and the capacity management plan does not document 1) critical mainframe or application utilization benchmarks and required responses and 2) clear organizational and staff roles and responsibilities for ongoing capacity management planning.

Effective FHA modernization is critical to address systems risks

The rapid growth in FHA's business volume, market share and new housing program initiatives have highlighted the impact of FHA's minimal investment in new systems development over the last ten years. HUD recently commissioned a study that identified numerous deficiencies in the current operating environment and prioritized a long list of system modernization initiatives, including the replacement of a number of critical FHA business systems. Given their current state, FHA's financial systems will continue to require expensive maintenance and monitoring and are likely to pose increasing risk to the reliability of FHA's financial reporting until replacement efforts are completed. FHA and the HUD OCIO should commit to a prioritized plan of activities, affirm the enterprise architecture required to support the modernization effort, provide resources to the modernization efforts, and develop a more detailed modernization implementation plan.

Economic conditions and inherent model design increase risks to management estimates

FHA's process for estimating the Loan Guarantee Liability for single family programs uses assumptions developed through an annual independent actuarial study of the Mutual Mortgage Insurance fund. The econometric models developed for this study are driven by historical claim payment patterns and numerous economic and portfolio variables. The projections for future claim payments for endorsements made in the last two years, which represent over half of the total liability, are based on very limited direct claim performance. Notable changes in the composition of these loans relative to past history and drastic changes in the housing market may impact the model's ability to fully incorporate the impact of these changes. Due to significant declines in house prices, the liability estimates are also acutely sensitive to small changes in house price projections.

Currently, FHA does not have an effective process to assess and document the impact of other potential risk factors or leading indicators, such as delinquencies or unemployment data, that may impact program performance and either support the reliability of management estimates based on the model, or provide evidence to support an adjustment of the model estimates. Federal accounting standards allows an agency to integrate management assumptions when current models may not be reliable.

FHA should enhance the general ledger system user access management processes

FHA granted general ledger access rights to system developers and certain users to support the implementation of two new Multifamily business systems during FY2009. FHA's control to detect this access was not effective because the FHASL audit logging capability was not properly configured. Inactive user accounts were also not removed timely. FHA's system modernization efforts will require ongoing access to FHASL by programmers and non-standard users, increasing the risk of inappropriate or unauthorized information being introduced or deleted from the agency's primary financial system of record without adequate compensating controls. FHA is developing an enhanced audit log reporting and monitoring process.

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

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we believe none of the significant deficiencies described above is a material weakness.

Compliance with Laws and Regulations

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

The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's Mutual Mortgage Insurance Fund maintain a minimum level of capital sufficient to sustain a moderate recession. This capital requirement, called the Capital Ratio, is defined as capital resources (assets minus current liabilities) less the liability for future claim costs (net of future premiums and recoveries), divided by the value of insurance-in-force. The Act required FHA to maintain a minimum Capital Ratio of two percent and conduct an annual independent actuarial study to calculate this ratio. The Housing and Economic Recovery Act of 2008 requires that the Secretary submit a report annually to the Congress describing the results of such study, assess the financial status of the Fund, recommend adjustments and evaluate of the quality control procedures and accuracy of information used in the process of underwriting loans guaranteed by the Fund. As of the date of our audit, this report had not yet been submitted, but FHA data indicated that this ratio fell to 0.53% based on September 30, 2009 amortized loan balances.

Supplementary Information

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

Management Responsibilities

Management is responsible for the information in the Annual Management Report, including the preparation of: 1) the Principal Financial Statements in conformity with accounting principles generally accepted in the United States of America, 2) Management's Discussion and Analysis (including the performance measures), and 3) Required Supplementary Information. Management is also responsible for 1) establishing, maintaining and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers Financial Integrity Act of 1982 (FMFIA) are met, 2) ensuring that FHA's financial management systems substantially comply with the Federal Financial Management Improvement Act of 1996 (FFMIA), and 3) complying with applicable laws, regulations and government-wide policies.

Objectives, Scope and Methodology

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

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

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

material effect on the financial statements, and (3) any other laws, regulations, and government-wide policies identified by OMB audit guidance.

We did not test all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We are also responsible for testing compliance with selected provisions of laws, regulations and government-wide policies that have a direct and material effect on the financial statements. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended September 30, 2009. Compliance with FFMIA will be reported on by the HUD Office of Inspector General (OIG) in connection with their audit of the consolidated financial statements of HUD.

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

FHA Comments and Our Evaluation

FHA management concurred with three of our four findings and their related recommendations. FHA management did not concur that additional information is necessary to support the estimate of the Liability for Loan Guarantees. The HUD OCIO did not concur that the capacity management controls represented a significant deficiency to FHA's controls over financial reporting. The full text of FHA management's response is included in Appendix B. We did not perform audit procedures on FHA management's written response and accordingly, we express no opinion on it. Our assessment of FHA management's response is included in Appendix C. The current status of prior year findings and recommendations is included in Appendix D.

We also noted other less significant matters involving FHA's internal control and its operation, which we have reported to the management of FHA in a separate letter, dated November 9, 2009.

Distribution

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

Urbach Kahn & Werlin LLP

Arlington, Virginia
November 9, 2009

In our report dated November 9, 2009, we described the results of our audits of the consolidated balance sheets of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2009 and 2008, and the related consolidated statements of net cost, changes in net position, and the combined statements of budgetary resources (Principal Financial Statements) for the years then ended. The objective of our audits was to express an opinion on these financial statements. In connection with our audits, we also considered FHA's internal control over financial reporting and tested FHA's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements. The following sections present additional detail on the internal control matters discussed in that report.

Background

FHA's current financial system is comprised of numerous aging information systems developed independently over the last thirty years and integrated with the general ledger through electronic interfaces. Most of these systems are COBOL-based applications on either an IBM or Unisys mainframe. Substantially all of FHA's source transaction data is entered by and transmitted from lenders via electronic data interchange or web interfaces. Many of FHA's business systems are owned by the Office of Single Family Housing or the Office of Multifamily Housing and support both HUD and FHA program activities. Infrastructure and general support of FHA and HUD systems are provided by HUD's Office of the Chief Information Officer. When FHA's general ledger system, the FHA Subsidiary ledger (FHASL), was implemented in 2003, FHA planned to integrate new business applications as modules that would be on the same platform and language as FHASL. Due in part to FHA's declining single family mortgage loan market share and reduced IT systems development budgets, few systems were replaced through 2008 and only two multifamily systems were replaced in FY2009. As a result, the aging technologies are becoming more expensive to maintain and these systems are at higher risk of not being able to adequately support FHA's financial reporting needs.

