Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Housing and Urban Development, pursuant to the requirements of the Chief Financial Officers Act of 1990 (31 U.S.C. 3515 (b)). While the financial statements have been prepared from HUD's books and records in accordance with formats prescribed by the Office of Management and Budget, 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 principal financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity. One implication is that liabilities reported in the financial statements cannot be liquidated without legislation that provides resources to do so.

The financial statements included in this annual report are as follows:

- Consolidated Statement of Financial Position;
- Consolidating Statement of Net Cost;
- Consolidating Statement of Changes in Net Position;
- Consolidated Statement of Budgetary Resources; and
- Consolidated Statement of Financing.

These financial statements include all of HUD's activities, including those of the Federal Housing Administration and the Government National Mortgage Association. All of HUD's budget authority is covered by these financial statements.

Department of Housing and Urban Development
Consolidated Statement of Financial Position
As of September 30, 1998
Dollars in Millions

ASSETS	
Entity Assets	
Intragovernmental	
Fund Balance with Treasury (Note 2)	$ 77,267
Investments (Note 4)	19,724
Interest Receivable (net)	174
Other Assets (Note 6)	417
Total Intragovernmental Assets	$ 97,582
Accounts Receivable (Note 5)	348
Credit Program Receivables (Note 7)	11,707
Other Assets (Note 6)	1,103
Total Entity Assets	$110,740
Non-Entity Assets	
Intragovernmental	
Fund Balance with Treasury (Note 2)	246
Other Assets (Note 6)	6
Total Intragovernmental Assets	$ 252
Accounts Receivable (Note 5)	407
Other Assets (Note 6)	64
Total Non-Entity Assets	$ 723
TOTAL ASSETS	$111,463
LIABILITIES	
Liabilities Covered by Budgetary Resources	
Intragovernmental Liabilities	
Accounts Payable	$ 189
Interest Payable	361
Debt (Note 8)	6,609
Other Intragovernmental Liabilities (Note 9)	5,025
Total Intragovernmental Liabilities	$ 12,184
Accounts Payable	913
Interest Payable	36
Liabilities for Loan Guarantees (Note 7)	9,416
Unearned Premiums	891
Debentures Issued to Claimants (Note 8)	166
Insurance Liabilities	205
Loss Reserves (Note 10)	511
Other Governmental Liabilities (Note 9)	617
Total Liabilities Covered by Budgetary Resources	$ 24,939
Liabilities Not Covered by Budgetary Resources	
Intragovernmental	
Debt (Note 8)	$ 6,784
Other Intragovernmental Liabilities (Note 9)	57
Total Intragovernmental Liabilities	$ 6,841
Debt (Note 8)	3,305
Other Governmental Liabilities (Note 9)	72
Total Liabilities Not Covered by Budgetary Resources	$ 10,218
TOTAL LIABILITIES	$ 35,157
NET POSITION	
Unexpended Appropriations (Note 11)	$ 70,377
Cumulative Results of Operations	5,929
TOTAL NET POSITION	$ 76,306
TOTAL LIABILITIES AND NET POSITION	$111,463

The accompanying notes are an integral part of these statements

Department of Housing and Urban Development
Consolidating Statement of Net Cost
For the Year Ended September 1998
Dollars in Millions

	Federal Housing Administration	Government National Mortgage Association	Public and Indian Housing	Housing (excluding FHA)	Community Planning and Development	Other	Consolidated
COSTS:							
Unsubsidized Mortgage Insurance Programs							
Intragovernmental	$ 387						$ 387
With the Public	1,973						1,973
Total Expenses	$2,360						$ 2,360
Less: Earned Revenues	(2,777)						(2,777)
Net Program Costs	$ (417)						$ (417)
Subsidized Mortgage Insurance Programs							
Intragovernmental	$ 83						$ 83
With the Public	763						763
Total Expenses	$ 846						$ 846
Less: Earned Revenues	(548)						(548)
Net Program Costs	$ 298						$ 298
Government National Mortgage Association							
Total Expenses With the Public		$ 93					$ 93
Less: Earned Revenues		(767)					(767)
Net Program Costs		$(674)					$ (674)
Section 8:							
Expenses With the Public/Net Program Costs			$ 8,010	$7,426	$ 36		$15,472
Low Rent Public Housing Loans and Grants							
Intragovernmental			$ 214				$ 214
With the Public			3,968				3,968
Total Expenses/Net Program Costs			$ 4,182				$ 4,182
Operating Subsidies:							
Expenses With the Public/Net Program Costs			$ 3,128				$ 3,128
Housing for the Elderly and Disabled							
Intragovernmental				$ 503			$ 503
With the Public				847			847
Total Expenses				$1,350			$ 1,350
Less: Earned Revenues				(691)			(691)
Net Program Costs				$ 659			$ 659
Community Development Block Grants:							
Expenses With the Public/Net Program Costs					$4,675		$ 4,675
HOME:							
Expenses With the Public/Net Program Costs					$1,292		$ 1,292
Other:							
Intragovernmental			$ 2	$ 44	$ 75	$ 2	$ 123
With the Public			545	900	968	115	2,528
Total Expenses			$ 547	$ 944	$1,043	$117	$ 2,651
Less: Earned Revenues			0	(115)	(19)	43	(91)
Net Program Costs			$ 547	$ 829	$1,024	$160	$ 2,560
Costs Not Assigned to Programs			$ 118	$ 94	$ 57	$ 29	$ 298
NET COST OF OPERATIONS	$ (119)	$(674)	$15,985	$9,008	$7,084	$189	$31,473

The accompanying notes are an integral part of these statements

Department of Housing and Urban Development
Consolidating Statement of Changes in Net Position
For the Year Ended September 1998
Dollars in Millions

	Federal Housing Administration	Government National Mortgage Association	Public and Indian Housing	Housing (excluding FHA)	Community Planning and Development	Other	Consolidated
Net Cost of Operations	$ (119)	$ (674)	$ 15,985	$ 9,008	$ 7,084	$ 189	$ 31,473
Financing Sources (other than exchange revenue)							
Appropriations Used	(1,838)		(15,953)	(9,173)	(7,033)	23	(33,974)
Imputed Financing	(5)					(11)	(16)
Transfers (In)/Out	2,668					(224)	2,444
Net Results of Operations	$ 706	$ (674)	$ 32	$ (165)	$ 51	$ (23)	$ (73)
Prior Period Adjustment (Note 2)	(9,746)						(9,746)
Net Change In Cumulative Results of Operations	$ (9,040)	$ (674)	$ 32	$ (165)	$ 51	$ (23)	$ (9,819)
Change in Unexpended Appropriations	(1,143)		994	820	(571)	3,247	3,347
Change in Net Position	$(10,183)	$ (674)	$ 1,026	$ 655	$ (520)	$ 3,224	$ (6,472)
Net Position – Beginning of Period	4,190	(5,135)	(24,391)	(21,702)	(18,202)	(4,594)	(69,834)
Net Position – End of Period	$ (5,993)	$(5,809)	$(23,365)	$(21,047)	$(18,722)	$(1,370)	$(76,306)