The collapse of the commercial subprime mortgage loan market and the related credit crisis has resulted in a dramatic rise in FHA's market share and endorsement levels for its single family mortgage programs, straining FHA's information systems' storage and response capabilities. In response, HUD commissioned a study of the market environment's impact on FHA's loan application and endorsement systems and processes. This study, issued in February 2009, not only identified system capacity concerns but noted inadequate levels of processing staff to support the expanded endorsement and oversight processes. Most of this study's recommendations were aimed at improving business processes and reducing the human capital limitations.

In addition, new housing initiatives enacted by the Hope for Homeowners Act of 2008 and the Housing and Economic Reform Act of 2008 have required significant programming changes in FHA systems that cost in excess of $20 million during FY2009. These efforts further illustrated the inflexibility of the current system architecture. The following risks to the reliability of FHA's financial reporting identified during our audit are largely due to the recent growth and change in FHA programs and activities.

1. Financial system capacity limitations could impact business processing

As a result of increased loan application and endorsement volume, the Unisys mainframe began to approach its operating capacity in the fall of 2008. To address the degradation on processing performance and high workload on business critical Housing systems, HUD increased capacity on the Unisys host platform. In addition, HUD upgraded network circuits and expanded internet capacity critical to supporting FHA business activities.

HUD also planned to migrate several large applications from the Unisys mainframe platform to an Open Systems platform in 2009; however, the implementation did not occur as scheduled. Additional application and processing changes (e.g. improved batch process scheduling and search databases) were also implemented to optimize the use of the processing resources.

Throughout 2009, FHA and HUD closely monitored system utilization levels and increased data/processing capacity as needed. HUD also recently contracted for the delivery of a new, larger mainframe (scheduled for full implementation on November 30, 2009) to replace the existing IBM mainframe. FHA believes the system utilization levels are now within acceptable levels and management projects gradual declines in business volume for the next few years.

The Office of the Chief Information Officer developed an informal written short term capacity management plan at the end of FY 2009 that identifies the actions that have been taken and future activities required. However, because this growth in volume developed so quickly, the plan does not document 1) utilization benchmarks and required responses and 2) clear organizational and staff roles and responsibilities. Without a formalized plan, FHA and OCIO may not be able to sufficiently address further capacity issues timely or effectively, which may impact FHA's ability to process and record financial transactions timely and reliably.

Recommendation

We recommend the HUD Office of the Chief Information Officer in coordination with the Assistant Secretary for Housing, FHA Commissioner:

1a. Continue implementing the short term capacity management plan and further refine the plan to address 1) utilization benchmarks and required responses and 2) clear organizational and staff roles and responsibilities. (New)

2. Effective FHA modernization is necessary to address systems risks

In 2009, HUD commissioned a study to develop an IT Strategy and Improvement Plan that would identify strategic IT solutions to meet the agency's long-term programmatic objectives. This study served as a comprehensive IT systems risk assessment for FHA and thoroughly illustrates the numerous inefficiencies and limitations of the current system architecture. It examined operations at other federal agencies and several mortgage, banking, and mortgage insurance operations. The study recommended 33 technology and architecture approaches and 25 specific initiatives, including replacement of several of FHA's largest and most critical business systems. Critical objectives of the initiatives were to:

- Improve fraud detection
- Improve risk management and loss mitigation
- Improve program operations
- Limit mission constraints related to dated technology

Each initiative was reviewed, evaluated and prioritized based on established risk criteria. The efforts to address these system recommendations are expected to take several years and cost hundreds of millions of dollars. FHA has taken a first step by appointing a full time project management officer. In FY2010, FHA plans to perform a comprehensive risk assessment to ensure this plan is consistent with the current OCIO Strategic Plan. Given their current state, FHA's financial systems will continue to require expensive maintenance and monitoring and are likely to pose increasing risks to the reliability of FHA's financial reporting and business operations until the modernization efforts are completed. The proposed plan should include an effective implementation plan and leadership team to ensure that the current systems are replaced within a timeframe that does not put FHA's financial operations and reporting at further risk.

Recommendations

We recommend the HUD Office of Chief Information Officer, in coordination with the FHA Commissioner, Assistant Secretary for Housing:

2a. Conduct a risk assessment of the various system initiatives and required corrective actions in connection with the OCIO Strategic Plan and the IT Strategy and Improvement Plan. (Updated)

2b. Develop a prioritized plan of activities, including the development of the required enterprise architecture, into a detailed implementation plan to support the IT Strategy and Improvement Plan presented to Congress. (New)

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

Management's current year estimate of the Liability for Loan Guarantee (LLG) for the Mutual Mortgage Insurance (MMI) Fund (a) may be optimistic due to an inherent design assumption, (b) may not fully reflect the potential impact of recent events, and (c) is extremely sensitive to changes in house price forecasts. These factors increase the risk of error in the estimate, which could be mitigated by additional data analysis.

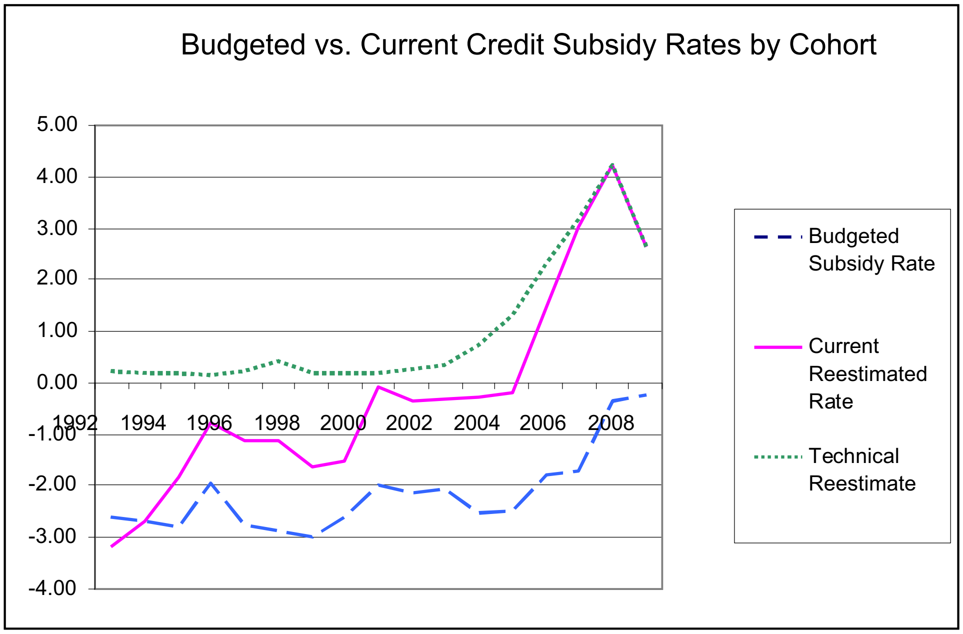
This LLG estimate is based on actuarially developed long term historical claim payment patterns over time and is not intended to precisely predict cash flows for any given policy year, as the estimate projects cash flows over a thirty-year period. Accordingly, management's estimate is uniquely dependent on the presumption that the performance of current loans will be consistent with historical experience, accounting for changes in established loan and economic variables. However, FHA has experienced deteriorating portfolio performance over the last eight years, resulting in persistent upward revisions to its liability estimates. The rapid growth in endorsements makes this year's estimate even more dependent on this historical relationship than in prior years, and increases the risk of continued optimistic cash flow projections.