The accompanying notes are an integral part of these statements

Department of Housing and Urban Development
Consolidated Statement of Budgetary Resources
For the Year Ended September 1998
Dollars in Millions

BUDGETARY RESOURCES	
Budget Authority	$ 32,607
Unobligated Balance – Beginning of Year	44,853
Net Transfers Prior Year Balance, Actual	(2,300)
Spending Authority from Offsetting Collections	14,185
Adjustments	(1,627)
TOTAL BUDGETARY RESOURCES	$ 87,718
STATUS OF BUDGETARY RESOURCES	
Obligations Incurred	$ 43,454
Unobligated Balances Available	16,779
Unobligated Balances Not Available	27,485
TOTAL STATUS OF BUDGETARY RESOURCES	$ 87,718
OUTLAYS	
Obligations Incurred	$ 43,454
Less: Spending Authority From Offsetting Collections and Adjustments	18,217
Obligated Balance, Net – Beginning of Period	122,576
Obligated Balance Transferred, Net	(1,458)
Less: Obligated Balance, Net – End of Period	112,184
TOTAL OUTLAYS	$ 34,171

The accompanying notes are an integral part of these statements

Department of Housing and Urban Development
Consolidated Statement of Financing
For the Year Ended September 1998
Dollars in Millions

OBLIGATIONS AND NONBUDGETARY RESOURCES	
Obligations Incurred	$43,454
Spending Authority from Offsetting Collections and Adjustments	(18,140)
Financing Imputed for Cost Subsidies	16
Transfers In (Out)	(2,431)
Exchange Revenue Not in the Budget	(1,969)
Other	(1,520)
TOTAL OBLIGATIONS AS ADJUSTED, AND NONBUDGETARY RESOURCES	$19,410
RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS	
Change in Amount of Goods, Services and Benefits Ordered, but not yet Received or Provided	$10,659
Costs Capitalized on the Balance Sheet	110
Financing Sources that Fund Costs of Prior Periods	(1,224)
Other	21
TOTAL RESOURCES THAT DO NOT FUND NET COST OF OPERATIONS	$ 9,566
COSTS THAT DO NOT REQUIRE RESOURCES	
Depreciation and Amortization	$ 2
Bad Debts Related to Uncollectible Non-Credit Reform Receivables	109
Other	(2,015)
TOTAL COSTS NOT REQUIRING RESOURCES	(1,904)
Financing Sources Yet to be Provided	$ 4,401
NET COST OF OPERATIONS	$31,473

The accompanying notes are an integral part of these statements

Notes to Financial Statements

Note 1 – Entity and Mission

The U.S. Department of Housing and Urban Development (HUD) was created in 1965 to (1) provide housing subsidies for low and moderate income families, (2) provide grants to states and communities for community development activities, (3) provide direct loans and capital advances for construction and rehabilitation of housing projects for the elderly and persons with disabilities, and (4) promote and enforce fair housing and equal housing opportunity. In addition, HUD insures mortgages for single family and multifamily dwellings; insures loans for home improvements and manufactured homes; and facilitates financing for the purchase or refinancing of millions of American homes.

HUD's major programs are as follows:

The **Federal Housing Administration** (FHA) was created as a Government corporation within HUD and administers some 40 active mortgage insurance programs which are designed to make mortgage financing more accessible to the home-buying public and thereby to develop affordable housing. FHA insures private lenders against loss on mortgages which finance single family homes, multifamily projects, health care facilities, property improvements, and manufactured homes.

The **Government National Mortgage Association** (Ginnie Mae) was created as a Government corporation within HUD to administer mortgage support programs that could not be carried out in the private market. Ginnie Mae guarantees the timely payment of principal and interest on mortgage-backed securities issued by approved private mortgage institutions and backed by pools of mortgages insured or guaranteed by FHA, the Rural Housing Service (RHS), and the Department of Veterans Affairs (VA).

The **Section 8 Rental Assistance** programs assist low- and very low-income families in obtaining decent and safe rental housing. HUD makes up the difference between what a low- and very low-income family can afford and the approved rent for an adequate housing unit.

Operating Subsidies are provided to Public Housing Authorities (PHAs) and Tribally Designated Housing Entities (TDHEs) to assist in financing the operations and maintenance costs of their housing projects.

The **Community Development Block Grant** (CDBG) programs provide funds for metropolitan cities, urban counties, and other communities to use for neighborhood revitalization, economic development, and improved community facilities and services.

The **Low Rent Public Housing Grants** program provides grants to PHAs and TDHEs for construction and rehabilitation of low-rent housing. This program is a continuation of the Low Rent Public Housing Loan program which pays principal and interest on long-term loans made to PHAs and TDHEs for construction and rehabilitation of low-rent housing.

The **Section 202/811 Supportive Housing for the Elderly and Persons with Disabilities** programs, prior to fiscal 1992, provided 40 year loans to nonprofit organizations sponsoring rental housing for the elderly or disabled. During fiscal 1992, the program was converted to a grant program. The grant program provides long-term supportive housing for the elderly (Section 202) and disabled (Section 811).

The **HOME Investments Partnerships** program provides grants to States, local Governments, and Indian tribes to implement local housing strategies designed to increase home ownership and affordable housing opportunities for low- and very low-income Americans.

Other Programs not included above consist of other smaller programs which provide grant, subsidy funding, and direct loans to support other HUD objectives such as fair housing and equal opportunity, energy conservation, assistance for the homeless, rehabilitation of housing units, and home ownership. These programs comprise approximately 8.33 percent of HUD's consolidated assets and 7.46 percent of HUD's consolidated revenues and financing sources for fiscal 1998.

Note 2 – Summary of Significant Accounting Policies

A. Basis of Consolidation

The financial statements include all funds and programs for which HUD is responsible. All significant intra-fund balances and transactions have been eliminated in consolidation. Transfer appropriations are consolidated into the financial statements based on an evaluation of their relationship with HUD.

B. Basis of Accounting

The financial statements include the accounts and transactions of the Ginnie Mae, FHA, and HUD's Grant, Subsidy and Loan programs.

The statements are presented in accordance with the Office of Management and Budget (OMB) Bulletin 97-01, Form and Content of Agency Financial Statements, and in conformance with the Federal Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS).

The financial statements are presented on the accrual basis of accounting. Under this method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Generally, procedures for HUD's major grant and subsidy programs require recipients to request periodic disbursement concurrent with incurring eligible costs.

C. Operating Revenue and Financing Sources

HUD operations are principally financed by appropriations, collection of premiums and fees on its FHA and Ginnie Mae programs, and interest income on its mortgage notes, loans, and investments portfolio.

Appropriations for Grant and Subsidy Programs

HUD receives appropriations on both an annual and multiyear basis. Appropriations are recognized as revenue when related program expenses are incurred. Accordingly, for grants provided by HUD, revenue and related expenses are recognized as recipients perform under the contracts. For subsidies provided by HUD, revenue and related expenses are recognized when the underlying assistance (e.g., provision of a Section 8 rental unit by a housing owner) is provided.

FHA Unearned Premiums

Premiums charged by FHA for single family mortgage insurance provided by its Mutual Mortgage Insurance (MMI) Fund and Cooperative Management Housing Insurance (CMHI) Fund include up-front and annual risk based premiums. Pre-credit reform up-front risk based premiums are recorded as unearned revenue upon collection and are recognized as revenue over the period in which losses and insurance costs are expected to occur. Annual risk-based premiums are recognized as revenue on a straight-line basis throughout the year. FHA's other activities charge periodic insurance premiums over the mortgage insurance term. Premiums on annual installment policies are recognized for the liquidating accounts on a straight-line basis throughout the year.

Premiums associated with Credit Reform loan guarantees are included in the calculation of the liability for loan guarantees (LLG) and not included in the unearned premium amount reported on the Balance Sheet, since the LLG represents the net present value of future cash flows.

Ginnie Mae Fees

Fees received for Ginnie Mae's guaranty of mortgage-backed securities are recognized as earned on an accrual basis. Fees received for commitments to subsequently guarantee mortgage-backed securities and commitments to fund mortgage loans are recognized when commitments are granted.

D. Appropriations and Monies Received from Other HUD Programs

The General Insurance (GI) Fund and Special Risk Insurance (SRI) Fund were not designed to be self-sustaining. As a result, the National Housing Act of 1990, as amended, provides for appropriations from Congress to finance the operations of these Funds. For post-1991 loan guarantees, appropriations to the GI and SRI Funds are made at the beginning of each fiscal year to cover estimated losses on loans to be insured during that year. For pre-1992 loan guarantees, the FHA has permanent indefinite appropriations authority to finance the cash requirements of operations.

Monies received from other HUD programs, such as interest subsidies and rent supplements, are recorded as revenue for the liquidating accounts when services are rendered. Monies received for the financing accounts are recorded as an addition to the liability for loan guarantees when collected.

E. Fund Balance with the U.S. Treasury

Substantially all of HUD's receipts and disbursements are processed by the U.S. Treasury which, in effect, maintains HUD's bank accounts. HUD's fund balances with the U.S. Treasury as of September 30, 1998, were as follows (dollars in millions):

Description	Entity Assets	Non-Entity Assets
Revolving Funds	$ 8,230	–
Appropriated Funds	69,037	$112
Escrow Fund	–	134
TOTAL – FUND BALANCE	$77,267	$246

The entity fund balances are required for payment of HUD's commitments under its various grant, subsidy, and loan programs. Non-entity fund balances relate to transfer appropriations.

F. Investments in U.S. Government Securities

HUD's investments, which principally comprise investments by FHA's MMI Fund and by Ginnie Mae, are limited to non-marketable market-based Treasury interest-bearing obligations (i.e., investments not sold in public markets). The market value and interest rates established for such investments are the same as those for similar Treasury issues which are publicly marketed.

HUD's investment decisions are limited by Treasury policy which: (1) only allows investment in Treasury notes, bills, and bonds; and (2) prohibits HUD from engaging in practices that result in "windfall" gains and profits, such as security trading and full scale restructuring of portfolios, in order to take advantage of interest rate fluctuations. FHA's normal policy is to hold investments in U.S. Government securities to maturity. However, as a result of Credit Reform, cash collected on insurance endorsed on or after October 1, 1991, is no longer available to invest in U.S. Government securities, and may only be used to finance claims emanating from insurance endorsed during or after fiscal 1992. FHA may have to liquidate its U.S. Government securities before maturity to finance claim payments from pre-fiscal year 1992 insurance endorsements. However, management does not expect early liquidation of any U.S. Government Securities and believes it has the ability to hold these securities to maturity.

Investments in U.S. Government securities are reported at amortized cost. Premiums or discounts are amortized into interest income over the term of the investment. HUD's intent is to hold investments to maturity, unless needed for operations. No provision is made to record unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity.

G. Credit Program Receivables and Related Foreclosed Property

HUD finances mortgages and provides loans to support construction and rehabilitation of low rent housing, principally for the elderly and disabled under the Section 202/811 program. Prior to April 1996, mortgages were also assigned to HUD through FHA claims settlement (i.e., mortgage notes assigned, MNAs). Single family mortgages were assigned to FHA when the mortgagor defaulted due to certain "temporary hardship" conditions beyond the control of the mortgagor, and when, in management's judgment, it is likely that the mortgage could be brought current in the future. In addition, multifamily mortgages were assigned to FHA when lenders filed mortgage insurance claims for defaulted notes.

During 1996, Congress mandated that FHA discontinue the single family assignment program and develop and implement a loss mitigation program to reduce defaults and related costs. FHA, however, continues to take single family assignment on those defaulted mortgage notes that were in process at the time the assignment program was terminated. 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 predetermined point.

Credit program receivables for direct loan programs and defaulted guaranteed loans assigned for direct collection are valued differently based on the direct loan obligation or loan guarantee commitment date. These valuations are in accordance with the Federal Credit Reform Act of 1990 and SFFAS No. 2, "Accounting for Direct Loans and Loan Guarantees." Those obligated or committed on or after October 1, 1991 (post-Credit Reform) are valued at the net present value of expected cash flows from the related receivables.

Credit program receivables resulting from obligations or commitments prior to October 1, 1991, (pre-Credit Reform) are recorded at the lower of cost or fair value (net realizable value). Fair value is estimated based on the prevailing market interest rates at the date of mortgage assignment. When fair value is less than cost, discounts are recorded and amortized to interest income over the remaining terms of the mortgage or upon sale of the mortgages. Interest is recognized as income when earned. However, when full collection of principal is considered doubtful, the accrual of interest income is suspended and receipts (both interest and principal) are recorded as collections of principal. Pre-Credit Reform loans are reported net of allowance for loss and any unamortized discount. The estimate for the allowance on credit program receivables is based on historical loss rates and recovery rates resulting from asset sales and property recovery rates, net of cost of sales.

Foreclosed property acquired as a result of defaults of loans obligated or loan guarantees committed on or after October 1, 1991, is valued at the net present value of the projected cash flows associated with the property. Foreclosed property acquired as a result of defaults of loans obligated or loan guarantees committed prior to 1992, is valued at net realizable value. The estimate for the allowance for loss related to the net realizable value of foreclosed property, is based on historical loss rates and recovery rates resulting from property sales, net of cost of sales.

H. Liability for Loan Guarantees

The liability for loan guarantees (LLG) related to Credit Reform loans (made after October 1, 1991) is comprised of the present value of anticipated cash outflows for defaults such as, claim payments, premium 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 interest on Secretary-held notes.