Although the estimation methodology is designed to compensate for changes in identified loan characteristics and future house price appreciation, it only incorporates a limited amount of current year data. Recent changes in the composition, loss severity and delinquency performance of recent loans relative to past history, and the rapidly changing housing market environment raise questions about the model's ability to fully respond to these changes and provide a reliable estimate of future cash flows with the same precision as in more stable economic periods.

The model design also projects claims relative to the borrower's negative equity position and the current declining house price environment results in claim projections that are more sensitive to small changes in projected house price indices than in periods of more stable or increasing house prices.

Impact of model design: The Cranston-Gonzales National Affordable Housing Act of 1990 required that FHA's MMI Fund obtain an independent actuarial study to assess the financial soundness of the fund. FHA's process for estimating their LLG on single family programs uses assumptions developed by this independent actuarial study performed each year. The econometric models developed for this study have been tailored to address specific factors unique to FHA's business and are heavily driven by historical claim payment patterns, economic projections related to house price appreciation, and numerous loan level attributes, such as borrower credit score, age, loan-to-value ratio, loan type and seasonality. We examined analyses of portfolio data prepared by FHA throughout FY2009 to assess whether this information supported the cash flows projected for FY2010. We also examined other potential indicators, such as initial unemployment claims, which did support the projected level of FY2010 mortgage claims, partly because a large portion of FHA's defaults are attributable to loss of income, which is not the case in more stable economic environments. However, the results were not always consistent since the independent actuarial model is based on claims paid and is not intended to integrate short term market variations that might be evident through leading indicators (e.g. delinquency or unemployment data). This model design combined with a quickly changing economic environment impacts the agency's ability to reliably estimate future cash flows. The long term impact of this design is illustrated below.

FHA's premium rates are designed to be sufficient to meet the claim costs to be paid, net of recoveries, on a net present value basis. This net surplus, is referred to a negative subsidy, in that the taxpayers are not "subsidizing" the cost of loans endorsed by FHA. These subsidy rates are recalculated each year and published in a special Appendix to the President's Budget. The historical data in this Appendix indicates that the net surpluses, or negative credit subsidy, of FHA's MMI fund program endorsements have been lower than originally budgeted for 15 of the last 16 years and frequently rise notably for the first three years after the year the loans are endorsed. The FY2009 subsidy reestimate continues this trend. The following chart shows the original budget credit subsidy rate, the current credit subsidy rate and the increase attributable to macroeconomic or programmatic factors, rather than interest costs, through FY2008.



Source: Federal Credit Supplement, Budget of the United States

Our analysis found that this bias appears to take three years to correct. On average, the first reestimate (made in the year after endorsement) was an upward reestimate of 0.92 percentage points. In the next year, another upward reestimate of 0.24 percentage points is made (on average). In the third and subsequent years, an additional upward reestimate is made that, on average, is 1.25 percentage points – roughly equal to the first two year's reestimate combined.

The upward bias for the 2004 – 2008 cohorts can be largely attributed to the impact of seller-funded downpayment assistance loans, the effect of which was not fully integrated into projections for future claims until 2007 when the weaker performance was segregated and quantified during the FY2007 actuarial study. The current year and prior year upward reestimates were also impacted by the unexpected and deep recession. The cause for the smaller, but consistent, bias in prior cohorts is less clear but may be due to a general trend in the mortgage industry during the 1990s toward loosened credit standards through lower acceptable loan-to-value ratios and expanded reliance on electronic underwriting systems. Accordingly, the model's dependence on long-term historical experience results in optimistic projections given the consistently declining portfolio performance.

This reliance on historical performance may have a significant impact on the most current cohorts. Due to the dramatic growth in endorsements over the last two years, the projections for future claim payments for these recent loans are based on very limited direct claim history of loans endorsed during this time period. The MMI fund's FY2009 and FY2008 cohorts comprise almost 62% of the MMI fund's insurance-in-force and 53% of FHA's total insurance-in-force agency-wide. In contrast, the two most current cohorts of the MMI fund represented only 27% of the agency's portfolio at September 30, 2007. The aggregate projected cash flows for these two cohorts make up almost

70% of the total cash flows comprising the September 30, 2009 Liability for Loan Guarantees. In contrast, the amount of paid claims for these two cohorts through March 31, 2009 totaled only $231 million, or less than 0.1% of the $61 billion in total projected claims to be paid over the life of these cohorts.

Impact of recent events: Financial reporting timelines also restrict the amount of current year data which can be used in the calculations, but late changes in economic forecasts or portfolio performance could result in unexpected relationships between actual and projected results.

A major enhancement to the current year actuarial model was a dynamic loss severity model, which used several years of property disposition data to develop varying recovery rates by cohort and future policy year. The actuaries did not use any recovery data from FY2009 in their analysis. However, FHA recovery rates have dropped over 20% in FY2009, which is a steeper decline than can be supported solely by the weak housing market and changes in house price indices or down payment assistance trends. We noted no statistical variables that could isolate the cause of this decline. The omission of this recent data resulted in forecasted recovery rates for FY2010 and FY2011 that are significantly higher than FY2009 rates and exceed any forecasted rebound in home prices. We would expect to observe improvements in the recovery rates in later policy years but believe this recovery should be more gradual. One current market study suggested that the market values of distressed properties are more volatile than the general market because of the high concentration of properties within a geographic area. We believe further evaluation of the correlation of distressed market values and FHA's disposition data could result in improved support for the projected trends in recovery rates. Similar analysis by FHA was instrumental in identifying an error in the independent actuarial study model that resulted in a $1.6 billion downward correction to projected cash flows from future asset dispositions. The accompanying financial statements have been corrected for this error.