The pre-Credit Reform LLG is computed using the net realizable value method. The LLG for pre-Credit Reform single family insured mortgages includes estimates for defaults that have taken place, but where claims have not yet been filed in the MMI/CMHI, GI, and SRI Funds. In addition, the LLG for pre-Credit Reform multifamily insured mortgages includes estimates for defaults which are considered probable but have not been reported to FHA in the GI, SRI, and MMI/CMHI Funds.

I. Full Cost Reporting

Beginning in FY 1998, SFFAS #4 requires that full costing of program outputs be included in Federal agency financial statements. Full cost reporting includes direct, indirect, and inter-entity costs. For purposes of the consolidated department financial statements, HUD identified each responsible segment's share of the program costs or resources provided by HUD or other Federal agencies. These costs are treated as imputed cost for the Statement of Net Cost, and imputed financing for the Statement of Changes in Net Position and the Statement of Financing.

J. Accrued Unfunded Leave and Federal Employees Compensation Act (FECA) Liabilities

Annual leave and compensatory time are accrued as earned and the liability is reduced as leave is taken. The liability at year-end reflects cumulative leave earned but not taken, priced at current wage rates. Funding for earned leave deferred to future periods is to be provided by future appropriations. HUD offsets this unfunded liability by recording future financing sources in the Net Position section of its Consolidated Statement of Financial Position. Sick leave and other types of leave are expensed as taken.

HUD also accrues the portion of the estimated liability for disability benefits assigned to the agency under the FECA, administered and determined by the Department of Labor. The liability is based on the net present value of estimated future payments based on a study conducted by the Department of Labor and is $57 million as of September 30, 1998. Future payments on this liability are to be funded by future appropriations. HUD offsets this unfunded liability by recording future financing sources.

K. Loss Reserves

HUD records loss reserves for its mortgage insurance programs operated through FHA and its financial guaranty programs operated by Ginnie Mae. FHA loss reserves are recorded for actual or probable defaults of FHA-insured mortgage loans. Ginnie Mae reserves are established for actual and probable defaults of issuers of Ginnie Mae-guaranteed mortgage-backed securities. Such reserves are based on management's judgment about historical claim and loss information and current economic factors.

L. Retirement Plans

The majority of HUD's employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS went into effect pursuant to Public Law 99-335 on January 1, 1987. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired before January 1, 1984, can elect to either join FERS and Social Security or remain in CSRS. HUD expenses its contributions to the retirement plans.

A primary feature of FERS is that it offers a savings plan whereby HUD automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. Under CSRS, employees can contribute up to 5 percent of their pay to the savings plan, but there is no corresponding matching by HUD. Although HUD funds a portion of the benefits under FERS relating to its employees and makes the necessary withholdings from them, it has no liability for future payments to employees under these plans, nor does it report CSRS, FERS, or FECA assets, accumulated plan benefits, or unfunded liabilities applicable to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are not allocated to the individual employers. HUD's matching contributions to these retirement plans during fiscal 1998 was $56 million.

M. Pension and Other Retirement Benefits

The Department's pension and other retirement benefit expenses totaled approximately $82 million for fiscal 1998. This amount includes $16 million to be funded by the OPM. Amounts funded by OPM are charged to expense with a corresponding amount considered as an imputed financing source in the statement of changes in net position.

N. Prior Period Adjustment

In prior years the consolidated financial statements did not comply with Statement of Federal Financial Accounting Standard (SFFAS) Number 2, *Direct Loans and Loan Guarantees*, as it related to the mortgage insurance programs of FHA. Had this standard been applied to FHA, FHA's net position as of September 30, 1997 would have been $9.746 billion higher than was reflected in the prior year consolidated financial statements. This amount is reflected on the statement of changes in net position as a prior period adjustment.

Note 3 - Commitments Under HUD's Grant, Subsidy and Loan Programs

A. Contractual Commitments

HUD has entered into extensive long-term contractual commitments under its various grant, subsidy and loan programs. These commitments consist of legally binding agreements the Department has entered into to provide grants, subsidies, or loans. Commitments become liabilities when all actions required for payment under an agreement have occurred. The mechanism for funding for these commitments generally differs, depending on whether the agreements were entered into before or after 1988.

Prior to fiscal 1988, HUD's subsidy programs, primarily the Section 8 program and the Section 235/236 programs, operated under contract authority. Each year, Congress provided HUD the authority to enter into multiyear contracts within annual and entire contract limitation ceilings. HUD then drew on and continues to draw on permanent indefinite appropriations to fund the current year's portion of those multiyear contracts. Because of the duration of these contracts (up to 40 years), significant authority exists to draw on the permanent indefinite appropriations. Beginning in fiscal 1988, the Section 8 and the Section 235/236 programs began operating under multiyear budget authority whereby the Congress appropriates the funds "up-front" for the entire contract term in the initial year, the effect of which substantially increases HUD's net position.

As shown below, appropriations to fund a substantial portion of these commitments will be provided through permanent indefinite authority. These commitments relate primarily to the Section 8 program, and the Section 235/236 rental assistance and interest reduction programs, and are explained in greater detail below.

HUD's commitment balances are based on the amount of unliquidated obligations recorded in HUD's accounting records with no provision for changes in future eligibility, and thus are equal to the maximum amounts available under existing agreements and contracts. Unexpended appropriations shown in the Consolidated Statement of Financial Position comprise funds in the U.S. Treasury available to fund existing commitments that were provided through "up-front" appropriations, and also include permanent indefinite appropriations received in excess of amounts used to fund the pre-1988 subsidy contracts.

HUD's obligations and contractual commitments under its grant, subsidy, and loan programs as of September 30, 1998 were as follows (dollars in millions):

	Commitments Funded Through		
Programs	Unexpended Appropriations	Permanent Indefinite Appropriations	Total Contracted Commitments
Section 8 Rental Assistance	$20,843	$39,260	$ 60,103
Community Development Block Grants	9,016	–	9,016
HOME Partnership Investment Program	3,646	–	3,646
Operating Subsidies	1,382	–	1,382
Low Rent Public Housing Grants and Loans	7,776	29	7,805
Housing for Elderly and Disabled	3,590	–	3,590
Section 235/236	75	11,282	11,357
All Other	5,804	107	5,911
TOTAL	$52,132	$50,678	$102,810

Of the total Section 8 Rental Assistance contractual commitments, $50.38 billion relates to project-based commitments, and $9.73 billion relates to tenant-based commitments. With the exception of the Housing for the Elderly and Disabled and Low Rent Public Housing Loan Programs, which have been converted to a grant program and Section 235/236, and a portion of "all other" program, HUD management expects all of the above programs to continue to incur new commitments under authority granted by Congress in future years. However, estimated future commitments under such new authority are not included in the amounts above.

B. Administrative Commitments

In addition to the above contractual commitments, HUD has entered into administrative commitments which are reservations of funds for specific projects (including those for which a contract has not yet been executed) to obligate all or part of those funds. At the time of contract execution, the administrative commitments become contractual commitments.

HUD's administrative commitments as of September 30, 1998 were as follows (dollars in millions):

Program	Administrative Commitments Funded Through: Unexpended Appropriations	Permanent Indefinite Appropriations	Total Reservations
Section 8 Rental Assistance Project-Based	$1,603	–	$1,603
Section 8 Rental Assistance Tenant-Based	922	–	922
Low Rent Public Housing Grants and Loans	1,617	–	1,617
Housing for Elderly and Disabled	2,692	$ 73	2,765
All Other	1,594	47	1,641
TOTAL	$8,428	$120	$8,548

Note 4 – Investments in U.S. Government Securities

The U.S. Government securities are non-marketable securities. Interest rates are established by the U.S. Treasury and during fiscal 1998 ranged from 5.2 percent to 6.1 percent annually. The amortized cost and estimated market value of investments in debt securities as of September 30, 1998 was as follows (dollars in millions):

Description	Cost	Unamortized (Premium) Discount	Net Investments	Unrealized Gain	Market Value
Intragovernmental Securities:					
Non-marketable: Market-Based	$19,961	$(237)	$19,724	$1,826	$21,550

Note 5 – Accounts Receivable

A. Section 8 Settlements

Section 8 subsidies disbursed during the year under annual contribution contracts are based on estimates of amounts due under the contracts by PHAs. At the end of each year the amount actually due under the contracts during the year is determined. The excess of subsidies paid to PHAs during the year over the amounts actually due them are reflected as accounts receivable in the statement of financial position. These amounts are "collected" by offsetting such amounts with subsidies due to PHAs in subsequent periods, and totaled $310 million at September 30, 1998.

B. Bond Refundings

Many of the Section 8 projects constructed in the late 1970s and early 1980s were financed with tax exempt bonds with maturities ranging from 20 to 40 years. The related Section 8 contracts provided that the subsidies would be based on the difference between what tenants could pay pursuant to a formula, and the total costs of operation of the Section 8 project, including debt service. The high interest rates during the construction period resulted in high subsidies. When interest rates came down later in the 1980s, HUD was interested in getting the bonds refunded. One method used to account for the savings when bonds are refunded (PHAs sell a new series of bonds at a lower interest rate, to liquidate the original bonds), is to continue to pay the original amount of the bond debt service to a trustee. The amounts paid in excess of the lower "refunded" debt service and any related financing costs, are considered savings. One-half of these savings are provided to the PHA, the remaining 50% is returned to HUD. As of September 30, 1998, HUD was due $407 million.

The above accounts receivable are reflected in the statement of financial position as follows (dollars in millions):

Description	Entity Assets	Non-Entity Assets
Section 8 Settlements	$310	–
Bond Refundings	–	$407
Other Receivables	38	–
TOTAL	$348	$407

Note 6 – Other Assets

HUD's Other Assets as of September 31, 1998 were as follows (dollars in millions):

Other Entity Assets	FHA	GNMA	Section 8 Rental Assistance	All Other	Total
Intragovernmental Assets:					
Receivables from unapplied disbursements	$213	–	–	–	$ 213
Section 312 Rehabilitation Loan Program Receivables	4	–	–	–	4
Advances against Defaulted MBS Pools	–	$ 29	–	–	29
Borrowing Receivables from Treasury	–	–	–	$149	149
Other Receivables	–	–	–	22	22
TOTAL INTRAGOVERNMENTAL ASSETS	$217	$ 29	$ –	$171	$ 417
Other Assets:					
Receivables Related to Asset Sales	$ 32	–	–	–	$32
Receivables Related to Credit Program Assets	77	–	–	–	77
Equity Interest in Multifamily Mortgage Trust 1996	60	–	–	–	60
Premiums Receivable	25	–	–	–	25
Accrued Interest and Other Receivables		$103	–	–	103
Property and Equipment	–	–	–	$ 24	24
Advances to the Public	–	–	$663	119	782
TOTAL OTHER ASSETS	$194	$103	$663	$143	$1,103
Other Non-entity Assets					
Intragovernmental Assets:					
Other Receivables	$ 6	$ –	$ –	$ –	$ 6
Other Assets:					
Other Receivables	$ 64	$ –	$ –	$ –	$ 64

Note 7 – Direct Loans and Loan Guarantees, Non-Federal Borrowers

Direct loan obligations or loan guarantee commitments made prior to fiscal 1992, and the resulting direct loans or defaulted guaranteed loans, are reported net of allowance for estimated uncollectable loans or estimated losses.

Direct loan obligations or loan guarantee commitments made after fiscal 1991, and the resulting direct loans or defaulted guaranteed loans are governed by the Federal Credit Reform Act of 1990, and are recorded as the net present value of the associated cash flows (i.e. interest rate differential, interest subsidies, estimated delinquencies and defaults, fee offsets, and other cash flows). Analysis of loans receivable, loan guarantees, liability for loan guarantees, and the nature and amounts of the subsidy and administrative costs associated with the loans and loan guarantees for fiscal 1998 were as follows:

A. List of HUD's Direct Loan and/or Loan Guarantee Programs:

1. FHA
2. Ginnie Mae
3. Housing for the Elderly and Disabled
4. Low Rent Public Housing Loan Fund
5. All Other
   a) Revolving Fund
   b) Flexible Subsidy
   c) CDBG, Section 108(b)
   d) Public and Indian Loan Guarantee
   e) Loan Guarantee Recovery Fund
   f) Public and Indian Housing Loan Fund

B. Direct Loans Obligated Prior to FY 1992 (Allowance for Loss Method)
(dollars in millions):

Direct Loan Programs	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans
FHA	$ 88	$ 13	$ (76)	–	$ 25
GNMA	5	–	–	$ 1	6
Housing for Elderly and Disabled	8,143	82	(20)	1	8,206
Low Rent Public Housing Loans	38	5	(13)	–	30
All Other	1,019	58	(745)	–	332
TOTAL	$9,293	$158	$(854)	$ 2	$8,599

C. Direct Loans Obligated After FY 1991 (dollars in millions):

Direct Loan Programs	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property	Value of Assets Related to Direct Loans
FHA	$6	$ –	$ –	$ –	$6

D. Defaulted Guaranteed Loans from Pre-1992 Guarantees (Allowance for Loss Method) (dollars in millions):

Direct Loan Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan and Interest Losses	Foreclosed Property, Net	Defaulted Guaranteed Loans Receivable, Net
FHA	$2,690	$640	$(2,460)	$560	$1,430

E. Defaulted Guaranteed Loans From Post-FY 1991 Guarantees (dollars in millions):

Direct Loan Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Foreclosed Property, Gross	Value of Assets Related to Defaulted Guaranteed Loans
FHA	$614	$21	$(1,315)	$2,352	$1,672