Current model sensitivity: In an environment of declining house prices, small changes in housing prices can have a profound impact on projected claims because the model projects borrowers' propensity to default based on the level of a borrower's negative home equity. Thus, the projected claim costs can increase dramatically with relative small declines in home prices. This can be illustrated by the 27% overestimate ($9.7 billion vs. $13.3 billion projected) of FY2009 claims caused by the prior year's overly pessimistic forecast for house price declines in the latter half of 2008.

The Housing and Economic Recovery Act of 2008 requires FHA to submit quarterly reports to Congress specifying endorsement volume, composition, variances from projections of claims, prepayments and recovery rates, and projected credit subsidy rates. We believe documenting management's conclusions regarding this reporting, along with additional analyses by management of certain current and leading indicators, would provide additional support for the reasonableness of the near term cash flows or identify whether manual modifications to management's estimate of the LLG are necessary to account for recent changes in internal, policy or economic factors not integrated into the model or its assumptions.

Recommendations

We recommend that the Assistant Secretary for Housing, FHA Commissioner, in coordination with the FHA Comptroller and the Office of Evaluation:

3a. Continue to analyze trend data on seriously delinquent aged loans and determine whether a statistical correlation exists to support this metric as a leading indicator for short-term claim payment trends. (New)

3b. Continue to track and report the reasons for default and as long as "loss of income" remains a major factor for default, determine whether another economic indicator, such as initial unemployment claims, may be useful to support near term estimates for claim payments. (New)

3c. Continue to analyze property disposition data in order to better support near-term projected recovery rates. (New)

3d. Expand management's financial cash flow model validation documentation to include expanded analyses of seriously delinquent aged loans data, case level historical recovery data, and other leading indicators as appropriate. (New)

3e. Conduct research into available information on inventories and sales of "distressed" properties and consider whether such an indicator can be used to assist in supporting near-term trends in historical and projected recovery rates. (New)

3f. Document the final overall management conclusion whether the analyses performed suggest whether adjustments to the projected cash flows are warranted, and if so, how those adjustments are determined and their resulting value. (New)

4. FHA should enhance the general ledger system user access management processes

As indicated in the FHA Office of Housing IT Strategy and Improvement Plan, "FHA IT systems are a significant constraint on FHA's ability to rapidly and effectively adjust to this new environment. Over the last decade, little investment has been made in modernizing FHA's technology." An initial step of system modernization was implemented in FY2009, with the integration of the Multifamily Endorsement/Premium and Claims processes into FHASL. During this implementation, additional developers and end-users were provided access to FHASL environments to perform various development activities, testing and training functions. We noted that developers had access to the production environment in a greater than read-only capacity and end-users had access to the development environment. Additionally, we noted that four employees had excessive rights within the Multifamily Premiums module of FHASL (i.e., endorsement entry, premium reviewer, termination clerk, and mortgage servicer role) and compensating controls preventing the same user from performing incompatible functions on the same transaction were not effective. While granting these access levels may appear to improve the efficiency of system implementation, it increases the risk of transactions being inappropriately authorized and processed.

The monitoring of user business process functions within an application, audit logging, is essential in ensuring that only personnel with proper access rights are performing job functions. During FY2009, we noted that limited audit logging is performed over business functions; and the data elements that are being logged do not appear to be consequential to the process. Additionally, the audit logs produced are not reviewed to ensure appropriate actions have been taken as required by HUD policy. A plan has been developed by the system owner that incorporates identifying the data elements to be audited, selecting the capture mechanism, defining reports and filters and establishing the review process; however, this has not been implemented completely. The recording of auditable events and the periodic review of audit logs is essential to mitigate the risk of unauthorized access attempts or inappropriate personnel actions.

A final component of user access management is the process of removing access no longer required by users. One method for completing this process is the disabling or removal of accounts after a specified period of inactivity. HUD policy mandates that inactive users be deleted after 90 days of inactivity. We noted that approximately 30 user accounts with active access to FHASL had not logged into the application in more than 90 days. FHASL is configured to have passwords automatically expire after 90 days of inactivity; however, these accounts are not permanently locked and can be reset by the user contacting the Help Desk. Accounts are manually deleted if they have been inactive for more than twelve months since the beginning of the previous year. In this situation, users do not have the ability to contact the Help Desk to reactivate their accounts. We noted that this process is manual because FHASL does not have an automated mechanism for disabling or removing accounts. By not disabling unused accounts timely, there is an increased risk that accounts may be used to gain unauthorized access to FHASL.

Recommendations

We recommend the Director, Office of Financial Analysis and Reporting, Office of the Comptroller:

4a. Coordinate with Multifamily Insurance Operations Branch to enforce least privilege by restricting access only to modules that are needed for the performance of specified tasks. (New)

4b. Identify system roles that are incompatible and develop automated edit checks in FHASL to prevent the same person from performing conflicting functions on the same transaction. (New)

4c. Terminate the parallel deployment of the Revenue Management and MFIS/F47 modules and restrict access to the development environment of FHASL to only those individuals with development responsibilities. (New)

4d. Limit developers' access to the production environment to read-only, and ensure any support or training is completed in a test environment. (New)

4e. Ensure proper implementation of the PeopleSoft application audit logging by identifying the data elements and the actions to capture, selecting the capture mechanism and defining the filters and reports to be generated to ensure accurate and relevant information is produced. (New)

4f. Establish and implement a formal review process of the audit logs by updating policies and procedures to incorporate the generation of the audit logs, the periodic review of the logs, and the actions to be taken based on the results in accordance with HUD's Security Policy and NIST standards. (New)

4g. Implement automated mechanisms or mitigating manual account reviews to ensure disabling of accounts that have been inactive for 90 days consistent with HUD's Security Policy. (New)

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Appendix B
Management's Response

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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

OCT 27 2009

MEMORANDUM FOR: Urbach Kahn & Werlin LLP

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

SUBJECT: Response to UKW's Fiscal Year 2009 FHA Audit Report

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

General Comments

FHA is pleased that UKW has noted progress in many areas. With regards to findings 1, 2 and 4, FHA has already or will shortly, begin addressing these recommendations. FHA does not agree with the third finding regarding the estimate of the Liability for Loan Guarantees. FHA believes its current practices for estimating and reviewing the Liability for Loan Guarantees provides the best possible mechanism for estimation.