F. Guaranteed Loans Outstanding (dollars in millions):

Loan Guarantee Programs	Outstanding Principal, Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
FHA Programs	$518,069	$475,236
All Other	1,399	1,399
TOTAL	$519,468	$476,635

G. Liability for Loan Guarantees (Estimated Future Default Claims, Pre-1992) (dollars in millions):

Loan Guarantee Programs	Liabilities for Losses on Pre-1992 Guarantees, Estimated Future Default Claims	Liabilities for Loan Guarantees for Post-1991 Guarantees (Present Value)	Total Liabilities For Loan Guarantees
FHA Programs	$7,473	$1,931	$9,404
All Other	–	11	11
TOTAL	$7,473	$1,942	$9,415

H. Subsidy Expense for Post-FY 1991 Loan Guarantees (dollars in millions):

Subsidy Expense for Current Year Loan Guarantees

Loan Guarantee Programs	Endorsement Amount	Default Component	Fees Component	Other Component	Subsidy Amount
FHA	–	$1,870	$(5,169)	$665	$(2,634)
All Other	–	7	–	–	7
TOTAL	$ –	$1,877	$(5,169)	$665	$(2,627)

Subsidy Expense for Loan Guarantee Re-estimates for FHA

The cash flow models and financial data used to calculate the fiscal 1998 subsidy expense re-estimates for FHA are substantially different from the models used to calculate the fiscal 1997 re-estimates. These differences primarily resulted from additional refinements in the calculation process, cash flow assumptions and models, as well as additional information about the actual performance of outstanding loan guarantees.

The initial September 30, 1997, subsidy expense re-estimate was $2 billion. This re-estimate was based on the best available information and cash flow models at the time. This re-estimate, if calculated based upon revised models and financial data developed during fiscal 1998, would have resulted in a revised fiscal 1997 re-estimate of $3.4 billion, an increase of $1.4 billion in the fiscal 1997 re-estimate. As the fiscal 1997 re-estimate would have been $1.4 billion higher, the fiscal 1998 re-estimate would have been lower by that amount.

Note 8 – Debt

Several HUD programs have the authority to borrow funds from the U.S. Treasury for program operations. Additionally, FHA in certain cases is authorized by the National Housing Act to issue debentures in lieu of cash to pay claims. Funds were also borrowed by PHAs and TDHEs from the private sector and from the Federal Financing Bank (FFB) to finance construction and rehabilitation of low rent housing; these borrowings are being repaid by HUD on behalf of the PHAs and TDHEs. HUD borrowings, and borrowings by

PHAs/TDHEs for which HUD is responsible for repayment, were as follows as of September 30, 1998 (dollars in millions):

Liabilities Covered by Budgetary Resources:

Description	Beginning Balance	Net Borrowings	Ending Balance
Agency Debt:			
Held by the Public	$ 68	$ 98	$ 166
Other Debt:			
Debt to the U.S. Treasury	$ 3,639	$ 2,940	$ 6,579
Debt to the Federal Financing Bank	36	(6)	30
Total Other Debt	$ 3,675	$ 2,934	$ 6,609
Classification of Debt:			
Intragovernmental Debt			$ 6,609
Debentures Issued to Claimants			166
TOTAL DEBT			$ 6,775

Liabilities Not Covered by Budgetary Resources:

Description	Beginning Balance	Net Borrowings	Ending Balance
Agency Debt:			
Held by Government Accounts	$ 1,561	$ (70)	$ 1,491
Held by the Public	3,586	(281)	3,305
Total Agency Debt	$ 5,147	$ (351)	$ 4,796
Other Debt:			
Debt to the U.S. Treasury	$ 6,174	$ (881)	$ 5,293
Debt to the Federal Financing Bank	–	–	–
Total Other Debt	$ 6,174	$ (881)	$ 5,293
TOTAL DEBT	$11,321	$(1,232)	$10,089
Classification of Debt:			
Intragovernmental Debt			$6,784
Debt held by the Public			3,305
TOTAL DEBT			$10,089

Interest paid on borrowings was $598 million during the year ended September 30, 1998. The purposes of these borrowings are discussed in the following paragraphs.

Borrowings from the U.S. Treasury

HUD is authorized to borrow from the U.S. Treasury to finance Housing for Elderly and Disabled loans. The Treasury borrowings typically have a 15-year term, but may be repaid prior to maturity at the discretion of HUD. However, such borrowings must be repaid in the sequence in which they were borrowed from Treasury. The interest rates on the borrowings are based on Treasury's 30-year bond yield at the time the notes are issued. Interest is payable on April 30 and October 31. Interest rates range from 7.44 percent to 11.41 percent for fiscal 1998.

Borrowings from the Federal Financing Bank (FFB) and the Public

During the 1960s, 1970s, and 1980s, HAs obtained loans from the private sector and from the FFB to finance development and rehabilitation of low rent housing projects. These borrowings are being repaid by HUD on behalf of the HAs, through the Low Rent Public Housing program. For borrowings from the Public, interest is payable throughout the year. Interest rates range from 2.25 percent to 6 percent for fiscal 1998. The borrowings from the FFB have terms up to 40 years; the borrowings from the private sector have terms up to 30 years. FFB interest is payable annually on November 1. Interest rates range from 10.6 percent to 16.1 percent for fiscal 1998.

Before July 1, 1986, notes issued by units of general local government and guaranteed by HUD under Section 108 were purchased by the FFB. These notes had various maturities and carried interest rates that were one-eighth of one percent above rates on comparable Treasury obligations. No note purchased by the FFB has ever been declared in default. Substantially all outstanding notes are still held by the FFB.

NOTE 9 - OTHER LIABILITIES

HUD's Other Liabilities as of September 30, 1998 were as follows (dollars in millions):

Other Liabilities Covered by Budgetary Resources:

Description	Non-Current	Current	Total
Intragovernmental Liabilities:			
FHA Payable from Unapplied Receipts Recorded by Treasury	–	$210	$ 210
GNMA Deferred Income/Revenue	–	25	25
Other Liabilities for Borrowings from Treasury			
HUD All Other	$ 153	–	153
Resource Payable to Treasury			
Housing for the Elderly and Disabled	4,113	–	4,113
Advances Fed Other			
HUD All Other	–	5	5
Miscellaneous Receipts Payable to Treasury			
Section 8 Rental Assistance	519	–	519
TOTAL INTRAGOVERNMENTAL LIABILITIES	$4,785	$240	$5,025
Governmental Liabilities:			
FHA Other Liabilities	$ 14	$100	$ 114
FHA Escrow Funds Related to Mortgage Notes	–	204	204
GNMA Accounts Payable and Accrued Liabilities	–	21	21
Deferred Credits			
Section 8 Rental Assistance	–	164	164
Deposit Funds			
Low Rent Public Housing G/L	–	8	8
Housing for Elderly and Disabled	–	13	13
HUD All Other	–	93	93
TOTAL GOVERNMENTAL LIABILITIES	$ 14	$603	$ 617

Other Liabilities Not Covered by Budgetary Resources (dollars in millions):

Description	Non-Current	Current	Total
Intragovernmental Liabilities:			
Other Actuarial Liabilities			
HUD All Other	$57	$ –	$57
Governmental Liabilities:			
Accrued Unfunded Annual Leave			
HUD All Other	$72	$ –	$72

Note 10 – Loss Reserves

Loss reserves of $511 million were established by Ginnie Mae through a provision charged to operations and represents probable defaults by issuers of mortgage-backed securities. The reserve is relieved as losses are realized from the disposal of the defaulted issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights which inure to Ginnie Mae upon the default of the issuer. Ginnie Mae management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed mortgage-backed securities.