Report on Internal Controls – Significant Deficiencies

1. Financial system capacity limitations could impact business processing

We will continue to coordinate with the Office of the Chief Information Officer (OCIO) to implement a short term capacity management plan and to address 1) established utilization benchmarks and required responses and 2) clearly identified organizational and staff roles and responsibilities.

2. Effective FHA modernization is necessary to address systems risks

We concur that effective FHA modernization is necessary to address systems risks and with your recommendations. We will continue to implement our IT Strategy and Improvement Plan using resources that the Congress and OMB make available. We have constituted a team to develop all of the analyses and documents required to support this major IT investment, including a risk assessment and a prioritized plan of activities. Working with the OCIO, we will coordinate system initiatives, corrective action plans, OCIO's Strategic Plan, HUD and federal enterprise architectures, and FHA's IT Strategy and Improvement Plan.

www.hud.gov espanol.hud.gov

3. Management should support the estimate of the Liability for Loan Guarantees with additional analysis

UKW presents a concern that the Liability for Loan Guarantee (LLG) item in the FHA financial statements for single-family mortgage insurance:

> "(a) may be optimistic due to an inherent (actuarial study) design assumption, (b) may not fully reflect the potential impact of recent events, and (c) is extremely sensitive to changes in house price forecasts."

UKW believes that these asserted risk factors "could be mitigated by additional data analysis" provided by FHA and used to adjust the LLG from what is otherwise produced using inputs from the annual, independent actuarial study. UKW concludes with six recommendations, all of which point to a request that FHA consider adding a management adjustment to the LLG calculation that ostensibly captures analysis on the most recently available information on delinquencies and property dispositions, at the time that the annual financial statements are prepared.

FHA disagrees with the premise of the UKW recommendation, that the actuarial studies used as a basis for the LLG calculations are missing vital information that creates a significant deficiency for FHA. FHA also disagrees with the notion that it would be prudent to adjust long-term estimates with short-term dynamics.

Actuarial Study Model Design

UKW's criticisms of the modeling approach used by the independent actuarial contractor reflect a lack of understanding of basic economic modeling techniques. This misunderstanding occurs in two primary areas: the use of historical data in forecasting future events, and behavioral modeling as opposed to time-series analysis.

The use of historical data in forecasting future events. Past experience is used to estimate how borrowers with different financial, property, and loan characteristics respond to changes in economic conditions. Such behavioral responses must then be applied to current and future loans and borrowers, and to forecasts of future economic conditions (especially, interest rates and house prices). Resulting predictions of insurance claims and loss can be vastly different from and inconsistent with historical experience.

Behavioral parameters that come out of the econometric models developed by the independent actuarial contractor have proved quite accurate, even for short-run forecasting. In the process of developing the FY 2009 econometric model, the contractor undertook extensive testing and comparison of actual experience and previously predicted claim and prepayment experience in FY 2009. The contractor examined detailed quarterly performance of loans for all insurance cohorts and activity periods since FY 2004, and found that the models did not systematically under- or over-estimate claim probabilities. Differences between actual claim and prepayment rates and those estimated using the FY 2008 econometric model could be explained by two factors: (1) differences between the Global Insight house price appreciation and interest rate forecasts and the actual performance of the U.S. economy in early FY 2009; and (2) the limited loan data available for determining the composition of the FY 2009 insured portfolio (two quarters) at the time data tabulations were provided to the contractor. In the first case, Global Insight predicted a much greater decline in home prices than actually occurred, and a smaller drop in interest rates than occurred. Additional comparisons were developed for all cohorts and time periods back to FY 2004, to confirm that deviations of predictions from actuals for all cohorts in early FY 2009 were affected by deviation of actual economic outcomes from what had been predicted by Global Insight in the summer of 2008.

The use of behavioral modeling techniques versus time series modeling. UKW states several times in its report that the use of so-called "leading indicators," such as serious delinquencies and reasons for default, would improve the accuracy of the LLG estimates over what is provided by the actuarial model. The belief is that changing economic conditions require real-time information for accurate forecasts. UKW is concerned that the actuarial contractor has a data cut-off date of March 31, and thus must use predictions for the second half of the fiscal year in question.

The use of such leading indicators is typical in time-series econometric models that are designed for making very short-run forecasts. These models do not explain behavior, based on the underlying factors, but simply capture stylized pool-level trend patterns. Indeed, a time-series model would itself be subject to errors, and especially because it would fail to capture the nuanced differences among borrowers, loan types, and financial incentives that behavioral models capture.

The modeling approach used for the actuarial study does not need "leading indicators" because they are included as the exact factors that lead to insurance claims. In developing the econometric models, the contractor spent a great deal of time and effort assessing the impact of including the exact variables suggested by UKW. In each instance, they did not improve the accuracy of the final model. Using judgment rather than statistical evidence, would bias the forecasts.

Econometric Models and Budget Forecasts. UKW shows data on FHA's budget re-estimates to make its point that the econometric models used to estimate the LLG are inherently biased toward over-valuing the FHA portfolio. The initial budget estimates provided by FHA to OMB for inclusion in the President's Budget are made nearly two years before a cohort of loans has actually taken shape. With such lead time, they will naturally miss changes in portfolio composition and economic conditions. As UKW points out, the budget re-estimation process is designed to bring the original estimates in-line both with the characteristics and size of the actual insurance cohort, and with the dynamics of actual economic conditions through the life of the cohort. HUD is aware of historical, systematic over-valuations of expected budget receipts in the initial estimates made for the President's Budget. Those over-valuations can be explained by a number of factors. These factors are subjects for study in the actuarial analysis each year, and changes are made to the actuarial models when possible and appropriate.

First is the design of econometric models used prior to 2004 to predict loan performance (claims and prepayments). Previous actuarial contractors used a single house-price path without adequate consideration of the dispersion of actual, individual house price paths around the average. Without a full measure of such dispersion, claim-rate predictions are too low and prepayment predictions too high. That problem was corrected when the current contractor was engaged for the FY 2004 actuarial study.