Ginnie Mae incurs losses when insurance and guarantees do not cover expenses that result from issuer defaults, including such expenses as: (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees; (2) ineligible mortgages included in defaulted Ginnie Mae-pools; (3) improper use of proceeds by an issuer; and (4) non reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

Note 11 – Unexpended Appropriations

HUD receives appropriations on both an annual and multiyear basis for all non-revolving fund activity. Unexpended appropriations are amounts not yet expended, which have not lapsed, been rescinded, or been withdrawn. Analysis of HUD's Unexpended Appropriations for fiscal 1998 is as follows (dollars in millions):

Description	Unobligated Available	Unobligated Unavailable	Undelivered Orders	Accounts Receivable from Public	Total
FHA – Subsidized Programs	$ 43	$ 372	$ 25	–	$ 440
FHA – Unsubsidized Programs	–	1,264	–	–	1,264
Section 8 Rental Assistance	7,105	–	20,843	$ 14	27,962
CDBG	845	–	9,016	–	9,861
HOME	242	–	3,646	–	3,888
Operating Subsidies	68	–	1,382	–	1,450
Low Rent Public Housing Loans and Grants	1,743	–	7,776	1,466	10,985
Section 202/811	2,798	–	3,577	–	6,375
All Other	2,236	84	5,829	3	8,152
TOTAL	$15,080	$1,720	$52,094	$1,483	$70,377

Balances of Budget Authority

HUD's balances of budget authority include obligated balances for which outlays have not yet been made, along with unobligated balances. These balances are reported in the Consolidated Statement of Budgetary Resources. Unexpended appropriations reported in the Consolidated Statement of Financial Position will not agree with HUD's balances of budget authority, for the following reasons:

a) Unexpended appropriations do not include contractual commitments and reservations for which appropriations have not yet been received. As explained in Note 3, commitments and reservations funded through Permanent Indefinite Appropriations relate primarily to the Section 8 and Section 235/236 programs, resulting from contract authority provided prior to FY 1988 (contract authority is not an appropriation);

b) HUD's balances of budget authority includes FHA and GNMA activity. To the extent this activity is recorded for financial statement purposes, it is included in other net position accounts; and

c) Commitments to fund future interest and principal payments relating to loans made to PHAs and TDHEs for which repayment was subsequently assumed by HUD, are included in HUD's balances of budget authority, but are not reported in commitments in Note 3.

Unexpended appropriations can be reconciled to HUD's balances of budget authority as of September 30, 1998, as follows (dollars in millions):

Appropriations recorded in proprietary and budgetary records:	
Contractual commitments relating to grant, subsidy and loan programs funded through unexpended appropriations (Note 3)	$ 52,132
Administrative commitments relating to grant, subsidy and loan programs funded through unexpended appropriations (Note 3)	8,428
Appropriations received relating to grant, subsidy and loan programs, not yet obligated nor reserved	6,693
Accounts receivable due from the public	1,483
Unexpended appropriations relating to FHA	1,704
Other	(63)
Unexpended appropriations reported in the Consolidated Statement of Financial Position	$ 70,377
Budgetary transactions not recorded in Proprietary records:	
Contractual commitments funded through permanent indefinite appropriations (Note 3)	$ 50,678
Administrative Commitments funded through permanent indefinite appropriations (Note 3)	120
FHA unexpended balances, not included in unexpended appropriations	17,874
GNMA unexpended balances, not included in unexpended appropriations	5,857
Public and Indian Housing Loan future interest payments assumed by HUD, not included in unexpended appropriations	6,183
Contractual commitments relating to the debt service fund, not included in unexpended appropriations	1,420
Other reconciling items	3,939
Total Budgetary transactions not recorded in proprietary records	$ 86,071
TOTAL BALANCES OF BUDGET AUTHORITY	$156,448

Note 12 – Financial Instruments With Off-Balance Sheet Risk

Some of HUD's programs, principally those operated through FHA and Ginnie Mae, enter into financial arrangements with off-balance sheet risk in the normal course of their operations.

A. FHA Mortgage Insurance

Unamortized insurance in force outstanding for FHA's mortgage insurance programs as of September 30, 1998 was $518 billion and is discussed in note 7F.

B. Ginnie Mae Mortgage-Backed Securities

Ginnie Mae financial instruments with off-balance sheet risk include guarantees of Mortgage Backed Securities (MBS) and commitments to guaranty MBS. The securities are backed by pools of FHA-insured, RHS-insured, and VA-guaranteed mortgage loans. Ginnie Mae is exposed to credit loss in the event of non-performance by other parties to the financial instruments. The total amount of Ginnie Mae guaranteed securities outstanding at September 30, 1998 was approximately $542 billion. However, Ginnie Mae's potential loss is considerably less because the FHA and RHS insurance and VA guaranty serve to indemnify Ginnie Mae for most losses. Also, as a result of the structure of the security, Ginnie Mae bears no interest rate or liquidity risk.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guarantee MBS. The commitment ends when the MBS are issued or when the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities due, in part, to GNMA's ability to limit commitment authority granted to individual issuers of MBS. Outstanding commitments as of September 30, 1998, were $22 billion.

Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers.

In fiscal 1998, Ginnie Mae issued a total of $36.9 billion in its multiclass securities program.. The outstanding balance at September 30, 1998, was $83.4 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

C. Section 108 Loan Guarantees

Under HUD's Section 108 Loan Guarantee program, recipients of CDBG Entitlement Grant program funds may pledge future grant funds as collateral for loans guaranteed by HUD (these loans were provided from private lenders since July 1, 1986). This Loan Guarantee Program provides entitlement communities with a source of financing for projects which are too large to be financed from annual grants. The amount of loan guarantees outstanding as of September 30, 1998, was $1.38 billion. HUD management believes its exposure in providing these loan guarantees is limited, since loan repayments can be offset from future CDBG Entitlement Program Funds and, if necessary, other funds provided to the recipient by HUD. HUD has never had a loss under this program since its inception in 1974.