Next was the continued growth of seller-funded downpayments for FHA-insured homebuyers. They started in 1999 and grew to over 35 percent of all FHA-insured home-purchase loans by FY 2007. The differential claim experience of such loans could not be included in statistical models until there was sufficient data to prove that such a differential existed and was not simply the result of other factors. A behavioral factor for downpayment source was added in the FY 2005 actuarial study, and it proved extremely valuable in identifying the heightened risk of seller-funded-downpayment loans. Even then, FHA did not predict the continued growth of that sub-portfolio as a share of overall insurance endorsements. Thus, LLG and budget calculations involved lags for a number of years. The share of downpayment assisted loans among FHA endorsements finally peaked in FY 2007, declined somewhat in FY 2008, and then was reduced to zero by the second quarter of FY 2009. UKW itself identifies the seller-funded-downpayment assisted loans as a primary source of any over-estimate of value in the 2004-2007 period. The continuous growth of that business into FY2007 is something that is only known with hindsight.

The final factor identified by FHA as having caused a positive bias in budget estimates for a number of years was the changing geographic concentration of FHA insurance during the recent housing boom. That boom was fueled by easy conventional mortgage credit, which relegated FHA to an ever-smaller share of a growing mortgage market. FHA was virtually shut out of major markets like California, missing both the extreme run-up of prices in those markets, and the resulting, precipitous decline in prices in the same localities. This phenomenon affected FHA budget and LLG estimates because the house price forecasts being used were national forecasts. Home values in FHA's portfolio did not grow as fast as did national price indices during the boom, and they did not fall as hard when national price indices came back down. The result was an over-valuation of the FHA portfolio through FY 2007, but then an undervaluation in FY 2008. For FY 2009, FHA and the actuarial consultant began the process of migrating to use of local, metropolitan area home price forecasts, which are now available for purchase from private vendors. That process will be completed in the FY 2010 cycle. For now, what prevents any material undervaluation is that, each year, the entire outstanding portfolio is marked-to-market at the beginning of the forecast period. That process uses a combination of metropolitan area and non-metropolitan area home price indices from the Federal Housing Finance Agency. Also, the FY 2009 cohort is a dominant force in the FHA portfolio because of its sheer size. That cohort represents the national housing market, as FHA is now playing a significant role in all markets.

It is not possible to anticipate or pre-emptively correct for all changes that occur either within the portfolio, or in the broader economy. FHA works diligently with the actuarial contractor to identify and understand deviations between projected performance and actual performance each year. This is a dynamic process that leads to continuous improvements in modeling techniques. When factors causing these deviations are identified and measured, they are factored into the actuarial model and resulting LLG calculations.

Accounting for the Impact of Recent Events

UKW suggests that there is information in near-term movements in seriously delinquent rates and property recoveries that may require adjustments to the LLG calculations. Again, this presumes that there is something in short-term fluctuations that should override the behavioral basis of the econometric-model forecasts. There might be some basis for this approach, were the LLG calculation akin to private sector loss reserve accounting. The LLG calculation, however, is not a short-run liability. It represents the net present value of expected net losses over a 30-year time period. Thus, it would be imprudent to adjust it for short-run phenomena that may or may not provide any actual, independent information from what is produced by the actuarial models. Because the LLG accounts for 30-years of forecasted claims and prepayments, it can provide for measured loss reserves that are far greater than what would be required under private sector standards. The fact that it is forward looking over a 30-year period means that any deviations of actual performance from predicted in the first year of the forecast period are not meaningful in determining whether FHA has enough dedicated reserves to pay for claims before the next annual LLG calculation. The LLG calculation will nearly always over-reserve for any near-term events.

As the national housing market continued to show signs of distress this past year, FHA commissioned its actuarial contractor to build an econometric model of the expected losses from insurance claims. That model captures borrower, property, and loan characteristics, and thus provides forecasts that are consistent with the claim and prepayment projections. Results portend historically high loss severities in the near term, with movement back to more normal rates in the future. Using instead some indicators from recent property disposition recoveries and losses would be a mistake of the same order as would using short-term delinquency statistics for predicting claim rates.

Sensitivity to House Price Forecasts

UKW is also concerned that the econometric models at the heart of the actuarial study and LLG calculations is sensitive to economic forecasts. FHA insures a portfolio of loans with much less equity than does the conventional mortgage market. FHA has also, historically, served a lower-income clientele than does the prime, conventional mortgage market. The issue with the over prediction of claims in FY 2009 from the FY 2008 actuarial study was primarily due to the severe decline in home prices that had been predicted by Global Insight in the summer of 2008. A national house price decline of any magnitude is indeed an event not seen since the Great Depression. It in itself is a stressful situation for a national mortgage insurance portfolio and so the FHA portfolio should have been sensitive to a national house price decline of over 8 percent. UKW would be concerned if the econometric model predictions were not sensitive to economic forecasts.

This year, IHS Global Insight is again forecasting a one year house price decline of over 8 percent, essentially moving last year's forecast ahead by one year. If the national average home price declines by 8 percent, there will be many communities with declines on the order of 10 to 20 percent. Those are significant events that will, if they transpire, result in high levels of insurance claims.

Operational Problems with the UKW Recommendations

FHA and its actuarial-study and financial-analysis contractors work under very tight timeframes to provide inputs for the LLG calculations. The annual financial statements have hard deadlines, and the auditors require significant amounts of data, analysis, documentation, and discussion in the process. Adding any process of management review of additional data sources would be difficult from a process standpoint given the tight timeframes.

Conclusion

While FHA management will continue to track and analyze trend data on delinquencies, foreclosures, REO dispositions and recoveries, and general economic conditions, it does not agree additional management judgment based on short-term analyses should be in the calculation of the LLG for the annual financial statements. FHA continues to prefer working with the actuarial study contractor to identify research and study issues that could improve the econometric modeling and forecasting each year.

4. FHASL user access management processes need to be enhanced

We concur that user access management processes need to be enhanced and with your recommendations. The Office of the Financial Analysis and Reporting, working with the Office of Systems and Technology in the Office of FHA Comptroller, will develop and execute plans to correct the conditions noted in your recommendations.

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

OFFICE OF THE CHIEF INFORMATION OFFICER

NOV 0 2 2009

MEMORANDUM FOR: Urbach Kahn & Werlin LLP

FROM: For [signature] Jerry Williams, Chief Information Officer, Q

SUBJECT: Response to Draft Independent Auditors' Report on FHA Financial Statement Internal Controls

Thank you for giving us the opportunity to respond to the Draft Independent Auditor's Report on FHA Financial Statement Internal Controls. The Office of the Chief Information Officer has reviewed the report and provides the comments below on the recommendation addressed to us.

Report on Internal Controls – Significant Deficiencies

1. ***Financial system capacity limitations could impact business processing***

The Office of the Chief Information Officer (OCIO) does not concur with characterization of this recommendation as a "significant deficiency." The need for proactive system capacity management is acknowledged; however OCIO has capacity benchmarks in place and conducts ongoing reviews. Infrastructure contractors, as part of contract deliverables, provide reports on systems capacity metrics. Trends are routinely presented to senior OCIO management and with direction provided to address particular concerns. OCIO has designated a specific IT modernization team which is already coordinating closely with FHA on its transformation effort. This team, in conjunction with Housing's office of Systems and Technology is addressing issues, setting priorities, and making decisions to move forward. The process integration with FHA's overall effort, throughout all levels of OCIO, is established and functioning.

We look forward to working with you and your staff to resolve and close-out this recommendation. Should you have any questions or need additional information please contact Steve Hill at 202-402-8346.

Attachment

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Appendix C
UKW's Assessment of Management's Response

UKW has obtained and reviewed FHA management's response to the findings and recommendations made in connection with our audit of FHA's 2009 Principal Financial Statements, which is included as Appendix B. We did not perform audit procedures on FHA or HUD's written response to the findings and recommendations and accordingly, we express no opinion on them. Our assessment of management's responses is discussed below.

Assessment of management's response to significant deficiency Nos. 1, 2 and 4:

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

The HUD OCIO did not concur with our assessment of the finding related to capacity management as a significant deficiency. Our audit assessment of control findings is not limited to the status as of the end of the fiscal year. We believe the FHA systems presented a significant risk to the reliability of FHA's financial reporting throughout FY2009 due to the dramatic growth in business volume in endorsements. Extraordinary efforts by FHA systems staff were required to ensure the continuity of operations, including the acquisition of a new mainframe computer. We believe that until the new mainframe computer is fully operational, the system environment, inclusive of the deficiencies in the capacity management plan, presents a significant risk to the continuing operation of critical FHA business systems.

Assessment of management's response to significant deficiency No. 3:

We appreciate management's thorough discussion of FHA's risks in the current market and how those risks were considered in the Liability for Loan Guarantees (LLG). However, management's response indicates that they may have misinterpreted the intent of our finding and recommendations. Management appears to be concerned that we recommend the models be changed to incorporate short term indicators. The purpose of our recommendations was to encourage management to better document its consideration of the extraordinary economic environment affecting the housing market and how those risks affect the reliability of the resulting calculated liability. This is consistent with the guidance in Federal Financial Accounting and Auditing Technical Release 6, which states that "In certain limited instances, informed opinion may be used to support cash flow projections in the absence of historical data."

The following paragraphs contain our assessment of the specific disagreements in management's response.

Actuarial Study Model Design – The use of historical data in forecasting future events
We agree that the independent actuarial study methodology has been enhanced over the last seven years. Inclusion of credit scores and additional loan attribute variables, especially seller-funded downpayment assistance, has improved the predictiveness of claim and prepayment rates. However, we are concerned that the actuarial study's reliance on historical data to forecast borrower behavior may not sufficiently reflect the uncertainties in the current economic conditions. We continue to believe it is prudent for

FHA management to thoroughly document its considerations that validate and supplement the results of the actuarial study and other calculated assumptions in light of the economic environment. Management's response itself is the kind of analytical documentation being recommended. For example, the response states that the independent actuarial contractor "undertook extensive testing and comparison of actual experience and previously predicted claim and prepayment experience in FY 2009….and found that the models did not systematically under- or over-estimate claim probabilities." Formalizing the documentation of the results of that testing and management's consideration of the results would provide additional validation of the results of the model's estimation.

Actuarial Study Model Design – The use of behavioral modeling techniques versus time series modeling

Management's response states that leading indicators are typically used in time-series models for making short-run forecasts and that the actuarial study model incorporates such factors. It further states that "In developing the econometric models, the contractor spent a great deal of time and effort assessing the impact of including the exact variables suggested by UKW. In each instance, they did not improve the accuracy of the final model." Once again, documenting the results and conclusions of such analysis would better support management's reliance of the model's assumptions and output. We emphasize and concur with FHA's comment that the FY2009 cohort should correlate better with national house price forecasts due to its large size and relative market share, but claim and recovery cash flows from this cohort will not be significant in the near term.

Actuarial Study Model Design – Econometric models and budget forecasts

Management's response explains that the historical, systematic over-valuations of expected budget receipts in the initial Presidential Budget estimates were caused by 1) the pre-2004 econometric model's use of a single house price path, 2) the growth of seller-funded downpayment loans without a specific behavioral factor in the model, and 3) the changing geographic concentration of FHA insurance during the housing boom. The response concludes that "It is not possible to anticipate or preemptively correct for all changes that occur either within the portfolio, or in the broader economy…When factors causing these deviations are identified and measured, they are factored into the actuarial model and resulting LLG calculations." This approach to improving the econometric model is appropriate. However, as noted by management, it results in a model that lags portfolio and economic changes. In the current, fast-changing environment, our recommendations would provide a way for management to document their consideration of such changes in a more prospective manner.

Accounting for the Impact of Recent Events

Management's response asserts that the LLG calculation of the net present value of expected net losses over a 30-year period is superior to a calculation using the near-term movements in seriously-delinquent rates and property recoveries. As we explained above, our concern is that the actuarial study's reliance on historical data to forecast borrower behavior may not sufficiently reflect the uncertainties in the current economic conditions. Changes in the timing of claims, as may be indicated by seriously-delinquent rates, and the amount of property recoveries do affect net present value calculations even for a 30-year calculation period.

Operational Problems with UKW Recommendations

We recognize that our recommendations may require some additional analyses that would require more work. However, as we point out in several examples above, management is already performing such analyses and would need only to better document their consideration. Furthermore, as the economy and the housing market stabilize, the necessity for additional analytics should recede.