Note 13 – Contingencies

Lawsuits and Other

HUD is party in various legal actions and claims brought against it. In the opinion of management and General Counsel, the ultimate resolution of these legal actions and claims will not materially affect HUD's financial position or results of operations for the fiscal year ended September 30, 1998. Payments made out of the Claims, Judgments and Relief Acts Fund in settlement of the legal proceedings are subject to the Department of Justice's approval.

A case was filed by owners of 43 multifamily projects regarding the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA) and the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA). The Court of Federal Claims has ruled that the project owners' mortgage contracts had been breached by implementation of ELIHPA and LIHPRHA, and a trial was held in November 1996 to determine damages, if any, with respect to that claim as regards four "test" properties. The court awarded $3,061,107 in damages to the Plaintiff owners of the four "test" properties. An appeal was taken by the United States from the judgment entered in this case. The United States Court of Appeals for the Federal Circuit reversed the judgement of the Court of Federal Claims, holding that ELIHPA and LIHPRHA did not breach contracts between the plaintiffs and HUD. Specifically, the Court of Appeals ruled that the requisite privity of contract did not exist between the owners and HUD with respect to prepayment of the mortgage loans so as to make HUD liable to the owners for breach of contract. The court based its holding on the fact that the contractual provision allowing prepayment appears only in the riders to the mortgage notes, to which HUD is not a party. The Federal Circuit remanded the action to the Court of Federal Claims for consideration of the plaintiffs' takings claims. The Federal Circuit's decision will govern the outcome of all the other pending actions, unless there is further review and a reversal by the Federal Circuit sitting en-banc or by the United States Supreme Court, in which event, the latter will be determinative. In several of the other LIHPRHA cases, the Court of Federal Claims Judge also held that the United States had not breached the owners' mortgage contracts by enacting ELIPHA and LIHPRHA because of a lack of privity of contract between the owners and HUD. To date, there are 23 other lawsuits involving approximately 800 multifamily projects, all of which allege the same cause of action as stated above. HUD intends to defend these matters vigorously. HUD is unable at this time to form a judgment about the likelihood of an unfavorable outcome, or to make an estimate of the amount or range of potential loss if the plaintiffs should prevail. Any adverse judgment would be paid out of the Claims, Judgments, and Relief Acts Fund administered by the Department of Justice.

Note 14 – Intragovernmental Financial Activities

HUD's financial activities interact with and are dependent upon those of the Federal government as a whole. Specifically, HUD is subject to financial decisions and management controls of the Office of Management and Budget (OMB). As a result of its relationship with other Federal government entities and OMB, HUD's operations may not be conducted, nor its financial position reported, as they would if HUD were a separate and unrelated entity.

HUD's financial statements are not intended to report the Department's proportionate share of the total federal deficit or of public borrowings by the Treasury, including interest thereon.

A. Claims, Judgments, and Relief Acts Fund

Most legal actions that affect HUD and involve an amount in excess of $2,500, with the exception of on-the-job injury claims as discussed in Note 2 and legal actions pertaining to the FHA and Ginnie Mae programs, are paid from the Claims, Judgments, and Relief Acts Fund maintained by the Department of the Treasury and administered by the General Accounting Office and the Department of Justice. HUD is not required to reimburse this fund for payments made on its behalf. During fiscal 1998 no material amounts were paid to settle actions against HUD.

B. Other Interagency Transactions

HUD maintains various agreements with other federal agencies under the Economy and Efficiency Act. The revenues, expenses, receivables and payables for these agreements for fiscal 1998 are not material. HUD's two largest federal transactions are with the General Services Administration (GSA) for the use and upkeep of HUD facilities, and the Department of Agriculture's National Finance Center for the processing of payroll and related benefits.

HUD also manages transfer appropriations from the Appalachian Regional Commission (ARC) and the Department of Energy (DOE). The ARC funding is used to facilitate joint Federal and State efforts to provide basic facilities essential to economic growth in Appalachia. The DOE funding is used to fund loans and grants related to solar energy conservation improvements. These funds are included in the "All other" category in the financial statements.

Note 15 – Excess Rental Subsidies

During fiscal 1998, HUD developed statistical estimates of the extent of unreported income and excess rental subsidies based on an analysis of a sample of assisted households nationwide that received rental assistance during calendar year 1997 (the most recent year for which data is available for computer matching purposes).

Under HUD's Section 8 and Low Rent Public Housing programs, tenants generally are required to pay 30 percent of their income towards rent, with HUD providing the balance of the rental payment. New applicants and existing tenants are to provide income information which is used in determining the amount of rent they are to pay. Tenants are also required to recertify their income on an annual basis, and in certain other circumstances, i.e., when there is a significant increase in household income. The applicants' or tenants' failure to disclose all of their income, or the housing agencies', owners', or agents' failure to timely recertify the tenants for rental assistance, may result in the Department paying a greater rental subsidy than would be required. This additional subsidy is referred to as excess rental subsidy.

During fiscal 1998, the Department selected a sample of households from its automated databases containing tenant data, and computer matched household income shown in those databases to Social Security Administration (SSA)/Internal Revenue Service (IRS) data. HUD staff examined source documents for each case where differences in income from computer matching sources and tenant-reported sources exceeded a predetermined threshold. These source documents were obtained from housing agencies, owners, and agents to determine if the income differences contributed to excess rental subsidies or were caused by other reasons that would not contribute to excess subsidies. For example, the computer matching would not identify excess subsidies if erroneous income information had been entered into the databases or SSA/IRS and tenant-reported income information were reported for different time periods.

The threshold used to determine computer matching differences was $3,000 for calendar 1997 data. Use of a threshold was necessary to provide a reasonable and cost effective basis for developing estimates of unreported income.

Based on the results of the statistical sample, the Department projects, with 95 percent confidence, that during calendar year 1997 the amount of excess rental subsidies (for the 4.0 million households included in the databases, which comprised approximately 90% of all households receiving assistance during calendar 1997) was $774 million ± $191 million. Extrapolating these results to the entire universe of assisted households yields an excess rental subsidy amount of $857 million ± $211 million. This extrapolation is based on the assumption that the characteristics of the households included in the databases from which the sample was selected are similar to those households not included in the databases.

The phrase "excess rental subsidies" does not necessarily equate to budgetary reductions that are realizable by eliminating the excess rental assistance. HUD's budgetary needs are affected by many variables not recognized in the above estimates.

Note 16 – Total Cost and Earned Revenue by Budget Functional Classification

HUD's total cost and earned revenue by budget functional classification is as follows (dollars in millions):

Budget Functional Classification	Gross Cost	Earned Revenue	Net Cost
Commerce and Housing Credit	$ 3,832	$(4,783)	$ (951)
Community and Regional Development	5,091	(284)	4,807
Income Security	27,394	(58)	27,336
Administration of Justice	24	–	24
Miscellaneous	257	–	257
TOTAL	$36,598	$(5,125)	$31,473