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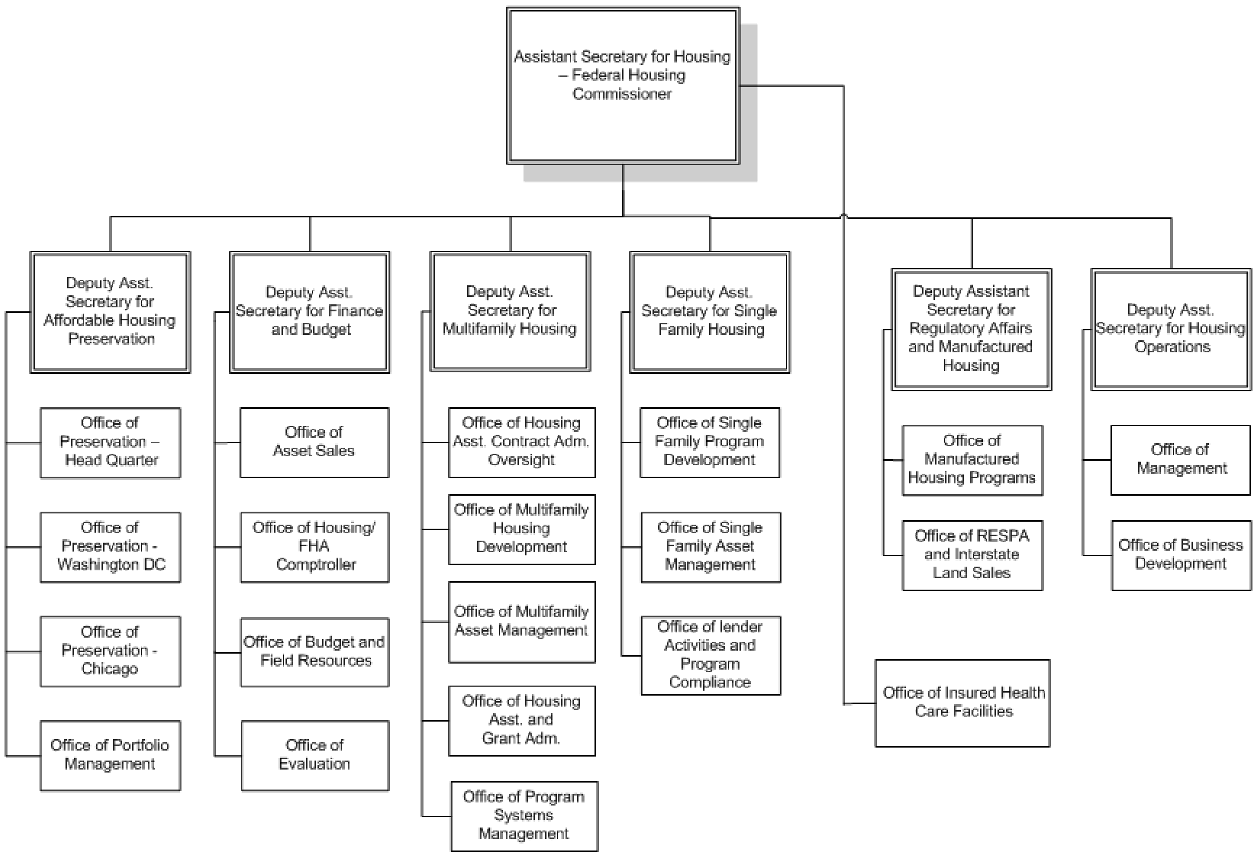
Appendix D
Status of Prior Year Findings and Recommendations

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

FY 2008 Finding/Recommendation	*Type*	*Fiscal Year 2009 Status*
1a. The FHA Commissioner, Assistant Secretary for Housing, coordinate with the HUD Secretary and the HUD CIO to conduct a risk assessment of the various systems initiatives and required corrective actions in connection with the OCIO Strategic Plan and document how HUD's/FHA's IT resources will be appropriately allocated in fiscal year 2009 to address the Department's and FHA's highest system priorities.	Significant Deficiency 2008	Partially Resolved. FHA plans to perform risk assessment of modernization in FY2010. See significant deficiency 1.
1b. The FHA Comptroller document the revised Multifamily business processes, identify and assess key internal controls and perform tests of those controls commensurate with the inherent risk for a new system in conjunction with the agency's OMB Circular No. A-123 Management Control Program and ensure the system's compliance with OMB Circular No. A-130, Management of *Federal Information Resources*.	Significant Deficiency 2008	Resolved.
1c. The FHA Comptroller develop an automated process for HECM claims and establish an automated interface with FHASL and ensure such interfaces are included in the overall system functional requirements document.	Significant Deficiency 2008	Partially Resolved. See Management Letter
1d. The FHA Comptroller should ensure the identified deficiencies in the controls over the HECM notes servicing system are corrected before proceeding with the Type II review.	Significant Deficiency 2008	Resolved.
1e. The FHA Comptroller should ensure the control testing of the HECM notes system to be performed under AICPA SAS No. 70, Type II is expanded to test for compliance with systems requirements unique to the federal government.	Significant Deficiency 2008	Resolved.
1f. The FHA Comptroller should ensure that any HECM system replacement is initiated in accordance with HUD system development life cycle guidelines and established program timelines.	Significant Deficiency 2008	Partially Resolved. Contract awarded to outsource all HECM data processing. See Management Letter.
1g. The FHA Comptroller should work with OCIO to correct the Generic Debt system interfaces to ensure FHASL properly balances the financing accounts at the cohort level. (New)	Significant Deficiency 2008	Not yet resolved. See Management Letter.

FY 2007 Finding/Recommendation	Type	Fiscal Year 2009 Status
1b. Coordinate with HUD's Acting Chief Information Officer and the Acting Deputy Assistant Secretary for Single Family Housing to establish a comprehensive system functional requirements document in accordance with HUD guidance for the new HECM system based on anticipated future volumes of transactions.	Material Weakness 2007	Resolved.
1d. Complete a full assessment of the effectiveness of the existing controls (including an Independent Type II review of the service provider under AICPA Statement on Auditing Standards No. 70, Service Organizations) over the notes database given the sensitivity of the data and the anticipated growth in reported assigned note balances and transactions.	Material Weakness 2007	Resolved.
1e. Develop and implement automated system interfaces between the current HECM claims and notes systems and FHASL, if the new system(s) cannot be implemented timely.	Material Weakness 2007	Partially resolved. HECM claims interface not developed due to outsourcing of processing. See Management Letter.

FHA Organizational Chart



The web address for this report can be found at:
http://www.hud.gov/offices/hsg/fhafy09annualmanagementreport.pdf

U.S. Department of Housing and Urban Development

November 2009
HUD - 2015 - FHA